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*This document provides a high-level overview of HSA and HRA health care programs from an employer's perspective.*

*This is one of a series of papers on current health topics.*

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## What Employers Need to Know About HSAs and HRAs

***"The progress of HSAs is largely unstoppable. I see a great future for them, and think we will really see them take off in 2006 and 2007."***

***Neil Trautwein, director of employment policy at the National Association of Manufacturers***

### Summary

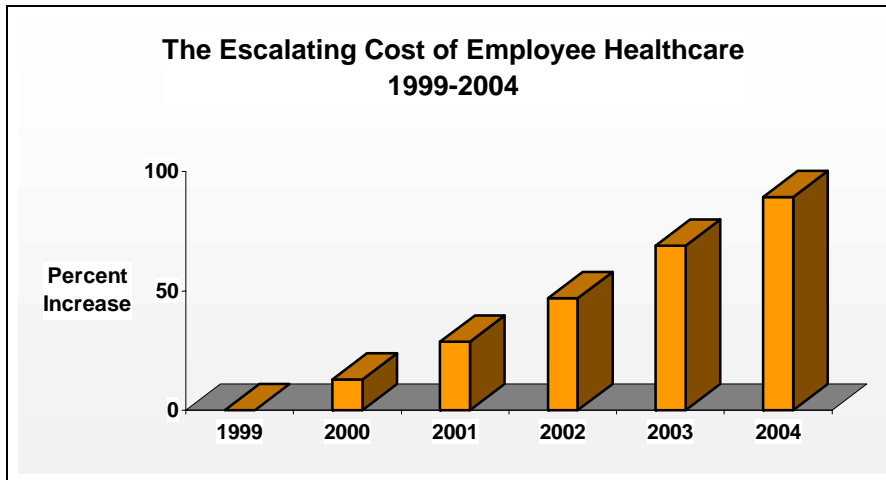
- HSAs (Health Savings Accounts) and HRAs (Health Reimbursement Accounts) are health care programs enacted by Congress in an attempt to hold down health care costs and encourage healthier employee behavior.
- Health care costs will continue to increase, but at a slower rate with HSAs and HRAs.
- HSAs and HRAs can help lower the cost of health insurance for the employer: Preliminary results show a positive cost trend for employer groups offering HRAs.
- HSAs are newer, and are expected to impact cost trends even *more* than HRAs.
- HSAs and HRAs are a part of Consumer-Driven Health Care, which is a major movement in today's health care environment. It promotes "consumer engagement" which is a proven concept with broad appeal.
- Generally...  
HRAs are "**employer** owned and operated."  
HSAs are "**employee** owned and operated."
- So far, employers and employees are very satisfied with HSAs and HRAs.

### How HSAs and HRAs Can Help Hold Down Costs for the Employer

- HSA and HRA health plan premiums are typically **lower** than most traditional plans.
- Employer contributions to HSAs and HRAs are generally **non-taxable**.
- They **shift** some of the financial burden to employees so they spend their own dollars *and* their employer's dollars prudently, reducing the size of premium increases for the employer.
- They engage employees in their health so they stay **healthier**, reducing health care costs.

## In the Skyscraper's Shadow

It's no secret that health care costs have been escalating dramatically for the past 20 years. All purchasers and consumers of health care are affected by the increasing cost of health care - especially employers who bear the biggest share of the health care cost burden. Unless something innovative is done soon to reduce costs, the system could be imperiled.



**In a 5-year period from 1999 to 2004, the cost of employee health care increased by almost 90%.**

Year	1999	2000	2001	2002	2003	2004
Annual Increase	Base	13%	14%	14%	15%	12%
Cumulative Increase	0%	13%	28%	46%	68%	89%

Source: PriceWaterhouseCoopers and Watson Wyatt Worldwide

By 2004, the average cost of employee health care per person had risen to about \$7,056/year. Older employees are a major cost concern: Age 55+ consumers account for 80% of the health care dollars, and with the baby boomers now hitting age 55, overall costs will continue to increase.

### Consumer-Driven Health Care: A new framework.

There has been a steady rise in consumer interest in having greater control of their own health care decisions. There is an equal interest on the part of businesses purchasing health care insurance to engage people in their health and health care spending. The American Medical Association has promoted a healthier, more accountable health care system for years. These ideas, along with some innovative venture firms and supporting legislation at the federal level have spawned the concept of Consumer-Driven Health Care (**CDH or CDHC**), putting the consumers in charge of their own health and health care dollars to a greater degree than ever before.

