A Fix for Health Care?

More Americans are opening tax-free health savings accounts to hedge against soaring medical costs.

First came the HMOs. Then the PPOs, Medical Savings Accounts, and Health Reimbursement Accounts. And now, for something with a totally new look, we have Health Savings Accounts.

Who could blame anyone for being skeptical about what looks suspiciously like the latest incarnation of the Great American health-care fix? Many of the earlier plans were heralded as being the solution to unstoppable, runaway health-care costs. They weren't, of course, and they haven't done much for small businesses, which is probably why roughly half still don't offer health insurance to their employees.

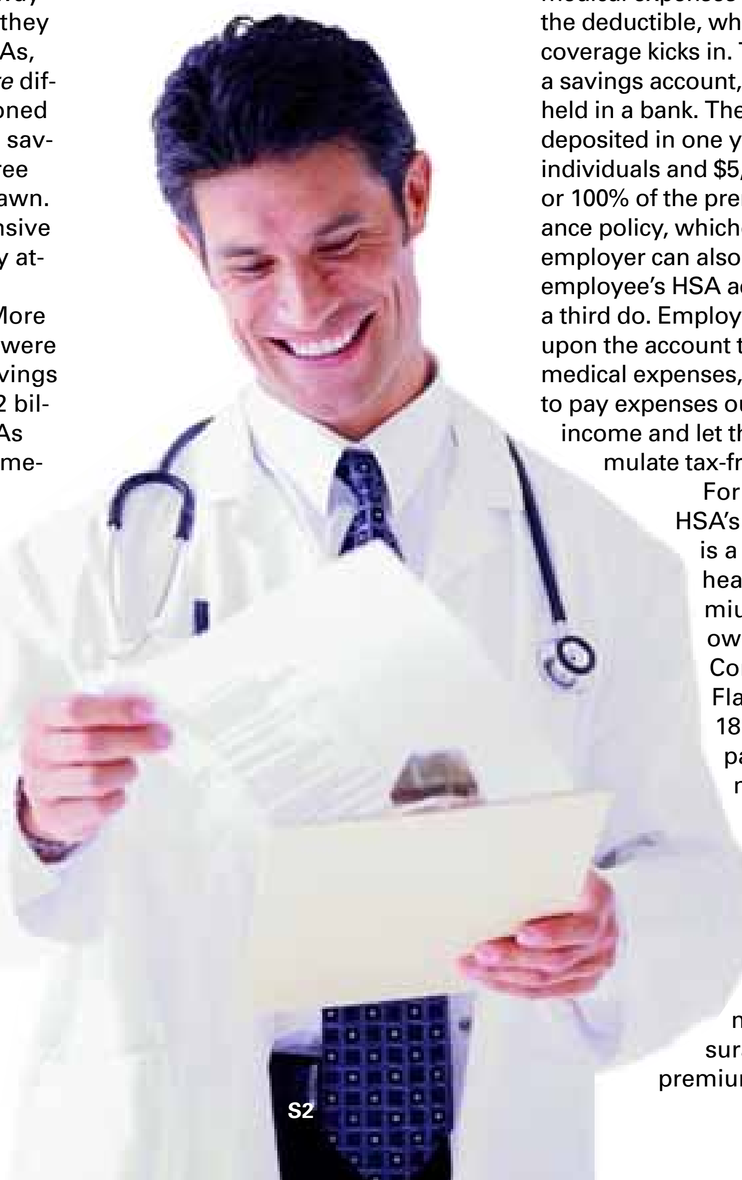
This time it's different, say the insurers and banks, which estimate that $94 billion will be tucked away in HSAs by 2010. And this time they may be right. For one thing, HSAs, which first appeared in 2004, *are* different. They combine old-fashioned health-insurance coverage with savings that accumulate on a tax-free basis until the funds are withdrawn. For another, they are less expensive to run, making them particularly attractive to small businesses.

