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Why HSAs Are a Good Choice

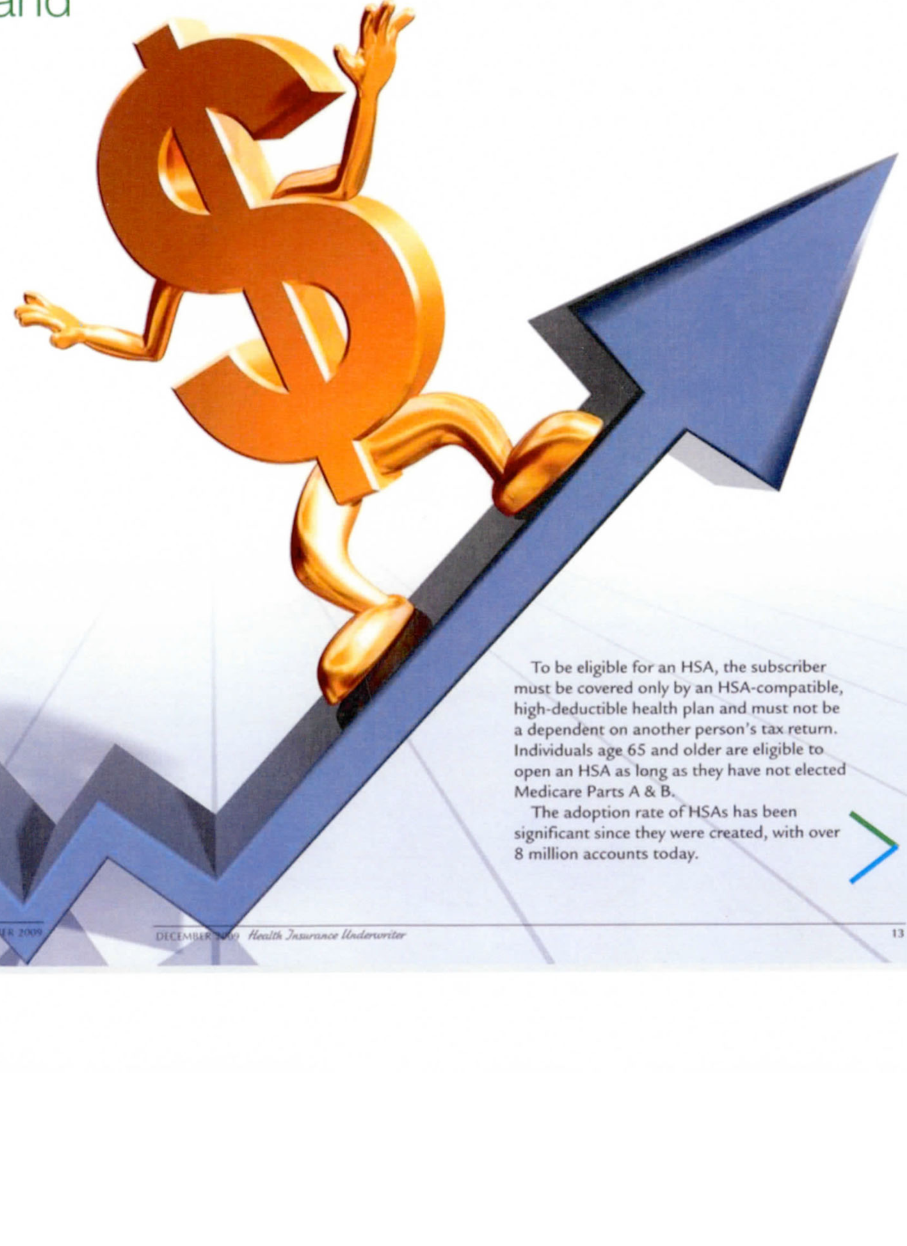
in Times of Health Care Reform and Economic Challenges

When Health Savings Accounts were created in 2004, no one anticipated that our nation's economy would be as distressed as it is today. Nor could we envision a proposed sweeping change to the U.S. health care system. As a long-time veteran of the health insurance industry, I have experienced many changes and obstacles over my 30-year career, but these conditions pose especially significant challenges.

As a result, I have spent the last few months evaluating HSA trends among the clients of my company, Sterling HSA, an independent third-party administrator of Health Savings Accounts. I have also met with many of our broker partners to talk about the impact of health care reform on HSAs and other consumer-directed products. While we see the challenges, we also see good opportunity for ongoing growth in the adoption of HSAs and the value they play in our health care system in the future.

This article explores trends among our accountholders and employer clients with respect to HSAs and the possible impact of health care reform on HSAs in the future.

First, for the reader who may not be familiar with HSAs, they are like "medical IRAs." They are tax-free accounts that individuals with an HSA-compatible, high-deductible health insurance policy can fund and use to pay for medical expenses. Because they are tax-advantaged and balances can accumulate over time, HSAs can also be used to accumulate savings.



To be eligible for an HSA, the subscriber must be covered only by an HSA-compatible, high-deductible health plan and must not be a dependent on another person's tax return. Individuals age 65 and older are eligible to open an HSA as long as they have not elected Medicare Parts A & B.

The adoption rate of HSAs has been significant since they were created, with over 8 million accounts today.

Changes in HSA Accountholder Behavior

The following observations are based exclusively on data from accountholder activity at Sterling HSA. Comparing our experience in 2007 versus 2008, we have seen tough economic times make liquidity concerns a big driver of consumer behavior. This view is affirmed in a review of three data points:

1 The average disbursement from an HSA per accountholder has increased 10%, from $1,140 in 2007 to $1,258 in 2008. During the same period, the average contribution per accountholder was up only three percent, from $2,047 in 2007 to $2,109 in 2008. So what we're seeing is only a modest increase in contributions, but significantly more disbursements.

