Health Savings Accounts and High-Deductible Health Plans help fight the spiraling cost of health insurance for companies and employees.

Healthy Savings

By John B. Ford, CMA

IF OUR OLD HEALTH INSURANCE PROVIDER hadn't announced it was going out of business a few years ago, I might not have had the push I needed to dive into other alternatives for our employees. Our premiums, like nearly everyone else's locally, had been jumping by more than 10% a year despite the usual cost-cutting measures of raising deductibles and scaling back some coverages. We had been rather reluctant to introduce too drastic a change to the company's healthcare plan before our provider called it quits, but with change coming anyway and 18 months' notice, I had time to consider several possibilities, including a revolutionary idea only recently available.

The high premiums that our single-coverage employees had to pay for medical insurance—with nothing to show for that expenditure at the end of 12 months—had always bothered me. Nationally, according to the 2005 *Henry J. Kaiser Family Foundation/Health Research & Educational Trust Employer Health Benefits Survey*, the average premium paid by an employee with a plan like ours was more than $730 per year. For family coverage, average premiums were well over $3,200 that year. (Visit www.kff.org for the latest survey data.)

True, covered employees could have seen their doctor anytime they needed (for a mere $25 copay), and their prescriptions were available at a reduced cost, but insurance expenses were still a huge outlay.

As controller, I knew we needed to find a lower-cost option, but as director of human resources (I wear two hats), I was loath to make further reductions or limitations to our program. With family coverage for the traditional plan costing so much, though, our people were feeling the pinch, and we were finding it increasingly difficult to recruit.

An editorial by Steve Forbes on Health Savings Accounts presented the most intriguing partial solution. After a lot of research (and despite our small size of fewer than 50 eligible employees), we decided to give our employees a choice between a traditional but somewhat costly Point of Service (POS) plan, as we had always offered, and a newer, high-deductible health plan (HDHP) accompanied by a Health Savings Account (HSA). Overall, that decision has proved to be one of the best moves we've ever made.

How the Plans Work

Most people are familiar with the traditional POS plan. The premiums pay for insurance coverage for doctor visits, medical procedures, etc., and there's usually a "copay" when the employee or a family member visits the doctor. In our plan, it's $25 to visit the primary care physician and $50 for a specialist (many plans have copays as low as a few dollars, and some even have none), and the employee is responsible for the first $500 of other medical costs ($1,500 for families), an amount usually known as the "deductible." In our POS plan, prescriptions are priced at three levels (it's a "three-tiered plan"): up to $15 for most generics, $25 for "formulary" items (brand-name medicines on an approved list), and $50 for prescription medicines not on the formulary list.

With a high-deductible health plan, on the other hand, the premiums are much lower, but the employee is responsible for *all* healthcare costs up to a ceiling, the "high deductible." Just as your auto insurance policy allows you to assume greater or lesser risk and to pay commensurately lower or higher premiums depending on the size of the deductible you're willing to carry, the HDHP is insurance to tackle the really big stuff. Once that deductible ceiling is pierced, the HDHP takes over and pays most or all of the employee's healthcare costs for the remainder of the plan year.

The concept is easy to understand, but the prospect can be daunting. For example, where our POS plan participant pays a $25 copay for an office visit for which the doctor charges $90, the HDHP participant pays the full $90. If that visit requires a subsequent consultation with a $145 specialist, the POS participant gets a referral and pays $50 for that appointment; the HDHP patient will be out the full $145. Many people aren't sure they can afford to face that high total in a year.

To help pay those costs, though, the HDHP employee can make pre-tax contributions via payroll deduction to a Health Savings Account (HSA) up to an annual limit established each year by the Internal Revenue Service (IRS). This is the feature that makes the HDHP attractive: Instead of paying high premiums for insurance coverage they might not even use, employees can pay lower premiums and save the difference (or more) in their own personal tax-deferred account, protecting themselves against unforeseen medical needs.

