STATE OF WISCONSIN
Department of Employee Trust Funds
Robert J. Conlin
SECRETARY

801 W Badger Road
PO Box 7931
Madison WI 53707-7931

1-877-533-5020 (toll free)
Fax (608) 267-4549
http://etf.wi.gov

CORRESPONDENCE MEMORANDUM

DATE: February 5, 2014

TO: Group Insurance Board

FROM: Tara Pray, Manager, Employee Reimbursement Accounts Program
Mary Statz, Director, Health Benefits & Insurance Plans Bureau

SUBJECT: Health Reimbursement Accounts Compared to Health Savings Accounts – Feasibility and Cost Effectiveness Study

This memo is for informational purposes only. No Board action is required.

Background

2013 Act 20 (the state budget) requires the Group Insurance Board (Board), beginning on January 1, 2015, to offer a high-deductible health insurance plan (HDHP) and a health savings account (HSA) (§40.515). The law also requires the state to make contributions to an employee's health savings account in an amount determined annually by the Director of the Office of State Employment Relations (OSER).

Act 20 also required ETF and OSER to study the feasibility and cost effectiveness of offering health reimbursement accounts (HRAs) compared to HSAs and present the findings to the Governor and the Joint Committee on Finance.

This memo is intended to provide the Board with a summary of the findings. A copy of the study is attached to this memo.

Findings

In terms of control and design, there are key differences between HRAs and HSAs:

- More control is afforded to the employee with an HSA and to the employer with an HRA;
- HSAs follow strict IRS guidelines, whereas the HRA design is more flexible;
- Both the employer and the employee can contribute to an HSA;
- Only the employer can contribute to an HRA; and
- Claims under an HRA are adjudicated, while HSA withdrawals are not adjudicated.

Reviewed and Approved by Lisa Ellinger, Administrator, Division of Insurance Services

Lisa Ellinger

Electronically Signed: 02/10/2014

Board	Mtg Date	Item #
GIB	2.19.14	7L

Any recommendation for which option is preferable depends on the public policy goals being sought. As policymakers weigh the HRA and HSA options, key considerations include the employee's interests and the employer's interests--including short-term and long-term cost for each--as well as the effect on the current group health insurance program.

Staff will be at the Board meeting to answer any questions.

Attachment A: Act 20 Health Insurance Options Feasibility Study

Act 20
Health Insurance Feasibility and Cost Effectiveness Study:

Health Reimbursement Accounts and Health Savings Accounts

WISCONSIN DEPARTMENT OF EMPLOYEE TRUST FUNDS

SERVING PEOPLE WHO SERVE WISCONSIN

STATE OF WISCONSIN

Department of Employee Trust Funds
Robert J. Conlin
SECRETARY
Office of State Employment Relations
Greg Gracz
DIRECTOR

January 31, 2014

THE HONORABLE SCOTT WALKER
GOVERNOR
115 EAST CAPITOL
MADISON WI 53702

THE HONORABLE ALBERTA DARLING
CO-CHAIR, JOINT COMMITTEE ON FINANCE
317 EAST STATE CAPITOL
MADISON WI 53707

THE HONORABLE JOHN NYGREN
CO-CHAIR, JOINT COMMITTEE ON FINANCE
309 EAST STATE CAPITOL
MADISON WI 53708

Dear Governor Walker, Senator Darling and Representative Nygren:

Wisconsin Act 20 requires the Secretary of the Department of Employee Trust Funds (ETF) and the Director of the Office of State Employment Relations (OSER) to study the feasibility and cost effectiveness of offering health reimbursement accounts compared to health savings accounts and report the findings and recommendations to the governor and the joint committee on finance.

As directed, the attached report compares health reimbursement accounts to health savings accounts and provides a brief description of a high deductible health plan.

We respectfully submit the attached report for your review.

Sincerely,

Robert J. Conlin
Secretary
Department of Employee Trust Funds

Gregory L. Gracz
Director
Office of State Employment Relations

Act 20
Health Insurance Feasibility and Cost Effectiveness Study:

Health Reimbursement and Health Savings Accounts

Submitted by

the Department of Employee Trust Funds and
the Office of State Employment Relations

January 2014

Introduction

The Department of Employee Trust Funds (ETF) administers retirement and other benefit programs for state and local government employees and retirees. The Office of State Employment Relations (OSER) oversees the state civil service system, manages compensation and labor relations and leads the state's affirmative action and equal opportunity employment programs.

In addition to the health insurance plans offered currently under §40.51 (6), 2013 Act 20 requires the Group Insurance Board (Board), beginning on January 1, 2015, to offer a high-deductible health plan (HDHP) and a health savings account (HSA) (§40.515) to all state employees.