For employers and employees, the basic implications of consumer engagement are:

**Employers** encourage and reward healthier lifestyles, promote wellness, and focus on those who need health care the most, for the greatest cost savings.

**Employees** are active participants in their health care with more options and greater responsibility to support their decisions.

The tools of consumer engagement are both **economic** and **informational**. Both categories of engagement are necessary. The economics motivate the employee to spend his money wisely, and information gives the employee the tools to do so.

### Consumer-Driven Health Plans (CDHPs)

Consumer-Driven Health Plans (CDHPs) were created to foster more consumer involvement in their health and health care spending to reduce health care costs.

Two types of Plans are:

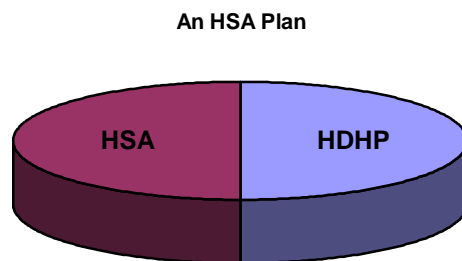
- **HSAs** - Health Savings Accounts.
- **HRAs** - Health Reimbursement Accounts (also called Health Reimbursement *Arrangements*).

### Health Savings Accounts (HSAs)

The Health Savings Account legislation was signed into federal law in December 2003, and made effective **January 1, 2004**.

An **HSA Plan** is a 2-part package:

- One part is a tax-exempt, personal savings account (or investment account) to be used for qualified health expenses, and known as an **HSA**. Employees, employers, or both, can contribute to an HSA.
- The other part is a **High Deductible Health Plan**, or **HDHP**.



These 2 parts work together to form the financial core of an HSA Plan.

Both parts promote **high consumer engagement** by providing financial incentives for consumers to manage their health and health care spending.

*An HSA is tax exempt for federal income and employment taxes. Many states have also passed laws to expand the exemption to state taxes. Check with your state tax office to see if the exemption also applies to your state taxes.*

### HSA Principles

HSAs are for use by individuals and families (including couples).

An HSA is similar to an IRA. The HSA is paid for with pre-tax dollars, and owned by the individual employee - not the employer.

Contributions:

Employees, employers, or both, can contribute to an HSA.

Maximum contributions (for legal purposes) are the sum of employer contributions plus employee contributions.

### Claims:

The employee is responsible for paying any costs up to the maximum out-of-pocket cost (no claim is involved). After that point is reached, the employee files a health claim with the insurance company, as with any traditional health claim.

### Using HSA Funds:

HSA funds which are used to pay for personal or family medical expenses (including OTC drugs such as aspirin) are not taxable.

### Unused Funds:

Funds unused at the end of the year roll over to the next year, encouraging prudent spending for health care expenses.

## HSA Eligibility Requirements

Most employees will normally be eligible for HSAs.

The basic employee requirements for eligibility are:

- Must not be enrolled in Medicare.
- Participates in a high-deductible health plan (HDHP).
- The HDHP has a minimum deductible of:
  - \$1,000 for individual
  - \$2,000 for family
- Annual out-of-pocket maximum for 2005 cannot exceed:
  - \$5,100 for individual
  - \$10,200 for family

## HSA Legislative Updates

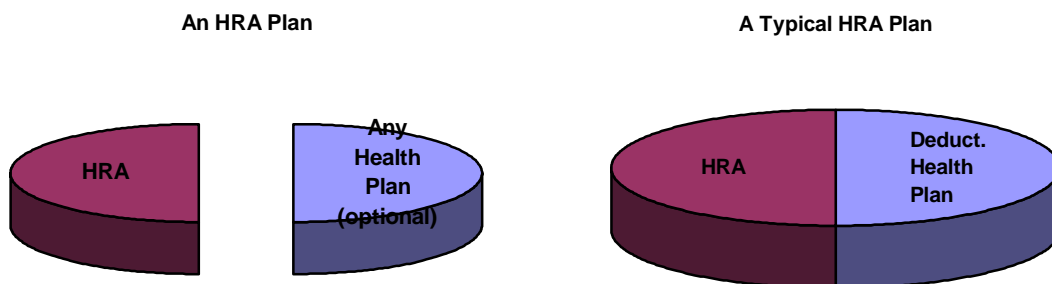
Guidance on the HSA legislation has answered most major questions from employers and health plans about how the IRS expects the plan to be administered. Additional guidance may be provided as HSAs become more mainstream and as additional questions arise.