The HSA is similar to an Individual Retirement Account (IRA) in that contributions are made before taxes, and the account's earnings aren't taxed. But the

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enormous difference is that while withdrawals from an IRA are taxed at the time funds are withdrawn, disbursements from an HSA, when used to pay qualified medical expenses, aren't taxed. IRS Publication 502, *Medical and Dental Expenses*, outlines "qualified medical expenses." Some examples are amounts paid for doctors' fees, prescription and nonprescription medicines, dental care, eye care, or other diagnosis, cure, treatment, or prevention of disease.

Another advantage of the HSA from the employee's perspective is that it's portable. Since the employee owns the account, the money in it always belongs to that employee and even goes with him or her if he/she changes employers.

Perhaps the HSA's biggest advantage, though, is that the account balance *isn't forfeited at year-end* but rolls over from year to year. That's not true of Flexible Spending Arrangements (FSAs), where any amounts not used by the end of the year revert to the employer. Many of our employees are relying on that continuing rollover feature as they work on building larger balances in their HSAs for future use in their retirement years.

Why We Chose an HSA

To obtain quotes and to understand the various plans available, we relied heavily on Kathy, our representative at a well-established local health insurance broker. She was enormously helpful in lining up plans, walking me through the various options, and selecting the most economical result for the company and employees. (See "HSAs and Other Healthcare Plans" on p. 34 for descriptions of the plans.)

We chose the Health Savings Account route for a handful of reasons. Because we weren't wild about the use-it-or-lose-it nature of the FSA, and the company wasn't really in a position to contribute to Health Reimbursement Arrangements (HRAs), we ruled those two out right away. The HSA seemed to provide the greatest number of possibilities for our employees, who we thought would find the accumulation idea particularly attractive. Indeed, that became the biggest selling point as we went about signing people up.

My doctor's view of HDHPs was rather skeptical. Although he immediately grasped the "consumer-driven healthcare" concept, he was concerned that patients might ignore symptoms or postpone treatment in order to save a few dollars. But we figured our employees, who already had responsibility for managing their own 401(k) accounts, would be able to make the right decisions for themselves.

The plan we used set the deductible amount at $2,500 for individual coverage and $5,000 for family (with different premiums for employee plus spouse, or employee plus child, or employee plus spouse plus children). Although for a slightly lower premium we could have chosen a plan to cover 80% of costs beyond the deductible, we figured the deductible would be a big enough hurdle by itself, so we chose the plan that covers 100% of costs after the deductible is met.

This was a much less expensive option for the employees, at least on the paycheck. The weekly premiums that single-coverage employees paid for the HDHP dropped by more than two-thirds compared to the premiums for the POS plan. For family coverage, the weekly premiums fell more than 50%.

Naturally, as the guy championing the HDHP concept, I was already leaning toward using that plan for my family. What tipped the scale for me was the prospect of actually saving the difference between the total insurance cost and the actual cost of my family's medical care. When I tallied up my annual premiums under the POS plan and added the prescriptions and copays we'd likely incur for doctor visits, my estimate was well over $4,700. I figured the chance I would take with the HDHP wasn't that big a gamble: On the one hand, I might be out $5,000, but at a much lower premium (so we could try to save the difference); on the other hand, I was *certain* to be out almost $5,000 anyway. My wife and I decided that we would sock away as much as possible early on, just in case we needed to pay for an unplanned appendectomy (which fortunately didn't happen) or an unexpected case of blepharitis (an eyelid infection that our daughter subsequently developed).

HSAs and Other Healthcare Plans

IRS Publication 969, *Health Savings Accounts and Other Tax-Favored Plans*, became one of my best friends during the transition process. HSAs, Archer Medical Savings Accounts (MSAs), FSAs, and Health Reimbursement Arrangements (HRAs) are all defined and presented in great detail in this publication. Here's a brief summary of each one:

Health Savings Account (HSA): a tax-exempt custodial account set up to pay (or reimburse) qualified medical expenses. The HSA must be accompanied by a high-deductible health plan (HDHP). Contributions, whether from a covered individual or from the employer, are excluded from the individual's taxable income. An annual limit to contributions is defined by the IRS (for 2009, that limit is $3,000 for an individual and $5,950 for family coverage). Distributions to pay or reimburse qualified medical expenses aren't taxed. Interest and other earnings of the account aren't taxed. Amounts accumulated remain in the account until used (no "use-it-or-lose-it" pressure). The HSA is "portable" and can move with the employee if he/she changes employers.