- The state shall make contributions into each employee's HSA in an amount specified by the Director of the Office of State Employment Relations.
- The Board shall ensure that the HDHP may be used in conjunction with an HSA.
- The Board may contract with any person to provide administrative and other services relating to HSAs.
- The Board may collect fees from state agencies to pay all administrative costs relating to the establishment and operation of HSAs.
- Beginning on January 1, 2015, to the extent practical, any agreement with any insurer or provider to provide health care coverage to state employees under § 40.51 (6) shall require the insurer or provider to also offer an HDHP that may be used in conjunction with an HSA.

Act 20 also charged the Secretary of ETF and the Director of OSER to study the feasibility and cost effectiveness of offering health reimbursement accounts (HRA) compared to HSAs. The provision states that the Secretary and Director shall report their findings and recommendations to the Governor and the Joint Committee on Finance no later than January 31, 2014.

Consumer Driven Health Plans

Consumer-Driven Health Plans (CDHPs) are health plans, typically with high deductibles, that include an HSA, HRA or similar medical payment product to pay routine health care expenses directly. In theory, overall healthcare costs will decrease when individuals have a greater financial stake in their healthcare decisions. The 2013 Kaiser Family Foundation and Health Research & Educational Trust Survey found that in 2013, 20 percent of covered workers were enrolled in a CDHP.

High Deductible Health Plans (HDHP)

Under federal law, the term "high deductible health plans" means a health plan that has a minimum annual deductible and a maximum annual out-of-pocket limit set by the Internal Revenue Service (IRS). For 2014 the minimum deductible for single coverage is $1,250 and $2,500 for family. The 2014 maximum out-of-pocket limit is $6,350 for single and $12,700 for family. An HDHP does not pay anything toward health care costs until the annual deductible has been met. An exception is made for preventive services mandated by the Patient Protection and Affordable Care Act (PPACA), which are not subject to the deductible.

Health Savings Accounts (HSAs) are accounts established by individuals to pay for health care. An individual may establish an HSA if he or she is covered by a “qualified health plan,” which is a plan with a high deductible that meets federally defined requirements. HSAs are only compatible with HDHPs, which by definition meet the IRS standards. Employers may assist their employees by identifying HSA options, facilitating applications, or negotiating favorable fees from HSA vendors.

Eligibility restrictions: Individuals are not eligible to open HSAs if they are over age 65; if they are already enrolled in a low-deductible insurance plan, Flexible Spending Account (FSA), or HRA; if they can be claimed as a dependent on someone else’s tax return or if they receive benefits from Medicare, Medicaid or other such programs.

Ownership: HSAs are owned by employees. Separate custodial accounts are required for each HSA participant. Employees may choose how and when to spend, or invest, the funds in their account. The savings account is owned by the individual who created the account, so balances roll over year to year and employees retain their HSA balances if they leave their job.

Contributions: Both employees and employers can contribute to an HSA. Annual contributions, whether made by the employee or employer, are limited by the IRS. For 2014, the HSA contribution limit is $3,300 for an individual and $6,550 for a family. Employers are not required to contribute to HSAs but if they elect to do so, their contributions are not taxable to the employee. IRS comparability rules require HSA employer contributions to be the same amount or the same percentage of the HDHP deductible for all employees with the same category (individual or family) of HDHP coverage.

Employee contributions are also made on a pre-tax basis, often through payroll deduction. HSAs provide employees a way to set aside their own tax-free dollars for when needed to pay for medical expenses. The American Association of Retired Persons (AARP) estimates that individuals will spend more than $100,000 on healthcare costs in retirement; an HSA can help save for those costs.

Contributions may be made to HSAs on a bi-weekly, monthly or annual basis as long as IRS compatibility rules are followed.

Reimbursements: HSA reimbursements are governed by IRS rules and cannot be limited by the employer. Qualified medical expenses, as defined by the IRS, may include expenses that are not covered by the HDHP in which the employee is enrolled. An employee must be covered by an HSA eligible HDHP to own an HSA, but the funds in the account can be used for any dependent regardless of whether they are covered under the HDHP. Withdrawals from the HSA by the account owner to pay for qualified health care expenses are not taxed.

The employer may not adjudicate HSA claims, meaning no documentation or receipts are needed in order to withdraw funds as no third party administrator is validating withdrawals. HSA funds may be used for nonmedical purposes, although such expenditure requires inclusion for income tax purposes and may result in a 20 percent additional tax. The 20 percent additional tax does not apply to amounts distributed in the event of death, disability, or after an individual reaches the age of Medicare eligibility.