2 The increase in disbursements has had a pronounced effect on the average ending balance of accounts. In 2007, the average ending balance per accountholder was $2,200, this after a steady increase of deposits net of distributions year-over-year since 2004. In 2008, the account balance dipped to $1,814. As of March 1, 2009, our average account balance was $1,896.

3 In 2007, Sterling HSA accountholders who saved their funds represented 57% of the total. Today, that percentage has dropped to 30%. Clearly, our accountholders are facing liquidity concerns, probably prompted by layoffs and business closures. Because we pay the bills for our clients, we're seeing more HSA funds go toward COBRA premium payments—another sign of a distressed economy.

We have seen the average age of our accountholders drop from 52 in 2004 when HSAs were introduced to 41 today.

What About Employer Behavior?

While employers continue to adopt HSAs and, in the vast majority of cases, contribute funds toward their employees' accounts, we are noticing that some employers are not being as generous in funding the HSAs of their employees. In some cases, employers have stopped funding entirely. In still other cases, employers facing severe financial distress have simply stopped providing health insurance coverage. This prompts employee withdrawal of funds to pay for COBRA or the closure of HSAs as employees scramble to obtain health insurance coverage on their own.

Not surprisingly, we've seen an increase in what we consider "involuntary terminations," that is, terminations due to employer action such as the closing of a business or reduction in force. Even when we caution our accountholders that funds disbursed as a result of closing accounts must be reported to the IRS as an unqualified distribution, our accountholders appear more concerned about paying bills and less concerned about regulatory action.

At the same time, we continue to see an increase in employer adoption of HSAs. The poor economy and the affordability of HSA-compatible plans have clearly influenced employers to choose high-deductible plans combined with an HSA to improve health care costs and provide another affordable benefit to employees. We're noticing that adoption spans every industry classification, every size group, private companies, municipalities, non-profit organizations and more Taft-Hartley groups, suggesting that HSA appeal is still broad and widespread.

Surviving Tough Times

Health Savings Accounts are effective tools in conserving assets and paying—with federal tax-free money—qualified medical expenses during difficult times. Now more than ever, we advise employers and their brokers to consider HSA-qualified plans, primarily because the economics of paying lower insurance premiums can be compelling.

We also advise employers to contribute toward the HSA accounts of their employees and to be especially generous in the first year. Why the first year? The risk of incurring out-of-pocket costs is obviously highest when accounts have just been opened and accountholders have not had sufficient time to accumulate savings. Employer contributions toward HSAs assure employees that funds are available to pay for health care expenses. And national experience shows that HSA adoption increases predictably when employers contribute.

For existing HSA employer clients, we advise steady and continuing funding of their employees' accounts, to the extent possible. Now is the time to emphasize even more how important it is for employees to be proactive about their health. Cost-conscious behavior translates to improved health care utilization, which logically should result in lower insurance premiums.

Current accountholders should keep funding their HSAs and use them for the purposes for which they are intended, including COBRA payments during periods of unemployment. HSAs are proving their utility in helping accountholders weather difficult economic times. These accounts provide yet another resource for employers and employees to face uncertain times with confidence.

What Would Health Care Reform Mean for HSAs?

Recently I had the opportunity to meet with many health insurance brokers and discuss concerns about health care reform as I traveled with my colleague and friend, Roy Ramthun. Roy is president of HSA Consulting Services and has decades of experience in health policy, government relations and private-sector operations. He led the U.S. Treasury Department's implementation of HSAs from inception in 2003. He then became the senior health policy advisor to President George W. Bush.

We shared our perspective and listened to what concerns brokers had about how new policies might impact HSAs.

Until we have a clearer picture of which of the proposed plans will take center stage as the congressional debates continue, it is difficult to predict how health care policy change will impact HSAs. However, we believe that HSAs will continue to be part of health care reform with some possible changes.

We know that some lawmakers want whatever bill is passed to include some constraints on HSAs, such as limiting the amount of the annual contribution made to an HSA by individuals and families to the amount of the insurance plan deductible. While this would impact the tax-advantaged savings rate that consumers can enjoy with a HSA today, the change reverts to the initial guidelines set by the IRS when HSAs were established in 2004. Despite this possible revision, we would expect HSA adoption to continue increasing.

In addition, some lawmakers are proposing higher penalties (20%) if HSA funds are used for non-qualified expenses and they want to require employers and HSA accountholders to substantiate the usage of funds for qualified medical expenses.

Despite these proposed changes, the fundamental benefits of HSAs would still be intact—the opportunity for consumers to save for medical expenses and fund their needs today and in the future. HSAs meet all of the eight principles for reform outlined by President Obama in his mandate to Congress:

- Protect families' financial health
- Make health coverage affordable
- Aim for universality
- Provide portability of coverage
- Guarantee choice
- Invest in prevention and wellness
- Improve patient safety and quality care
- Maintain long-term fiscal sustainability

Furthermore, HSAs are appealing to a younger, less affluent demographic that was previously uninsured, exactly meeting the desires of the White House. At Sterling, we have seen the average age of our accountholders drop from 52 in 2004 when HSAs were introduced to 41 today. Assurant recently reported that 40% of those buying high-deductible health plans and opening HSAs indicated that they did not previously have health insurance coverage. AHIP reported similar numbers with 37% of HSA policies being sold to previously uninsured consumers.

Health savings accounts are effective tools in conserving assets and paying—with federal tax-free money—qualified medical expenses while saving for the future. HIU