Archer Medical Savings Account (MSA): also a tax-exempt custodial account set up to pay (or reimburse) qualified medical expenses for the self-employed or employees of small employers. The MSA must be accompanied by a high-deductible health plan. Contributions are excluded from the individual's taxable income and may be made by the covered individual or by the employer, but not by both in the same year. Contributions are limited to a percentage of the annual deductible limit. As with the HSA, the account's earnings and distributions for medical expenses aren't taxed, there's no "use-it-or-lose-it" feature, and the account is portable.

Flexible Spending Arrangement (FSA): a benefit plan established by an employer, often as part of a cafeteria plan. These don't require a particular health insurance plan. The employee contributes to the FSA via payroll deduction before taxes (often called a "salary reduction agreement"). The plan must specify a maximum contribution amount or maximum compensation level. Distributions are made only to the individual to reimburse qualified medical costs. Any amounts not distributed during the plan year are forfeited at year-end. Other restrictions apply.

Health Reimbursement Arrangement (HRA): also a benefit plan established by an employer, but fund-

Differences among HSAs, FSAs, MSAs, and HRAs

Feature	Health Savings Account (HSA)	Flexible Spending Arrangement (FSA)	Medical Savings Account (MSA)	Health Reimbursement Arrangement (HRA)
High-Deductible Health Plan required	**YES**	no	**YES**	no
Contributions made from pre-tax income	**YES**	**YES**	**YES**	no
Contribution limit 2009	$3,000 (Individual) $5,950 (Family)	determined by the Plan	75% of HDHP Deductible	no limit
Contributions **by employer** excluded from pre-tax income	**YES**	**YES**	*	**YES**
Contributions remain in account forever or until used	**YES**	use it or lose it	**YES**	**YES**
Interest and other earnings tax-free	**YES**	**YES**	**YES**	**YES**
Tax-free distributions for qualified medical expenses	**YES**	**YES**	**YES**	**YES**
Account is "portable"—always belongs to the employee	**YES**	no	**YES**	no

* *Archer MSAs are designed for the self-employed or smaller employer; contributions may be made by the employee OR the employer, but not by both in the same year.*

ed only by that employer (employees may not contribute). An HRA may accompany an FSA or other health plan, but it doesn't require a particular health insurance plan. Contributions to an HRA aren't included in the employee's taxable income. Distributions are made only to the employee (or employee's spouse or dependent) to reimburse for qualified medical costs. Accumulations may roll over from year to year. Self-employed individuals aren't eligible for an HRA.

Other Considerations: An important feature in all of the medical plans we examined was the comparison of "in-network" and "out-of-network" benefits. The healthcare providers who participate with our health insurance company are considered part of the "network" and have agreed to provide their services for specifically discounted fees. Some of those discounts can be quite substantial. Although we're free to use a doctor who isn't part of the network, we know it will cost us more, not only because that doctor hasn't agreed to a lower price, but also because our deductible is higher for nonnetwork providers. The plan we chose included a large number of doctors in our area, so my family hasn't had to go outside the network, and our costs have been measurably lower.

To be sure, it helped that we already had roughly $5,000 in a savings account. Were we to incur some medical surprise before accumulating that amount in the HSA, we would be able to deal with it. I worried, though, about signing up an employee who might have to face an emergency early in the plan year. Putting my fears to rest, my boss agreed that the company would make an interest-free loan—up to the amount of the plan deductible—available to those in the HDHP who found themselves unable to meet some medical financial obligation. We haven't had to make a loan yet, but it's still an option for "converts" to the HDHP. (Indeed, several participants have punctured the deductible ceiling during a plan year as a result of various ailments, but all have managed financially on their own.)

Not an Easy Sell

It took a little selling to persuade people to give the HDHP a try. Kathy (the broker) and I presented both plans at a company-wide meeting, explaining how each would work. Kathy was invaluable at the meeting and afterwards, patiently answering everyone's questions and encouraging people to give the HDHP a close look. As the main proponent of the concept, I then met with many of our folks one-on-one to explain how the HDHP could work for them. These discussions were a little delicate because I didn't want to pry into employees' private lives, and I had to be careful about the provisions of the Health Information Privacy and Accountability Act (HIPAA).