Investment Options: Participants have several investment options dependent on what the HSA vendor offers. Commonly, an account balance has to reach a certain amount, such as $1,000, in order to invest the funds. Funds are often invested in mutual funds that the participant chooses from the available offerings. It is recommended that participants leave some funds liquid for expected short-term medical expenses.

Forfeitures: HSA funds are not forfeited. Any employer contributions are owned by the participant at the time of payment. At age 65 the funds can be used for anything, however, they will be taxed if not spent on healthcare. The funds in an HSA automatically carry over from year to year, reducing the risk of losing funds if medical expenses are overestimated. There is no limit to how much can be carried over.

Compatibility: An individual participating in an HDHP with an HSA is not allowed to participate in a standard Flexible Spending Account (FSA), also referred to as an Employee Reimbursement Account (ERA). However, employers may choose to offer limited health FSAs which can only cover preventive, dental and vision expenses, and/or a post-deductible FSA that can only be used once the HDHP deductible has been met. Typically, the dental and vision limited FSAs are offered because it is too administratively burdensome to determine what is an eligible preventive FSA expenditure to remain compatible with the HSA.

Cost: Administrators typically charge HSA account holders $10 to $25 in one-time account setup fees. Account maintenance fees range from approximately $18 to $48 per member, per year. Additionally, there are investment fees, which can vary depending on the type of investment. An example is $24 per year to invest in mutual funds. It is common practice for these account fees to be paid by the employer until the employee leaves employment.

Health Reimbursement Accounts (HRAs) are medical care reimbursement plans established by employers to pay for health care. Employers typically commit to make a specified amount of money available in the HRA for premiums and medical expenses incurred by employees or their dependents. HRAs can be coupled with any type of health insurance plan (as long as it meets the standards of PPACA). While it is most common for HRAs to be paired with HDHPs, it is not required.

Eligibility restrictions: There are almost no restrictions on who is eligible to participate in an HRA. Employers have the discretion to cover employees, their dependents and domestic partners. Employers can also choose to provide HRAs to retirees and former employees.

Ownership: HRA funds are owned by the employer. The employer can choose whether HRA funds remain with the employer when the employee leaves or are portable for the employee.

Contributions: HRAs are funded solely by employers and administered by a third party. The employer determines the amount to contribute to an HRA. The IRS does not limit the amount an employer can contribute or require contributions to be the same for all employees within the same category of coverage (individual or family). HRA contributions can also vary by type of participant (i.e., employee classification, annuitant status).

HRAs are notional accounts, meaning the funds are paid from the employer's bank account. Reimbursements are made from the employer's general assets as claims occur. The account does not have to be prefunded by the employer.

Reimbursements: The employer has control over the expenses that can be reimbursed in an HRA arrangement and reimbursements for qualified health care expenses are not taxed. Reimbursement could be limited to services covered by the State of Wisconsin Group Health Insurance uniform benefits. HRA funds are only available for covered dependents, as determined by the employer. The employer could include as dependents only those individuals who are covered by the insurance plan.

Under an HRA, a reimbursement may only be made after the expense has been adjudicated, much like the current FSA offering.

The employer can determine when contributions will be available for reimbursement by participants, either up front at the beginning of the plan year, or incrementally throughout the year. Employers pay when medical expenses are incurred, and only to the extent of the employer contributions available.

Investment Options: HRAs do not, on their own, offer investment options for the individual participants. Depending on employer design, HRAs can be offered alongside employee trust accounts for individual investment purposes. The amounts eligible for investment are at the discretion of the employer.

Forfeitures: Employers can determine whether employees may rollover funds not spent during the plan year and the length of time rollover funds are accessible to the employee. Unspent funds in the HRA can usually be carried over to the next year (sometimes with a limit). Typically, HRA balances are forfeited when the employee leaves employment or the plan.

Compatibility: HRAs can be coupled with any type of health insurance plan (as long as it meets the standards of PPACA). While it is most common that HRAs are paired with HDHPs, there are no IRS restrictions on the HDHP regarding a minimum deductible or benefits provided without first satisfying the deductible. This flexibility allows the employer to make offerings in the HDHP to meet the goals of the overall plan, including incentivizing employees to participate. This flexibility allows for prescription drug co-pays before the employee meets the high deductible and also for office co-pays if the employer chooses. These are HDHP program design aspects that help to keep the HDHP option affordable for a participant and encourage preventive care.

Cost: Typical HRA fees can vary depending on whether the employer sets aside the funds at a financial institution. Monthly administration fees can range from about \$3.59 - \$4.15 per participant per month.

