Rethinking HRA vs. HSA

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Objectives of This Course

- Identify the historical roots of our market’s preference for the HRA
- Look at national trends
- Compare and contrast HRAs and HSAs
- Review the traditional selling obstacles to HSA-qualified plans
- Explore how to create a self-sustaining reimbursement program with HSAs
Why Our CDH Penetration Lags the US

- The heavy penetration of first-dollar HMOs from 1980 to 2000 left a generation not knowing what a deductible is
  - Moving to a deductible plan is seen as a benefit reduction
- Policymakers mandated rich benefit packages
- Our population is disproportionately employed in traditionally benefit-rich sectors
  - Health care
  - High education
  - Financial services
  - Other white collar services
Why HRAs Became a Vehicle of Choice

- No restrictions on underlying health plan design
- Integrated HRAs works automatically – little additional employee effort
  - No paperwork to receive or substantiate reimbursement
  - Pay provider with reimbursement check
  - No employee income tax or legal compliance
- Employers can design the reimbursement programs
- HRA reimburses only as needed
- Employers can fund a $1 promise with 30 to 50 cents cash – a great deal
Why the Rest of the US Embraced HSAs

- Deductible products never lost their dominance
  - High cost-sharing was seen as a fact of life
  - Demographics played a role: more blue collar, more lower-wage retail and low-tech manufacturing

- State policymakers don’t mandate rich benefits

- HSA regulations requiring out-of-pocket maxima actually reduce potential financial responsibility

- The accounts allow individuals to cover their high out-of-pocket expenses with tax-free money
Which Is Better – HRA or HSA?
## Comparing the Two Programs

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>HRA</th>
<th>HSA</th>
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<tbody>
<tr>
<td>Employees aren’t fluent in English</td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>Employees aren’t financially fluent</td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>Work force is transient/high turnover</td>
<td>No (COBRA)</td>
<td>Yes</td>
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<tr>
<td>Employees seek tax-reduction strategies</td>
<td>No</td>
<td>Yes</td>
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<tr>
<td>Employees have long financial horizons</td>
<td>No</td>
<td>Yes</td>
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<tr>
<td>Employees max out retirement plan contributions</td>
<td>No</td>
<td>Yes</td>
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<tr>
<td>Employees have high unreimbursed expenses</td>
<td>No</td>
<td>Yes</td>
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<tr>
<td>Employer can’t afford FSA admin fees</td>
<td>No</td>
<td>Yes</td>
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<tr>
<td>Work force includes owners and their families</td>
<td>No</td>
<td>Yes</td>
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<tr>
<td>Employer wants to limit this year’s outlay</td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>Employer wants to phase out contributions</td>
<td>No</td>
<td>Yes</td>
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<tr>
<td>Employees have non-traditional relationships</td>
<td>No</td>
<td>Yes</td>
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Employees Aren’t Fluent in English

- They have trouble understanding their basic benefits
- An HRA program, particularly an integrated one that pays providers directly, doesn’t require them to do anything to complete the reimbursement process
- They won’t understand how to open an HSA, comply with rules and work their account
Employees Aren’t Financially Fluent

- They don’t care about tax-reduction strategies or long-term savings
- HRAs provide what they want – immediate relief from financial responsibility, paid by someone else
- They face no income tax reporting with an HRA
- HSAs, by contrast, require managing an account, adhering to IRS regulations and filing an additional tax form
Work Force Has High Turnover

- Both underlying health plans are subject to COBRA continuation
- HRAs are subject to COBRA continuation, which increases employer’s potential financial responsibility
  - The IRS considers HRAs to be health plans
- Employer HSA contribution programs are not subject to COBRA continuation
Employees Seek Tax Reduction

- HRAs offer no opportunity to reduce taxable income
- HSA contributions reduce taxable income dollar-for-dollar
Employees Have Long Financial Horizons

- HRAs are annual reimbursement programs with no benefit stretching beyond that year (unless the employer allows a carryover of unused funds into the following year or into a retirement HRA)

- HSA balances roll over automatically and grow over time, giving accountholders a tax-sheltered growth vehicle
Employees Save for Retirement

- HRAs offer no retirement opportunities, except in the rare case that an employer allows unused balances to roll over into a retirement HRA.

- HSA accountholders can roll over balances into retirement, where distributions remain tax-free and eligible expenses include Medicare premiums.
  - Distributions for these expenses from most qualified retirement accounts are taxed as ordinary income.
Employees Have High Medical Expenses

- HRAs generally are of no use in this situation, as employers generally limit reimbursement to health plan out-of-pocket expenses.