I made it clear that employees were under no pressure to disclose anything they felt was sensitive or confidential. I explained the kinds of costs people might encounter, and I pointed out the size of the financial obligation they might be taking on. Mindful of my doctor's concerns, I made sure to stress to each employee considering the HDHP the importance of good medical care and the corresponding need for prudent financial planning. I asked them to look back over the past couple of years and see how much they might have spent personally on medical costs if they had had the HDHP in place during that time. I pointed out how much they'd paid in premiums: People readily understood that if they'd been contributing the difference to an HSA, they might have accumulated a tidy sum. I said the same could happen in the coming year, though there were no guarantees about anyone's health, specifically acknowledging that last year's experience was by no means a predictor of next year's experience. Yet this plan seemed to offer at least a chance of their doing better than they'd done in recent years.

For our first plan year, we signed up 19% of our eligible employees.

Shifting Mind-sets

One of the greatest arguments in favor of the HDHP is that participants begin to approach their healthcare decisions as interested consumers. My family found that to be quite true. Because we're the ones who had to foot the bill, we became very careful about what we got for our money.

For example, when I was in the POS plan, my prescription for a dermatological cleanser used to cost $50 because it wasn't part of the plan formulary. When we switched to the HDHP and had to pay full price, the cost jumped to $85 for the same stuff. I asked our pharmacist if she could find a generic for less, but she did even better. After looking at the ingredients and consulting with my doctor, she was able to compound the cleanser in her shop for less than $40 a pop (and it smells better, too!). That option had never even occurred to me under the POS plan.

Similarly, another employee who was instructed by her doctor to submit to a number of tests set about rescheduling those tests in a way that reduced the number of office visits but still included everything necessary. Back when those visits didn't cost as much, she wasn't as concerned about reducing their frequency, but once she was faced with the full cost, she became extremely interested in finding ways to consolidate and save. In a minor way, she also freed up some of the medical facility's schedule.

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In both cases, the HDHP provided the incentive to find ways to save. While it's true that we could have sought those ways under a traditional plan, there was no compelling reason to take that initiative.

Some free "preventive care" elements of our HDHP that weren't obvious at the outset manifested themselves somewhat serendipitously later in the year. As a freshly minted 50-year-old, I was a little apprehensive when my doctor instructed me to go have a colonoscopy. I knew my annual physical would be paid for by the HDHP, but I was delighted to find out that a screening colonoscopy was also covered by the HDHP at no extra cost. It was Wanda, our indispensable health insurance customer service rep, who enlightened me on that count. She told me to make sure the billing was labeled "Screening" and not "Diagnostic" because the HDHP pays for the former, but the latter would go against my deductible. I dutifully instructed the billing clerk at the doctor's office to mark her paperwork "Screening," but soon after the procedure the bills began rolling in anyway. It took a few weeks of back-and-forth with the billing office and Wanda, but eventually the HDHP paid for everything, and nothing hit my deductible.

It turns out I'm not the only one who has faced a billing snafu. Two others in our HDHP also underwent colonoscopies in the past couple of years and had to push back on their doctors' offices to invoice properly for the procedure. It isn't clear at this point whether the HDHP still confuses billing offices or not, but it's certainly true that we've all been paying closer attention to the bills and Explanation of Benefits (EOB) statements since enrolling in the HDHP.

Choosing the Right Financial Institution

One important decision your company needs to make when setting up an HDHP and HSA is choosing a financial institution to hold the HSA funds. According to IRS Publication 969, *Health Savings Accounts and Other Tax-Favored Plans*, a qualified HSA trustee can be a bank, an insurance company, or anyone the IRS has approved as a trustee for IRAs. Because our HDHP carrier already had a relationship with a large, nationally known Midwest bank, we opted to set up our employees' accounts there. At the time, our local banks were just beginning to get involved with HSAs, so the bigger outfit had the greater experience. The automatic link that each HSA would have with the insurance company and the convenience of getting things going from the beginning were two important factors in the decision.

