



“CONSUMER DRIVEN” HEALTH PLANS

As health care costs continue to escalate, employer interest in so called “consumer driven” health plans is surging. In most cases, a consumer driven health plan is a high deductible health plan combined with one of two tax advantaged spending accounts: a Health Savings Account or a Health Reimbursement Account. Plan members use money from their spending account to pay for medical care, including prescription and non-prescription drugs. When the account money is depleted, plan participants must pay for medical care out-of-pocket until the plan’s high deductible is met. Once the deductible has been met, the high deductible health plan functions like a traditional major medical plan.

Supporters of these plans claim that giving health care consumers more of a financial stake in their medical care decisions will inject a dose of competition into the health care market place and better contain costs. Opponents, including AFSCME, understand that the accounts are part of a larger conservative agenda to dismantle employer-based health insurance coverage in order to shift risk from employers to employees, and to provide tax shelters for the healthy and wealthy. Following is more specific information on these plans.

HEALTH SAVINGS ACCOUNTS

- What is a High Deductible Health Plan (HDHP). A HDHP is a health plan with deductibles of at least \$1,100 for single coverage and \$2,200 for family coverage. Typically, the deductibles are considerably higher than the minimum levels. Total out-of-pocket expenses in 2008 (deductibles, co-payments, etc.) cannot exceed \$5,600 for an individual and \$11,200 per family. The deductible and out-of-pocket limits are indexed annually for inflation. HDHPs can, but are not required to, provide first dollar coverage for specified preventive care services. The deductible must apply to all services and medical expenses, including most prescription drug expenses, other than expenses incurred for preventive care.
- What is a Health Savings Account (HSA)? An HSA is an individual health spending account that is owned by the employee and may be used for the payment of current and future medical expenses, or as retirement income.
- Who is eligible to participate in an HSA? - HSAs are available to anyone under age 65 who is enrolled in a HDHP, who is not covered by other health insurance (except for insurance that provides preventive care or specific disease coverage), and who cannot be claimed as a dependent on someone else’s tax return. Although individuals 65 and older are prohibited from establishing or joining employer-sponsored HSAs, they may continue to use funds from their existing HSAs after age 65.

- Who can contribute to the HSA? - Individuals and/or employers can make pre-tax contributions. In late December 2006, the President signed the “Tax Care Relief and Health Care Act of 2006.” One provision of this act allows individuals to contribute up to the maximum annual HSA contribution. Prior to this, contributions were limited to the lesser of the HDHP deductible or the annual HSA contribution limit (\$2,900 for individuals and \$5,800 for families in 2008 - employer and employee contributions combined). These amounts are adjusted annually for inflation. The following table illustrates how this works.

	HDHP Deductible	Maximum HSA Deposit (2008)
Single Coverage	\$1,100	\$2,900
	\$1,500	\$2,900
	\$2,000	\$2,900
	\$2,500	\$2,900
	\$3,000	\$2,900
Family Coverage	\$2,200	\$5,800
	\$3,000	\$5,800
	\$4,000	\$5,800
	\$5,000	\$5,800
	\$6,000	\$5,800

Additionally, with the passage of this act, individuals can contribute the full amount regardless of the month he/she becomes eligible. Previously, the contribution amount was pro rated based on the number of months during the year the individual was an eligible individual.

Another aspect changed by the passage of the “Tax Relief and Health Care Act of 2006” concerns the employer contribution. Previously, employers were required to make comparable contributions on behalf of all participating employees. A provision in this act allows employers to make higher HSA contributions for non-highly compensated employees. For this purpose, the definition of “highly compensated employee” is based on the same definition used for qualified retirement plans.

Individuals age 55 and older can also make additional “catch – up” contributions. The maximum annual catch – up contribution is as follows:

- 2006 - \$700
- 2007 - \$800
- 2008 - \$900
- 2009 and after - \$1,000

- HSAs must be funded through a trust or custodial account similar to a deferred compensation or 401(k) account. The act passed in December 2006 allows rollovers from

health FSAs and HRAs into HSAs through 2011. The amounts rolled over may be over and above the amounts allowed as annual contributions. The maximum contribution is the balance of the FSA or HRA as of September 21, 2006 or if less, the balance as of the date of the transfer. The new rules also allow a one-time transfer from an IRA to an HSA. This contribution must be made in a direct trustee-to-trustee transfer. The transfer is limited to the maximum HSA contribution for the year, and the amount contributed is not allowed as a deduction. If the individual does not remain an eligible individual for the 12 months following the month of the contribution, the transferred amount is included in income and subject to a 10 percent additional tax.