In preparation for this study, the Board's consulting actuary, Deloitte LLC., prepared the following table comparing HSAs and HRAs:

Shaded cells reflect potential employer financial and/or administrative advantage between HSA and HRA.

Issue	Health Savings Account (HSA)	Health Reimbursement Accounts (HRA)
Established	• IRC §223 (December 2003)	• IRC §§105-106 (June 2002)
Eligibility	• Employees, retirees, and the self-employed who are covered under a qualified high-deductible health plan (HDHP), but not covered under any other health plan (vision plans, dental plans, and limited purpose or post-deductible ERAs and HRAs possible exceptions). • Medicare-primary eligible individuals cannot make contributions, but can draw down HSA balances.	• Must be paired with a medical plan option (cannot be "stand-alone"). • May be offered to current and former employees and individuals electing COBRA. • No restriction for individuals covered by Medicare. • Can be covered under an ERA as well, and can draw from previously-established HSA where no new contributions are being made.
Ownership	• Employee ownership	• Employer ownership
Employee Contributions	• Allowed if covered under qualified HDHP (payroll deferral and/or direct). • Contributions excludable from gross income.	• Prohibited.
Employer Contributions	• Allowed if covered under qualified HDHP. • Contributions excludable from gross income.	• Allowed ("required" in order to exist.) • Contributions excludable from gross income.

Issue	Health Savings Account (HSA)	Health Reimbursement Accounts (HRA)
Maximum Deduction and Exclusion Rule on Contributions	• The deduction and exclusion for contributions to an HSA cannot exceed the annual statutory maximum ($3,300 single coverage, $6,550 family coverage for 2014). • Additional "catch-up" contributions allowed for employees age 55+.	• No statutory limit, but benefits for highly compensated employees may be limited by the application of nondiscrimination rules under code 105(h).
Employee Tax Impact	• Reimbursements are tax free if they are distributed to reimburse for any qualified medical expenses. • Reimbursements taxed if not for any qualified medical expenses. • Reimbursements subject to 20% tax penalty if not for qualified medical expenses (20% penalty does not apply if made after death, disability, or age 65).	• Reimbursements are tax free if they are distributed to reimburse for plan-allowed qualified medical expenses. • Reimbursements typically not allowed if not for plan-allowed qualified medical expenses.
Funding Basis	• Actual.	• Notional.
Funding Requirements	• Must be funded in a trust or custodial account established by employee.	• Commonly designed as "virtual or notional accounts" with reimbursements made from employer's general assets as claims occur. • The account may be, but is not required to be, pre-funded by the employer.

Issue	Health Savings Account (HSA)	Health Reimbursement Accounts (HRA)
Tax Treatment of Earnings	• Earnings on HSA assets are not subject to tax while they are held in the HSA and are never taxed if they are distributed to reimburse for qualified medical expenses.	• Since accounts are notional, earnings at employer's discretion (not common feature). • If earnings provided, not subject to tax.
Paired Health Plan	• Compatible with a qualified HDHP (legislated definition). • For 2014: HDHP must have an in-network annual deductible of at least $1,250 for single coverage, $2,500 for family coverage. • For 2014: In-network out-of-pocket expense requirement cannot exceed $6,350 for single coverage, $12,700 for family coverage. • HDHP cannot have an "embedded individual deductible" as part of the family deductible.	• Flexible; defined by employer, with no lower limit to deductible and no upper limit to maximum out-of-pocket other than that specified under PPACA.

Issue	Health Savings Account (HSA)	Health Reimbursement Accounts (HRA)
Reimbursable Expenses	• Must reimburse for any health expenses defined in Section 213(d) of the Internal Revenue Code. • Generally cannot be used to pay for health plan premiums (exceptions include COBRA, long-term care premiums, and premiums for non-Medigap premiums for people over age 65).	• May reimburse for medical expenses defined in Section 213(d), including amounts paid for health plan premiums and long-term care coverage premiums, but cannot reimburse expenses for long-term care services.
Qualified Premiums	• Non-Medicare Supplement post-65 health insurance, Medicare, COBRA, qualified LTC, health insurance if unemployed.	• Retiree health insurance, including qualified LTC, COBRA.
Claim Processing	• Discretionary or automatic. • Can be via debit card. • Handled by claims administrator or separate HSA trustee. • Reimbursement limited to amount in account at time of reimbursement request.	• Discretionary or automatic. • Typically handled by claims administrator. • Reimbursement can be based on entire annual accrual amount even if not yet completely funded. If reimbursement limited to year-to-date pro-rata accrual, temporarily exposes employee to greater out-of-pocket cost exposure.
Claim Substantiation Requirements	• Employers and HSA trustees are not required to determine whether HSA distributions are used exclusively for qualified medical expenses. HSA holders should maintain supporting records. • Substantiation likely required under HDHP.	• ERISA plan - medical care expenses must be substantiated.