- Expenses eligible for tax-free distributions from an HSA include alternative medicine, dental/orthodontia, vision and OTC equipment and supplies.
Employers Can’t Afford FSA Admin Fees

- HRAs don’t replicate Health FSAs, since most employers limit reimbursement to health plan out-of-pocket expenses
- HSAs give employees the opportunity to pay for eligible expenses tax-free
Owners Work in the Business

- LLC members, partners in a partnership and 2% of greater owners of Sub S corporations are not eligible to receive tax-free reimbursements from an HRA
- These owners can participate in and enjoy the tax and long-term savings benefits of an HSA
  - They cannot receive tax-free contributions from the entity or make pre-tax payroll contributions
  - They can contribute personal funds and deduct those contributions on their personal income tax returns
    - They realize federal and state income tax savings, but they don’t recoup their FICA taxes paid
Employers Want to Minimize Outlay

- An HRA allows employers to promise a dollar of reimbursement, yet pay only about half a dollar of actual benefit
  - Most participants don’t come close to using all the reimbursement to which they’re entitled

- HSA contributions are in cash, whether or not the employee has corresponding deductible expenses
Employers Want to Phase Out

- HRAs need to be replenished with a new infusion of cash every year

- As participating employees build balances over time, employer can consider reducing future contributions
  - Note: This approach can be problematic with new employees
Non-traditional Relationships

- Same-sex spouses, domestic partners (of either sex) and ex-spouses can’t receive tax-free reimbursements from an HRA or an HSA

- These individuals, if they’re HSA-eligible, can establish their own HSAs, make personal tax-deductible contributions and reimburse their own and their dependents’ eligible expenses tax-free
Transitions

- Getting from where you are to where you want to be . . .
HRA-to-HSA Transition

- Keep deductibles the same
  - Premiums will decline because deductible is broader, and the family deductible generally doesn’t have an embedded individual family member deductible

- Channel HRA investment and premium savings into HSA contributions through one or more of the following
  - Make a direct employer contribution (preferably with front-loading to help with high expenses early in the year)
  - Set up negative elections so that employees enjoy disproportionate premium savings, which you automatically channel to the HSA
    - Employees can opt out at any time
  - Encourage employees to make pre-tax payroll contributions
First-Dollar Plan-to-HSA Transition

- Choose one of two deductible strategies
  - Low to ease employees into greater financial responsibility
  - High to maximize employer and employee premium savings, to allow you to make a greater employer contribution
    - Low utilizers will build HSA balances quickly
    - High utilizers will cover most of their deductible with employer contribution and reduced employee premium (channeled into HSAs through pre-tax payroll contributions)
HSAs in an Environment of Choice

- Consider a plan that covers preventive prescriptions subject to deductible
  - Reduces a huge psychological barrier to HSA adoption
  - Improves cash flow for employees who manage chronic conditions effectively with medications

- Use a defined contribution strategy
  - Fix employer contribution to premium as a percentage of the cost of the lower plan
  - Require employees to bear the full cost of buying up to the more expensive plan
  - May require two-year (but no longer) transition to prevent exploding premiums in the established plan
Enhancements to Any Strategy

- Provide ongoing education, during open enrollment and during the first year
  - Why and how to open your HSA promptly
  - Understanding EOBs and tracking deductibles
  - Shopping for services using carrier tools
  - Using HSAs to minimize your tax liability
  - Using HSAs to create a more secure retirement

- Require a positive enrollment
Enhancements to Any Strategy

- Consider offering voluntary coverage for accidents, hospitalizations and other potential high-deductible services
  - These plans pay cash that can pay deductible bills to help preserve HSA balances for future use
  - They’re a risk for employees, who may reach their full deductible without incurring any expenses for which the voluntary plan pays benefits
Consider establishing a payroll loan program for employees who incur very high expenses early in the year

- Create stringent rules, such as employer and employee contributions must cover the entire deductible
- Employee commitment is critical to the success of the program
Key Takeaways from This Program

- Our CDH market is quite different from the rest of the country
  - These differences are due primarily to the evolution of our market and our business mix
- HRAs have become the vehicle of choice here
- HSA are becoming more popular
- Each program has its place, depending on certain employer group characteristics
- An HSA offers superior flexibility and long-term benefits for employers and employees