

Proposals to Improve Health Savings Accounts (HSAs)

When Health Savings Accounts (HSAs) first became effective in January 2004, they sparked a great deal of interest among employers, health plans, and employees. By combining several important features, HSAs help make health coverage more affordable, encourage more prudent use of health services and allow tax-free spending on a wide range of medical expenses. Recent surveys confirm that an increasing number of employers are expected to offer HSAs to their employees starting in 2006 and many more are reportedly considering doing so in the future.

Many have asked employers what improvements could be made to the current rules for HSAs which might encourage more employers to offer this new health plan design to employees and encourage more employees to elect HSAs when they are available in the workplace. Here are several straightforward improvements Congress could make to HSAs:

Significant Policy Priorities

- **Permit early adopters of Health Reimbursement Arrangements (HRAs) to convert to HSAs.** Many employers who were the early adopters of HRAs report they would be more likely to offer health savings accounts if they were allowed a one-time opportunity to transfer individual HRA balances into HSAs. HRAs are very similar to HSAs but are funded solely by employer contributions and HRA balances are often subject to forfeiture when an individual leaves employment. Allowing a one-time conversion opportunity would be very valuable for employees because the balances currently in HRAs would become employee-owned funds to which they could also contribute in the future and could keep as they change employment.
- **Permit prescription drug coverage to be offered without a high deductible.** The current law for HSAs requires that prescription drug expenses be subject to the high deductible before coverage begins. However, many employers do not apply prescription drugs expenses toward their health plan deductibles, but instead require cost-sharing by an employee on each prescription they fill. Allowing prescription drugs to not be subject to a high deductible is likely to encourage more employers to offer HSAs and more employees to enroll.
- **Permit individual family members to satisfy the individual deductible for HSAs (\$1,000) rather than the family deductible (\$2,000).** Most employer-sponsored health plans begin providing coverage as soon as a family member meets the individual deductible for the plan rather than the full family deductible. Current HSA guidance only allows this practice if the individual deductible is at least the minimum deductible for *family* coverage (\$2,000). Allowing coverage to begin after a family member satisfies the individual deductible amount would help encourage more employees to elect HSAs for themselves and their families.
- **Encourage employees to save for retiree health expenses.** HSAs were designed to be both a spending *and* a savings vehicle. Current contribution limits, which may not exceed the health plan deductible, are unlikely to create the level of asset accumulation during an employee's working career that will be needed for health expenses in retirement. Allowing an individual or employer to make contributions above the amount of the health plan deductible would help many individuals save for their future health care needs in retirement.
- **Align the HSA contribution limit and the health plan deductible for employees who enroll mid-year.** If an employee joins the high deductible health plan (HDHP) and HSA mid-year, current rules require the HSA contribution limit to be pro-rated, although the employer may not pro-rate the deductible of the HDHP. This creates a disincentive for new employees to elect the HSA when they join an employer mid-year. This could be solved by either: 1) allowing the full HSA contribution limit to be made consistent with the annual deductible of the HDHP, or 2) allowing employers to pro-rate the HDHP deductible to conform with the current requirements to pro-rate contributions.
- **Allow an employer with an HSA to offer Flexible Spending Arrangements (FSAs) and/ or Health Reimbursement Arrangements (HRAs) that could pay for benefits below the high deductible.** Many employers would like to combine HSAs with other similar health plan options, such as flexible spending arrangements (FSAs) and health reimbursement arrangements (HRAs). Current rules significantly restrict the ability of employers and employees to efficiently use these other arrangements in tandem with HSAs. By permitting the use of FSAs and HRAs for health expenses below the deductible, many employees are likely to find HSAs more attractive for meeting both their current and future health care needs.

Additional Policy Changes

- **Permit employer contributions to be reserved for health expenses.** Employers and individuals may contribute to HSAs and the funds can be withdrawn tax free so long as they are used for qualified health purposes. Withdrawals for non-qualified expenses are subject to income tax plus a 10% penalty. More employers would sponsor HSAs and if employers were assured that their contributions would be reserved for qualified health expenses only instead of being available for unrelated purposes.
- **Permit an employer to contribute more to lower-paid workers.** Many employers recognize that lower-paid workers may need assistance contributing a meaningful amount to HSAs and, accordingly, would like to make an additional contribution on their behalf. Amending the comparable contribution rules to allow the additional contribution would provide a great benefit to lower-paid workers and their families.
- **Permit early retirees to pay for health insurance coverage out of their HSA funds.** The HSA law permits retirees age 65 or older to pay their employer retiree health plan premiums out of funds from their HSAs. Allowing funds from HSAs to be used by retirees, regardless of their age, for retiree health plan purposes would be a sensible change that could also make HSAs more attractive to many individuals.
- **Permit individuals to purchase Medigap coverage with HSA funds.** Individuals who are over age 65 may not use HSA funds to purchase a Medigap plan. Allowing individuals to purchase Medigap coverage with funds from HSAs would particularly benefit the many Medicare beneficiaries who may have no other source of health care coverage.

Minor and Technical Changes

- **Permit an employee to contribute to an HSA even if his spouse has an FSA.** Currently an individual may not contribute to an HSA if his spouse has an FSA, even if the individual never seeks to be reimbursed for any medical expenses from the spouse's FSA. This situation could be corrected by simply allowing the individual in the HSA to certify that he will not receive reimbursement for any health expenses from his spouse's FSA.
- **Require Treasury to provide earlier indexing.** The HSA statute directs Treasury to index deductible amounts, out-of-pocket expense limits, and limits on contributions to HSAs. Treasury is required to use third quarter economic data when making these annual updates, which means the new figures are typically issued in December, too late for many employers who need to make these updates much sooner in the year. Directing Treasury to complete the indexing of these amounts by June 1 using earlier economic data would give employers the information they need in enough time to modify their plan offerings that will take effect the following January.
- **Exempt HSAs from COBRA for ERISA purposes as they are now exempt for Tax Code purposes.** Congress exempted HSAs from the COBRA coverage continuation rules in the Internal Revenue Code. However, parallel rules exist in ERISA. While it is clear that COBRA will apply to the high deductible health plan, because HSAs are fully portable there is no need for the COBRA rules to apply in order to provide employees with continued access to their HSA funds. Exempting HSAs from the ERISA COBRA rules would remove confusion and the administrative burden of trying to apply the unnecessary ERISA COBRA rules to HSAs.
- **Conform the definition of dependent for HSAs to the definition applicable for health plans.** The Working Families Tax Relief Act of 2003 amended the definition of dependent referenced by several Tax Code sections, including limiting the amount of income an individual can earn and still qualify as a dependent. The Act included exemptions for most health plans but HSAs were unintentionally left out. Exempting HSAs from the income cap would mean that all individuals who are eligible dependents for high deductible health plan purposes will also be eligible dependents to make contributions to and receive distribution from HSAs.
- **Permit employees over age 65 to continue contributing to an HSA.** Active employees over age 65 are permitted to contribute to an HSA so long as the individual is not enrolled in Medicare. However, individuals are automatically enrolled in Medicare Part A (which covers hospital expenses) upon reaching age 65 even though their plan through their employer will typically continue to cover their medical expenses until they retire. Older workers who participate in HSAs should be allowed to continue to contribute to their accounts until they retire despite the fact that they were automatically enrolled in Medicare Part A at age 65.