- What can the HSA funds be used for? - Funds from the account can be used to pay for qualified medical expenses (medical care, prescription and non-prescription medications), and premiums for long-term care insurance. Qualified expenses, when covered under a traditional health insurance policy, include most benefits ordinarily not considered as taxable income to employees. HSA funds may not be used to pay health insurance premiums except when receiving unemployment compensation, COBRA coverage, or retiree health insurance (including Medicare Part B premiums). Funds may not be used for Medigap premiums.
- What is the tax treatment of HSA funds? - HSA funds are fully vested and may be carried over from year to year and are portable from employer to employer. Funds are not subject to taxation as the account grows or when it is used to pay for eligible medical expenses. HSA participants can use accumulated funds to pay for qualified medical expenses during their working career or retirement. Distributions for non-health expenses are subject to income tax and a 10 percent penalty. However, the penalty does not apply after death, disability or after an individual attains Medicare eligibility (age 65).

HEALTH REIMBURSEMENT ACCOUNTS

- What is a Health Reimbursement Account (HRA)? – HRAs are conceptually similar to HSAs but are completely controlled by the employer. HRAs are also used to pay for qualified medical expenses, but may be used to reimburse employees for the purchase of health insurance as well. Unlike HSAs, there is no requirement that these accounts be pre-funded, vested or linked to a HDHP. Typically, the employer does not specifically set money aside for covered individuals; rather, he or she reimburses employees for eligible medical expenses from general operating funds. Although not required, HRAs are usually accompanied by a high deductible health plan. Even though HRAs have been available for years, they have never been popular, probably because employee contributions are prohibited.
- Who is eligible for participation and who funds HRAs? - HRAs are only available through an employer and must be funded solely by the employer. The employer owns the account - unlike HSAs, which are owned by the individual.
- Can HRA funds be rolled over from year to year? – At the employer's discretion, money remaining in the account at year's end can be carried over to the next plan year. If the employer does elect to allow carry-overs, the employer may cap the carry-over amount.

- Are HRAs portable? – Because the employer retains ownership of the HRA, roll-overs to a new employer's HSA or HRA are at the employer's discretion. Likewise, the employer decides whether to allow employees to access any funds remaining in his or her account at termination or retirement. If the employer decides to give former employees access to their accrued HRA money, and it's used for non-medical expenses, such as a severance package, all amounts paid by the entire plan become immediately taxable, including prior medical reimbursements.

There are also two other types of health care pre-tax spending accounts. The first, Medical Savings Accounts, was an early approach to controlling health care costs that placed more responsibility on consumers than on providers. Congress has extended the provision dealing with MSAs multiple times, with the latest continuing the provision through 2007. The second, Flexible Spending Accounts, also allow participants to pay for qualified medical expenses with pre-tax dollars. Following is more information on these two types of spending accounts.

MEDICAL SAVINGS ACCOUNTS (MSAs)

MSAs, later called Archer MSAs, are a more limited form of HSA first allowed in the 1990s on an experimental basis. MSAs were limited to small businesses or self-employed individuals and failed to gain popularity. MSAs have basically been replaced with health savings accounts (HSAs). Existing MSA accounts can be rolled over into HSAs.

FLEXIBLE SPENDING ACCOUNTS (FSAs)

A flexible spending account (FSA) is a type of cafeteria plan authorized under Section 125 of the Internal Revenue Code. FSAs allow employees to pay for qualified benefits, such as medical or dental expenses, on a pre-tax basis. A FSA can stand on its own or be incorporated into a more comprehensive cafeteria plan. While FSAs are also tax advantaged plans, they are typically used to pay for premiums and out-of-pocket expenses in conjunction with a regular health insurance plan (not a HDHP) and are, therefore, not technically considered consumer driven health plans. *(For information on comprehensive cafeteria plans and flexible spending accounts, consult the AFSCME Research and Collective Bargaining Services factsheets on these plans.)*

CAN CONSUMER DRIVEN HEALTH PLANS CONTAIN COSTS?

Experts question whether consumer driven plans will save money or simply shift more health care costs to employees. The following are several reasons that consumer driven health plans are unlikely to contain health care costs:

- In 2007, the average annual deductible for a HSA qualified HDHP was \$1,923 for single coverage and \$3,883 for family coverage and average employer savings account contributions were \$428 for single and \$714 for family coverage. If individuals forgo preventive care and/or fail to purchase prescribed prescription drugs, serious adverse health consequences will lead to higher health care costs.
- Once an individual meets the plan's out-of-pocket maximum, the plan covers expenses in full. The bulk of health benefit costs are incurred by a small minority of patients with high health care expenses (10% of health plan participants account for 60% of total health care spending). Cost containment efforts should focus on individuals with high claims, typically

those with chronic illnesses. That can be accomplished by implementing quality initiatives and disease management programs. Consumer driven health plans do nothing to contain costs of high-end medical users.