The numbers tell the story. More than one million HSA accounts were opened in 2005; funds in the savings part of the accounts totaled $1.2 billion. One out of every three HSAs currently in place belongs to someone who was previously uninsured, and the pace is picking up. According to Information Strategies, an HSA research company and advisor based in Fort Lee, N.J., the number of accounts is likely to triple this year, with the savings portion growing to $5.1 billion.

"HSAs are less expensive for small companies and a much more effi cient way to spend health-care dollars," says Bill Thomas, executive vice president of PerfectHealth Insurance Co. of Staten Island, N.Y. He estimates that his firm, which targets businesses with fewer than 50 employees that are based in New York, will cover 10,000 people by the end of 2006, up from 1,800 at the end of 2005. Pending legislation may add another kicker to the plans' popularity. Proposed laws would allow industry associations to offer health insurance to their members. As the least expensive plan in the running, HSAs would likely be a major beneficiary of the legislation.

By the end of the decade there will be nearly 24 million HSA insured in the U.S. with medical savings of $94 billion.

—Information Strategies



Anatomy of an HSA

An HSA differs from a conventional health plan because it is composed of two pieces. The first is traditional health insurance coverage, with a very high deductible—at least $1,050 for an individual and $2,100 for a family. Employees pay for all their own medical expenses until they reach the deductible, when the insurance coverage kicks in. The second part is a savings account, which is usually held in a bank. The most that can be deposited in one year is $2,700 for individuals and $5,450 for families, or 100% of the premium for the insurance policy, whichever is less. An employer can also contribute to an employee's HSA accounts, and about a third do. Employees may draw upon the account to take care of their medical expenses, but many choose to pay expenses out of their regular income and let the HSA funds accumulate tax-free.

For employers, an HSA's key advantage is a dramatic drop in health-insurance premiums. Phil Hadley, owner of Collier Pest Control in Naples, Fla., and many of his 18 employees were paying $1,800 a month in premiums for family coverage under the company's old Blue Cross plan. When he shifted in 2003 to an HSA plan with medical-savings insurance, the monthly premium dropped to $200.

"Yes, we have a one-track mind.

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— Carmine Morano, CEO – PerfectHealth Insurance Company

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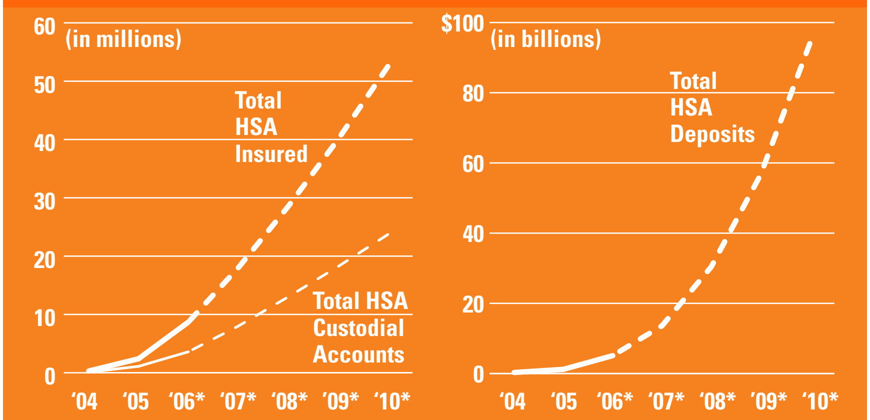
Footing the Bill

More and more individuals are opening HSA accounts.



**Estimated*

Source: Information Strategies

"We were almost at the point where all of our employees were thinking about bailing out of the old plan. Now they are very satisfied with what we have," he says. Contributions to employees' accounts are not only tax-deductible; they are also exempt from federal, state, and local withholding from wages (including the Federal Insurance Contributions Act [FICA] and the Federal Unemployment Tax Act [FUTA]).