Up-to-date HSA information can be found at [www.irs.gov](http://www.irs.gov).

## Health Reimbursement Accounts (HRAs)

An HRA Plan is a 1- or 2-part package:

- One part is an employer-paid, tax-exempt account to be used for qualified health expenses, known as an HRA (or HRA Account). Employees cannot contribute any funds to an HRA.
- Typically, a deductible plan is attached to an HRA, but it is not a legal requirement



The HRA (the reimbursement account) is the financial core of an HRA Plan. It alone promotes **consumer engagement**. If a deductible health plan - especially an HDHP - is attached to an HRA, **more consumer engagement** is likely.

## **HRA Principles**

HRAs are for use by individuals and families (including couples).

The employer determines the plan design, including eligible expenses.

### **Contributions:**

Employers designate a certain amount of money per employee for contributions to an HRA, which employees use to reimburse themselves for eligible medical expenses.

Typical employer contributions are half of the deductible amount of the underlying medical plan. For example, if the underlying medical plan has an annual \$1,000 deductible per individual employee, and a \$2,000 deductible per family, the employer's typical HRA contribution would be \$500/year for individuals and \$1,000/year for families.

### **Claims:**

Claims for HRA reimbursement are submitted by employees and drawn from the employer's general funds.

### **Using HRA Funds:**

HRA funds which are used to pay for personal or family medical expenses (including OTC drugs such as aspirin) are not taxable.

### **Unused Funds:**

HRA funds not used at the end of the year for current medical expenses can be rolled over to the next year for future needs, according to plan design. This allows employees to save for future health expenses, including retiree health expenses and provides an incentive to use HRA dollars wisely.

## **HRA Eligibility Requirements**

Generally, **ALL** employees will be eligible for HRAs.

## **HRA Legislative Updates**

Guidance on the HRA legislation has answered most major questions from employers and health plans about how the IRS expects the plan to be administered. Additional guidance may be provided as HRAs become more mainstream and as additional questions arise.

Up-to-date HRA information can be found at [www.irs.gov](http://www.irs.gov) .

None are expected.

## How HSAs and HRAs Differ

The following table illustrates the primary differences between HSAs and HRAs.

Feature	HSA	HRA
<b>Contributions</b>	<b>Made by the employee, employer, or both</b>	<i>Made by the employer only.</i> Limits on contributions are set by the plan documents. There are no statutory limits.
<b>Taxability of Employer Contributions</b>	<b>Tax-deductible</b>	<b>Tax-deductible.</b>
<b>Consumer Engagement</b>	<b>High</b>	<i>Lower.</i> While HRAs do engage consumers, generally HSAs have a greater impact since the funds belong to them.
<b>Fund Ownership</b>	<b>Individual/Employee</b>	<i>Employer.</i> The HRA is accounted for at the individual level, but is funded out of the general assets of the employer.
<b>Portability of Funds (for Consumer)</b>	<b>Portable</b>	<i>Non-portable.</i> HRA funds are not portable and cannot be cashed out. However, continued access to HRA funds (for medical expenses) may be allowed by the employer when an employee leaves.
<b>Eligibility</b>	HDHP enrollment, etc.	<b>Generally, All Employees are Eligible</b>
<b>Flexible Plan Design</b>	<i>Not as flexible as HRAs.</i> Must be paired with a high-deductible health plan. Requirements include minimum deductible and maximum out-of-pocket allowable amounts.	<b>Flexible</b>
<b>Dual Type Healthplan Coverage (HDHP and non-HDHP)</b>	<i>Dual types of healthplan coverage not permitted when contributing.</i> No contributions can be made to an HSA (employer or employee) if the employee is also covered by a low-deductible health plan.	<b>Dual Types Permitted</b>

## Some things to consider prior to launching an HSA or HRA plan

- **Determine your objectives:**  
 HSA or HRA program?  
 What are the financial goals of implementing a consumer directed health plan - short term and long term?  
 How much are you willing to contribute to the account?
- **Plan offerings:**  
 Keep the plan(s) as simple as possible.

Do you want to offer the plan as a sole option, or alongside other plans? Consider contribution strategies to drive participation into the plans you want employees to select. Reduce the likelihood that lower-wage employees will be offered and select plans with unaffordable out-of-pocket maximums: some employees could be seriously impacted.

