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Mitigating Healthcare Costs With HDHPS and HSAS: What Plan Sponsors Need to Know

It's no secret that healthcare is expensive—and costs are likely to continue going up. While preferred provider organizations (PPOs) are still the most popular plan type, many companies are turning to consumer-directed, high-deductible health plans (HDHP) to help manage costs and are adding reimbursement accounts like health savings accounts (HSA) to help employees pay for expenses.

Still, employees have many misconceptions about HDHPs and HSAs. In fact, just a little more than half of Americans say they understand HSAs, according to a March report by the LIMRA Secure Retirement Institute and Insured Retirement Institute. Employers have difficulty understanding these savings vehicles as well.

With more companies using and integrating consumer-driven benefits like 401(k)s and HDHP/HSAs, there's an opportunity for plan sponsors to learn more about ways to help employees optimize their funding for health and retirement wealth.

For Employers

First, why are companies moving to HDHPs?

According to the Kaiser Family Foundation's 2017 Employer Health Benefits Survey, PPO growth has slowed by 8 percent since 2012, while HDHPs have increased by 9 percent over the same period.

The reasons for this are varied, but most stem from cost. The average employer premium contribution to all plans for single coverage in 2017 was $5,477, compared to the HDHP employer contribution of $5,004 for the same group. The average employer portion to all plans for family coverage was $13,049 last year, compared to $12,982 contribution for HDHP plans only.

What kind of out-of-pocket reimbursement accounts are out there?

Health Reimbursement Accounts (HRAs) are set up and funded by employers to help employees pay for eligible medical expenses. The employer owns the account, and it can be used in conjunction with a flexible spending account (FSA). HRAs can also be paired with an HSA, but there are certain limitations. There is no contribution limit, but the employer can limit the amount carried over to the next year.

Health Savings Accounts (HSAs) are employee-owned accounts, similar to 401(k)s. These accounts must be linked to an HDHP and may be funded by employers and employees (pre-tax). The contribution limits for 2018 are $3,450 for single accounts and $6,850 for families. Also, those aged 55 years and older are allowed to make $1,000 catch-up contributions annually. The money stays in the account until it is used, tax-free for medical expenses. There are penalties if the money is withdrawn for non-medical expenses. The account is portable, meaning owners can take it with them when they leave a job. It can also be used to pay for healthcare in retirement. The money is deposited tax-free, it can grow tax-free, and it can be withdrawn tax-free for medical expenses. It can also be used with a limited-purpose Flexible Spending Account (FSA) or a limited-purpose HSA.

Flexible Spending Accounts (FSAs) set up by employers and may be funded by employees (pre-tax) and employers. The contribution limit for 2018 is $2,650. It's known as the "use it or lose it account," but employers can allow up to $500 (set by IRS limits) to be carried over to the following year. It can be paired with HRA as well as an HSA, but there are certain limitations.

Are companies required to contribute to an HSA?

The short answer is no—but some do. The 2017 Year-End HSA Research Report by consulting firm Devenir Group showed that 21 percent of employers made HSA contributions for the year; the average employer amount was $621.

What kind of administrative work is required with an HSA?

For employers, there isn't a lot of work involved because an HSA is run by a custodian or trustee and is a separate bank account. Employers must set up payroll deferrals and do comparability testing – similar to 401(k) discrimination testing— to make sure company contributions are fair to all workers, and there is a federal penalty for non-compliance. Employers also need to report employee deferrals to HSA accounts as well as employer contributions.

Can employers deduct the HSA contribution as a business expense? And are there any fiduciary responsibilities in offering an HSA?

Yes, contributions can be deducted as a business expense. And in general, the custodian or trustee of the HSA—who is in charge of administering the plan—assumes the fiduciary obligations.

Will an HSA help employees become better healthcare consumers?

That depends on a few factors. There have been studies showing that HSAs can positively change employee behavior. When coupled with a 401(k), workers wind up saving more than those who use one or the other, a 2018 HSA and 401(k) Contribution Analysis by Alight Solutions found.

Another study by the Employee Benefit Research Institute showed that employees with HSAs tend to avoid going to the doctor or refilling prescriptions more than those in other health plans. In this scenario, short-term savings may have an impact on long-term health issues and costs.

For Employees

What is the benefit of having an HSA?

HSAs are known for having the triple-tax advantage: money goes in tax-free, it grows tax-free, and is taken out for qualified medical expenses tax-free. For example, if you have a $100 medical cost and you're in the 32 percent tax bracket, that bill really only costs you $68, because the payment for that medical expense is excluded from your taxable income.

If I don't spend the money in my HSA, do I forfeit it?

The LIMRA study showed 2-in-5 Americans thought they would lose the money at the end of the year, but the truth is that—unlike with FSAs—the money stays in the account because it belongs to the employee. It works like a 401(k), where the employee makes a contribution and the employer may also make a contribution.

What can I use the money for?

Funds must be used for approved medical expenses found in IRS Code 213. People can't contribute to an HSA once enrolled in a Medicare plan, but HSA dollars can be used to pay for Part B premiums, Part C, and Part D prescription plans, as well as long-term care insurance.

Can I use the money for non-health expenses?

Yes, but it would be subject to income tax rules. Moreover, if you're under age 65, you would need to pay a 20% penalty tax on the amount withdrawn.

Can HSA dollars be invested in the stock market?

It depends upon the arrangement. Right now, most people use HSAs as a checkbook for current medical expenses and don't see it as an opportunity for assets to grow tax-free. Some HSA arrangements have a cash threshold employees must meet before they can move money into investments. According to Devenir, $27.5 billion was contributed to accounts in 2017, $22.5 billion was withdrawn, and only about $5 billion, or 18 percent of assets, were held in accounts and not used for medical expenses.

And I can use this money in retirement?

Yes. A couple retiring in 2017 will need $275,000 on average to pay for medical expenses, Fidelity Investments reported last year. It's a lot of money, and HSAs provide an option to consider when saving for and paying out medical expenses in retirement. A person would need to save less in an HSA account for retiree health expenses than they would in a traditional 401(k), because there would be no tax payment on the money withdrawn from the HSA. In a traditional 401(k), money is deposited tax-free and grows tax-free but it is subject to income tax rules when withdrawn.

Insight: Addressing the Need for HSA and HDPH Education

Funding rising healthcare expenses should be a central part of employees' retirement planning, and HSAs paired with HDHPs can be an effective part of this planning. But given the misconceptions and confusion surrounding these vehicles, plan sponsors need to first fully understand the nuances of these vehicles to determine whether they will be a good fit for their workforce. Companies that do decide to offer HSAs and HDPHs need to then develop an effective communication strategy to educate their employees on how to take full advantage of these benefits.