Issue	Health Savings Account (HSA)	Health Reimbursement Accounts (HRA)
Timing of Reimbursements	• Can receive reimbursement any time for any expense incurred after creation of HSA (even years later).	• Reimbursement window limited by employer (e.g., 90 days after close of plan year).
COBRA	• COBRA is not applicable to HSAs, but it would apply to the qualified HDHP. • Can use HSA to pay COBRA premiums.	• COBRA is applicable to both the HDHP and the HRA. • Can use HRA to pay COBRA premiums.
Ability To Roll Over Funds Year Over Year	• Yes	• Yes, at employer's discretion.
Portability	• Yes, completely (Statutory requirement).	• Only at employer's discretion, though COBRA-eligible benefit.
Administration Cost	• Yes (annual basis). • Fees often paid by employer while employee is active; paid by employee after termination (i.e., deducted from HSA).	• Yes (monthly basis). • Fees generally paid by employer.

Key Differences

- HRAs provide more control and design flexibility for the employer than HSAs.
    - HRA reimbursements must be adjudicated, ensuring that paid claims are for eligible medical expenses.
    - Employers can choose what medical expenses will be eligible for reimbursement.
    - The employer typically has more ways to structure a health insurance plan with an HRA to include various deductible and/or coinsurance combinations.
- HSAs, conversely, provide more control to the employee than HRAs.
    - HSA funds are not required by the IRS to be adjudicated.
    - Subject to potential tax consequences, the employee

may choose how to spend HSA funds, including for non-medical expenses.
    - Employers do not control the medical expenses that are eligible for HSA spending. It should be noted that, as a result, there is the possibility that HSA eligible medical expenses would not align with the State of Wisconsin Group Health Insurance uniform benefits.
- Funding an HRA would likely cost the employer less than funding an HSA at the same maximum employer contribution levels, because the HSA funds must be deposited into employee owned accounts. Once employer payments are made to the HSA accounts, they are the property of the participants. Because funds are only "committed" to HRAs, the employer's funds are not paid until actual claims are submitted. It is unlikely that every participant will ever incur enough eligible medical expenses to expend all funds.
- Employer contributions to an HRA can be forfeited by the employee upon leaving the plan or employment if the employer so chooses.
- HSAs have higher administrative costs than most HRAs and the FSA plan currently offered to state employees. This is due to fees assessed by the financial institutions and administrators that maintain the accounts, including set-up fees, monthly/annual account maintenance fees and investment management fees. However, these fees may be partially offset by investment earnings on the HSA account.
- The employer can choose whether to offer an HRA to existing retirees. State employees or annuitants who are 65 years or older would not be eligible to contribute to an HSA if they are eligible for *and* enrolled in Medicare. These groups could be potentially disadvantaged by establishing an HDHP/HSA.
- HSA participants establish interest bearing or investment accounts for their HSA funds. The funds can be saved indefinitely, can grow tax-free, are owned by the participant and are always portable.
- HSA account holders can also contribute to their own accounts (family members can also contribute) and decide how much to use, which expenses will be reimbursed and what types of investments to utilize to grow the savings account.
- There are limits to the total amount of annual contributions made to HSA accounts, the maximum contribution is a combined total of contributions from any source. If the account holder is age 55 or older, there is a provision for additional "catch-up" contributions.

Recommendation

As described above, there are key differences between HRAs and HSAs. Any recommendation for which option is preferable depends upon the public policy goals being sought. As policymakers weigh the HRA and HSA options, key considerations include the employee's interests and the employer's interests, including short-term and long-term cost for each, as well as the impact on the current group health insurance program.

Potential Next Steps

State statutes require the Board to make an HSA option available to state employees in 2015. If the policy considerations above result in a desire to offer an HRA option rather than an HSA option, the operative statute would need to be amended.

If a decision is made to offer an HRA combined with an HDHP along with an HSA combined with an HDHP, the Board has the authority to do so under §40.03 (6)**.** However, statutory authority would be required to fund an HRA.

References

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3. Fronstin, P. (2013). Findings from the 2013 EBRI/Greenwald & Associates Consumer Engagement in Health Care Survey. *EBRI Issue Brief, no. 393*.

4. Golub, I. M., & Chevlowe, R. K. (10/9/2013). *COBRA Handbook, 2014 Edition.* Aspen Publishers.

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