

Health Savings Accounts

What is a Health Savings Account? – Health Savings Accounts (HSAs) were authorized in the federal Medicare Modernization Act (HR 1) enacted in 2003. Linked to high-deductible health plans (HDHP), HSAs allow individuals to save pre-tax dollars for out-of-pocket medical expenses. Contributions, earnings and qualified medical expenses paid from the account are all tax-free. There is no “use it or lose it” feature, and accounts are completely portable. The individual HSA account holder owns the account whether or not he or she, an employer, or a combination contributes to the account.

By changing an individual’s health care buying incentives, HSAs provide an important market-based restraint on rising health care costs. HSAs save money in several ways: (1) HSAs remove a portion of medical expenditures from the system of third-party payment, encouraging competitive shopping by consumers and competitive pricing by providers; (2) HSAs provide access to catastrophic care at low premium costs on a tax-favored basis; (3) HSAs allow participants to earn investment income on their premium savings on a tax-favored basis; and (4) HSAs’ high deductible encourages healthier lifestyles.

Interest in HSAs has taken off in the private sector, with carriers around the country quickly developing compatible insurance offerings and companies of all sizes at least exploring the option. According to America’s Health Insurance Plans, as of January 2008 more than 6.1 million individuals were covered by an HSA/ HDHP -- up from 4.5 million in January 2007 and 3.2 million in January 2006. This study found that 27 percent of newly purchased individual policies were HSAs, and 31 percent of new policies sold to small businesses were HSAs.

How do Health Savings Accounts Work? – Account holders must have a qualified insurance plan, but the requirements have been eased considerably from earlier versions such as the Medical Savings Accounts (MSAs) approved by Congress in 1996. For 2008, the minimum deductible for an HDHP that is connected to an HSA is \$1,100 for an individual and \$2,200 for a family.

The maximum deductible requirement has been replaced by maximum out-of-pocket limits of \$5,600 for individuals and \$11,200 for families in 2008. These amounts will be adjusted annually for cost-of-living increases. The limits include deductibles and co-insurance for “in network” providers. Penalties for receiving services outside a preferred provider organization (PPO) network do not count toward the total costs to the insured. Specified preventive care services may be covered without a deductible or with a lower deductible than the annual deductible applicable to all other services.

Annual contributions to an HSA for 2008 are limited to 100 percent of the deductible to a maximum of \$2,900 for an individual or \$5,800 for a family. Account holders age 55+ may make additional contributions of \$900 in 2008, increasing by \$100 each year to \$1,000 in 2009.

Funds in an HSA may be invested as the account holder sees fit, except they may not be invested in life insurance contracts. The funds are held in a trust administered by a bank, insurance company or other approved administrator.

Funds may be withdrawn tax-free to pay for qualified medical expenses as defined by the IRS. They cannot be used to pay for health insurance premium payments except premiums for LTC insurance, COBRA continuation premiums, other premiums for people receiving unemployment benefits, or retiree premiums other than MediGap.

Funds withdrawn for non-medical purposes are included in the account holder's gross income and taxed accordingly. A penalty of 10 percent is applied except in cases of death, disability, or Medicare eligibility.

Issues and Outlook – The HRC supports efforts to empower health care consumers with tools that promote cost savings and greater control of health care decision making. Health Savings Accounts (HSAs) are an important new tool in the growing consumer-directed health care movement.

In 2006, Republican-sponsored HB 1383 (C 299 L 06) was signed into law to require an HSA/HDHP health benefit option for Washington public employees. In 2005, the Health Care Authority contracted for a feasibility study of an HSA/HDHP option for public employees. This study found that an HSA/HDHP option could save the state from \$3 million per year (0.3% of total cost) at 2% enrollment to \$20 million per year at 10% enrollment.

Unfortunately these estimated savings to Washington taxpayers have not been enough for the governor to direct the Health Care Authority (HCA) to implement this legislation. HCA originally projected that an HSA/HDHP option would be available in 2009. However, they continue to come up with excuses as to why they are not actively working towards making an HSA/HDHP available as directed by law (e.g., they don't have the budget authority, their computer system can't manage it, etc.).

In the small group health insurance market, community rating laws are a barrier to HSA/HDHPs as they restrict insurance carriers' ability to price health plans based on the risk of individuals in each health plan (see "*Community Rating in Health Insurance*" section for further explanation of *Community Rating*).