Two key factors work to keep HSA costs low. The first is that an insurance company is not on the hook to pay for medical expenses until a covered member spends $1,050 (the minimum deductible), or a family pays out more than $2,100. Because it has less exposure, the insurer charges much lower premiums—25% to 33% lower than a PPO plan, according to Information Strategies. The second cost-containment feature: consumers' altered behavior when they are spending their own money on doctor visits, specialists, and diagnostic tests. "Preliminary findings in our latest survey were that HSA users increased their use of wellness programs by 14% and reduced their use of emergency rooms by 7%. Members of HMOs, PPOs, and POS health plans reported behavior changes of less than 1%," says JoAnn Laing, president of Information Strategies.

Collier's Hadley reports that his employees, with three years under their belt of controlling their own health-care dollars, are even more aggressive. Many routinely ask their doctors to discount their fees because they are being paid in cash. "When you first ask, you'll fluster the office girl to death, but we get cash discounts of between 15% and 30%," he says.

Such efforts promise to rein in year-to-year premium hikes, say the experts. "In a traditional health plan you'll see a trend of annual increases of 10% to 15%, which means in 2016 employers could be paying 100% to 150% of today's health-insurance cost. Because you are shifting more costs to consumers with HSAs, you are seeing annual increases of 3% to 5%," says Marc Ver Straate, director of Consumer Driven Healthcare products at Great-West Healthcare, an employee benefits provider in Greenwood Village, Colo.

Weighing the Pros and Cons

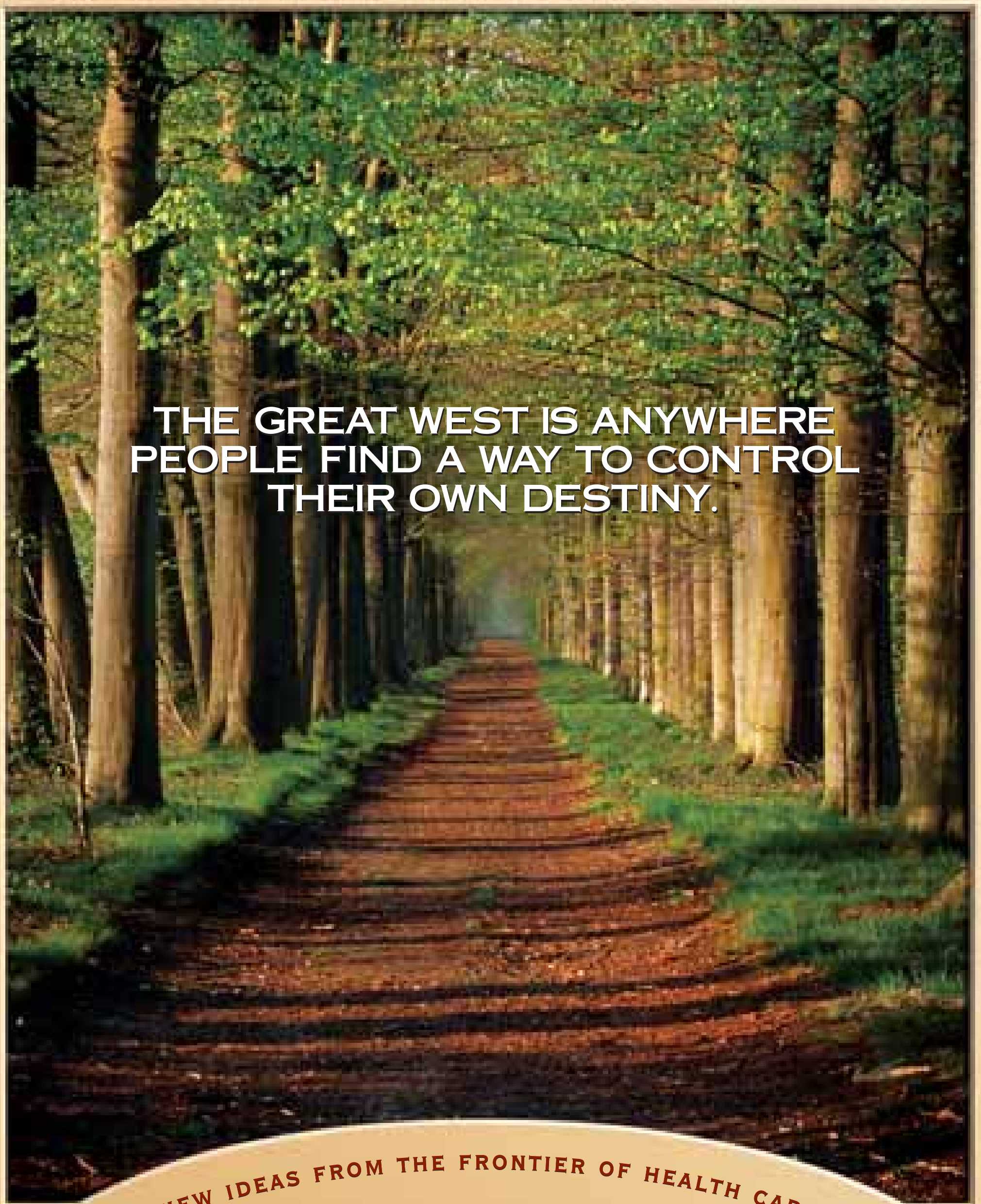
Appealing as the low cost is, employers should think carefully about whether they—and their employees—are prepared for an HSA. Very small companies, with only one or two employees, and companies that employ someone with a preexisting condition will probably find it difficult to obtain coverage at a good price. Some employers balk at the idea of contributing cash to an employee's account, because it will then belong to the employee—who can take it if he leaves the company. Psychologically, says PerfectHealth's Thomas, an employer feels better "giving the money to an insurance company with no hope of getting it back. They sometimes don't like to give employees more money—so it can be an actual barrier to signing up for an HSA."