Most financial institutions offering HSAs include a debit card for easy access to the account in paying bills. Our account features a VISA debit card, which initially confused almost every pharmacy and doctor's office where we presented it. Although it says "Debit Card" on its face, no PIN is required, and cash register systems seem to process it as a credit card. As HSA debit cards have caught on, though, we've had fewer and fewer problems.

The other way to get money from the account is to request reimbursement for a bill already paid, either online or by mail. The online request is slick: After a doctor visit and after the claim has been processed by the health insurance provider, I log into my account and click on that particular claim in the list of processed items. Several days later, the amount approved by the health plan is on its way, either by check or by direct deposit. For coverages not included in our HDHP, such as visits to the dentist or optometrist, we found we could use our regular credit card to pay a bill (and earn our local bank's "bonus points") and then submit the paperwork for reimbursement from the HSA. So far, those HSA disbursements have always arrived before the credit card bill, so we haven't had to pay interest on a balance.

Know the Features. One feature that was turned on when I opened my HSA was cryptically labeled "Crossover Activated." That turned out to be a fancy way to say that any claims processed by the insurer with an amount to be applied to the deductible—i.e., amounts to be paid by me, the insured—would automatically be disbursed from the account. That worked fine initially for my daughter's strep throat treatment. Unfortunately, I didn't think to turn off the "crossover" before the first colonoscopy bill was processed. Because the billing had been mistakenly classed as "Diagnostic," when an invoice for $601 came through, the money was out of my HSA and in my checking account before I knew it. Once the billing was cleaned up and the HDHP had paid the doctors and other costs, I had to return that $601 to the HSA. Wanda gave me the proper form, and I was able to replenish my account with no tax consequence.

In any case, the account holder must aver that the funds disbursed are being used to pay qualified medical expenses. At first, I requested paper checks. Later, after a check took several weeks to arrive through the mail, I chose the direct-deposit option, which was much simpler and certainly more convenient. More often than not, the money now gets to our checking account before we receive a bill from the doctor.

Investment Options. Another important consideration in choosing the trustee firm concerns the investment options offered. Balances under $1,000 in our trustee bank earn a money market rate of interest; an HSA owner with a higher balance can choose from among four other mutual funds offering varying degrees of exposure to the bond and equity markets.

Once my account balance had reached $2,000, I started moving some of the money into one of the equity funds with an eye toward improving our returns. Although that looked like a smart move through much of 2007, we probably would have done better if I hadn't tried to do better. Most of the other plan participants were clever enough to let things ride in the money market account, so there haven't been many complaints or concerns about the markets and HSA returns. (That isn't true of our 401(k) plan.)

Our Experience Has Been Excellent

In retrospect, the only major change we would make to the way we started our HDHP would be to have provided more education for our employees. Once employees understood all the ins and outs of the HDHP, they were more willing to give it a try. The feedback I've received was that people didn't understand everything the HDHP included that would *not* be charged to the deductible, such as a free annual physical, flu shots, and even health-club reimbursements. All along, I've urged our people on the traditional plan to keep examining their healthcare costs during the year with an eye toward converting at the next sign-up date.

Overall, we've had an excellent experience with the HDHP. In fact, we've enrolled additional people at each renewal. Now in its fourth year, our HDHP has an even more impressive 57% participation rate. Only two employees so far have switched back to the traditional plan. My doctor's early concern that people might downplay symptoms or postpone treatment to save a few bucks hasn't been borne out, at least in our employees' experience.

I can't imagine having gone through the entire process without Kathy the broker and Wanda the customer service rep. Kathy was a crucial component in setting up the HDHP and helping us get it off the ground. My only real disappointment with the plan has been that the premiums haven't dropped further. If the difference between the POS and HDHP premiums were sufficiently large, our company might save some money and still afford to contribute some meaningful amount to employees' HSAs. That could become the tipping point to encourage other employees to participate.

Although I'm sorry our previous health insurer went out of business, I'm very pleased with the resulting change we made. Just about all of our HDHP employees are better off now than they were two or three years ago. I'm convinced that the HDHP is one of the best tools for fighting the spiraling cost of health insurance. It isn't a panacea, but by giving people a true economic incentive to control expenses, it's certainly an excellent start in getting the upper hand on healthcare costs. **SF**

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