- **Other logistics issues:**

HSAs: Involve the Payroll department/vendor early if you intend to offer HSA contributions through payroll deduction. Ensure that the payroll system can accommodate pre-tax employer/employee contributions to an HSA, or will have enough lead-time to make the required changes.

HSAs/HRAs: Involve the Accounting and Programming departments (for tax purposes, etc.).

HSAs: Clarify the roles and responsibilities of the HSA custodian/trustee. This is an important discussion that you will want to have with your broker, consultant, health plan and financial advisor because it determines who administrates the savings account portion of the HSA.

HSAs: Do you want to facilitate HSA setup with a single HSA trustee or leave employees to establish the HSA with a trustee of their choice?

- **Consumer information tools (decision-support tools) are vital to success:**

Ensure that the following tools will be provided via web, telephone, and office access through a combination of your company, the healthplan provider, and the HSA/HRA custodian or trustee. Make a list of requirements and who is to fulfill each one, such as:

Using a **cost estimator** for planned medical procedures.

Comparing the cost of brand-name versus **generic** drugs by pharmacy.

Viewing **pharmacy co-pay** information prior to purchase.

Evaluating the **safety, quality** and **cost** of a medical procedure at a particular hospital or clinic, for choice-of-provider decisions.

**Network** lookup to locate medical service providers.

**Benefit and eligibility** lookup.

Being able to see the **financial effects** of past health care decisions.

Examining **healthclaims** information.

Checking an HSA or HRA **account** balance.

Customer support with **live customer assistance**.

- **Employee education is critical. Provide it early and often:**

Prepare human resource staff in advance – there is a learning curve for CDHPs.

Share information for employees in multiple venues such as employee newsletters, payroll stuffers, website stories, etc.

Explain the new plan and how it works, but also the **importance** and purpose of the new plan.

Illustrate the cost of health care, and how choices impact the cost to the employee.

## Industry-expert Predictions on HSAs and HRAs

Although some caution has been advised in viewing HRAs and HSAs as cure-alls for curbing double-digit rate increases, experts are optimistic that they will help, and predict substantial growth in these arrangements. HSAs currently number over 1 million and growing.

*"Given current health care trends, we'll all be in some kind of consumer-driven plan [soon]..."*

*Scott Keyes, senior consultant for Watson Wyatt Worldwide*

*"I think consumer-driven health care is going to catch on because there are tremendous market forces pushing us that way."*

*Glenn Melnick, PhD, health insurance expert, USC College*

## Testimonials from satisfied employers who have switched to an HRA

Excel Bank Minnesota is an 80-employee, commercial bank located in Minneapolis. Michelle Howk, the Plan Administrator, has high praise for HRAs. "We did a full replacement of our standard co-pay plan in January of 2004, converting to an HRA with a high deductible health plan. Our experience has been quite positive. In fact, the older employees understood the new plan faster than the younger employees since they had used deductible health plans before."

Michelle Howk, Plan Administrator  
Excel Bank Minnesota

United Products is a St. Paul-based distribution company with 200 employees in 9 locations, spanning 3 states. "After using an HRA plan for 18 months, we see that HRAs will be a very successful program for us, and will ultimately reduce our premiums without sacrificing care. We are extremely pleased."

Carol Miller, Plan Administrator  
United Products

## Resources to learn more about HSAs and HRAs

More information can be found at:

<http://www.treas.gov>

US Treasury website - Homepage.

<http://www.treas.gov/offices/public-affairs/hsa/>

US Treasury website - Homepage for HSAs.

[http://www.treas.gov/offices/public-affairs/hsa/pdf/hsa\\_tri-fold\\_brochure.pdf](http://www.treas.gov/offices/public-affairs/hsa/pdf/hsa_tri-fold_brochure.pdf)

US Treasury website - Excellent brochure on HSAs.

Suitable for employees and employers.

The basic facts in 2 pages.

[www.ustreas.gov/offices/public-affairs/hsa/pdf/hsa-basics.pdf](http://www.ustreas.gov/offices/public-affairs/hsa/pdf/hsa-basics.pdf)

US Treasury website - The basics of HSAs.

44 pages of a presentation on HSAs, large print.

[www.hsadecisions.org](http://www.hsadecisions.org)

An HSA organization sponsored by AHIP (America's Health Insurance Plans)