Some of the questions that Ver Straate suggests employers ask themselves before shifting to an HSA: Is it part of my benefit philosophy to help employees save in the long term? Do my employees understand the basics of insurance? Do they understand how to use the web? For those looking for answers, Great-West offers a five-minute employer-readiness test at greatwest-healthcare.com "It takes a lot longer to educate employees because they are not used to having a bank account or being in charge of their own health-care spending," he says.

An important part of the process is helping employees understand the cost of their current health-care insurance. If today's typical premium is combined with the $20 or $50 co-pays regularly shelled out by employees, the total cost of a PPO or HMO is surprisingly high, says Thomas. He claims that even a chronically ill person—for example, one with Type 2 diabetes—will find an HSA advantageous, primarily because once the deductible is met there are usually no co-pays for drugs, doctor visits, or required

23% of all small businesses offering health care will provide HSAs by the end of 2007

—*Small Business Digest*



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hospitalization. "There are people paying upward of $10,000 a year in co-pays—and they're in network. For most people, co-pays are a silent expense that nobody ever adds up," he says.

Once they understand how HSAs work, employees tend to find the plans eminently flexible. As a health-care account, HSAs pay for traditional medical expenses. But they also pay for services usually not covered by conventional insurers, such as acupuncture, chiropractic, psychological therapy, dental work, and corrective laser surgery for the eyes. Other expenses that are covered include drug and alcohol addiction treatment, schools and homes for mentally retarded family members, and the cost of transportation and hotels for trips related to treatment. Once they've saved enough to meet the deductible, many HSA beneficiaries also use their accounts to buy different types of coverage, such as disability or accident insurance.

Surprisingly, though, most people covered by HSAs barely touch their accounts, says Information Strategies' Laing. In part that's because nearly three-quarters of U.S. residents have less than $500 a year in medical expenses. But it's also because an HSA makes an effective retirement-savings tool. Contributions are tax-deductible, and no tax is owed on the earnings that accrue in the account. HSAs are also permanent assets; they belong to the person who owns the account, no matter how many times he changes jobs. And all the money in the account can be used for any purpose once the account owner turns 65, though withdrawals will be taxed as income.

HSAs are still unfamiliar to most people, but they may be in their last moments of obscurity. Insurers and banks are developing DVDs and online tools to help employers and employees learn more about how HSAs work. And now 401(k) administrators—which include giant financial institutions—are entering the fray with HSA offerings of their own. That suggests we can count on hearing a lot more about HSAs in the future. ■

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