- CDHPs are almost always offered as an alternative to traditional medical coverage. Younger and healthier individuals will be more likely to choose coverage under the CDHP because they are less likely to exhaust their spending accounts. This undermines the basic concept of insurance, which is to spread risk among those that use the benefit and those that do not, leveling the cost for everyone. When the less healthy are the only ones left in the traditional plan, the cost per person will eventually increase, making coverage unaffordable for many.
- CDHP members are expected to shop for health care with the same consideration of prices and quality they show in buying a house or car. However, there is currently limited information available on medical care costs and the quality of medical providers. Accessing and interpreting the information is difficult at best, and impossible for those without a computer or computer skills because it is virtually always provided via the internet. Even if such information were readily available, experts are skeptical that employees will use patient information to guide their medical decisions. Several years ago, one study traced the impact of giving consumers greater control over their health care dollars and treatment decisions. While people did use fewer services, they were not able to determine when they really needed care and when they didn't, so they just cut back indiscriminately.
- CDHPs, with their multiple components, will result in higher administrative costs. In addition to the cost of administering the high deductible plans, each individual spending account will have to be managed. It is likely that employees will be paying the spending account administrative costs.

PITFALLS

If the employer insists on implementing a CDHP option, the union should attempt to negotiate the following protections:

- HSA and HRA spending accounts should provide first dollar coverage for specified preventive care. Certain prescription drugs, such as those used to prevent a heart attack, treat obesity, or help someone quit smoking, also count as preventive care. The union should negotiate that the plan provide coverage of allowable preventive care, without payment of the deductible.
- The union should be sure that medical services paid for with spending account dollars are subject to in-network discounts.
- CDHPs do not provide high-end medical users with any incentives to control costs once the out-of-pocket maximum is met. The HDHP should include appropriate disease and case management programs to ensure that available health care dollars are spent effectively and appropriately.
- CDHP advocates claim that individuals will make better health care decisions when using their own money to pay for care, but information needed to “be a better health care

consumer” is often unavailable or incomplete. Every effort should be made to provide complete and accurate information on the quality of medical providers in the network.

- The union should attempt to negotiate for full employer payment of CDHP administrative costs.
- Because the high deductible must be met before coverage for prescription drugs becomes effective, individuals may not have necessary prescriptions filled. To lessen the impact of this prohibition, employer contributions to the savings account should be as high as possible and deductibles should be set at the minimum allowed by law.
- Advocates of CDHPs say that active employees can save money to pay their retiree health care costs. However, studies have found that the amount that can be saved, if any, will be insufficient to pay those costs. Even so, the employer may use this as an argument to eliminate or decrease current funding of retiree health care.

There is a considerable amount of skepticism about CDHPs on the part of both employers and employees. A recent survey found that only 17 percent of large surveyed firms agree that CDHPs are very effective in lowering health care use and spending, and only 5 percent of employers not currently offering them are very likely to offer a CDHP by 2008. Among larger employers, 53% are either very or somewhat likely to offer a CDHP in 2008. The Federal Employee Benefit Program now offers a consumer-direction option to federal workers and retirees. This is of concern because large employers have been the catalysts of change in the health care market in the past. For example, managed care began with the largest companies and filtered down to smaller employers. Consumer driven plans may follow a similar path.

High deductible plans run counter to emerging approaches to increasing patient financial responsibility for healthcare. Rather than imposing high deductibles, leading-edge employers and insurers are developing financial incentives to steer patients to efficient providers and medical services by varying cost-sharing depending on these choices. The goal is to avoid large financial burdens on low-income individuals or patients with medical conditions that require expensive treatments, even when delivered efficiently.

In August 2006 the Government Accounting Office (GAO) released a study detailing early enrollee experiences with HSAs. The study concluded that HSAs are greatly skewed toward healthy, wealthy individuals. The Center on Budget and Policy Priorities released a report on the GAO study in September 2006. It can be found at www.cbpp.org/9-20-06health.pdf. The full GAO report can be found at www.gao.gov/cgi-bin/getrpt?GAO-06-798. Also, in November 2006, the Kaiser Family Foundation released a national survey of enrollees in CDHPs. It found that while 71 percent of those covered under these plans are more likely to consider cost when seeking health care, 50 percent say they would be very or somewhat likely to change health plans if given the opportunity. (A summary of this survey can be found at: <http://kff.org/kaiserpolls/upload/7594.pdf>)

For more information on consumer driven health plans, high deductible health plans, health savings accounts or health reimbursement accounts, contact Mary Meeker at the Research and Collective Bargaining Services Department at 202/429-1058.

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