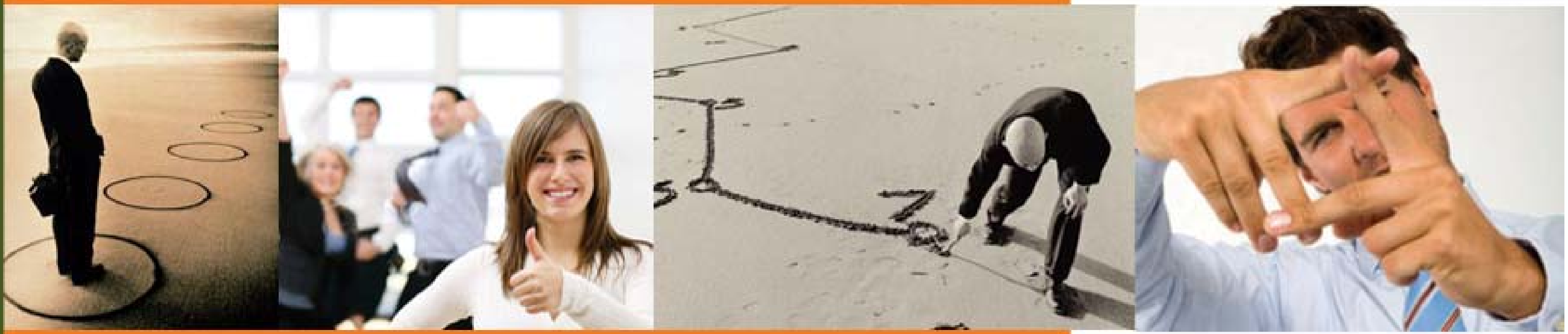

Understanding Consumer Driven Health-Care (CDH)

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Agenda

- Consumer-Driven Health
- Health Reimbursement Arrangement
- Health Savings Account
- HRA or HSA?
- Flexible Spending Account

Consumer Driven Health (CDH)

Definitions

- Consumer-Driven Health (CDH): An approach to health insurance that engages members by increasing their responsibility in managing their card. CDH gives them tools and incentives to become more prudent consumers, improve their health and evaluate the financial impact of their treatment options.

- Health Reimbursement Arrangement (HRA): An IOU that employers fund and offer to employees to help them pay certain out-of-pocket health plan expenses

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Definitions

- Health Savings Account (HSA): A tax-free checking account that eligible employees establish to reduce income and pay certain out-of-pocket health expenses with pre-tax dollars

- Flexible Spending Account: A program that allows employees to elect pre-tax payroll deductions to reimburse certain health care and dependent care expenses

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Defining CDH

- Broad Definition: Any health plan with an individual deductible of $1,000 or more

- Narrower Definition:
  - A health plan with an individual deductible of $1,000 or more in conjunction with an HRA

OR

  - A qualified-High Deductible Health Plan (qHDHP) with an HSA (or even an HRA)

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Understanding CDH

- CDH is not just a plan
- CDH is a philosophy
- CDH is a program that incorporates
  - financial incentives (deductible)
  - tax-favored reimbursement vehicle (HRA/HSA)
  - wellness programs and online resources
  - tools to help members become consumers
  - incentives to stay healthy and utilize prudently

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CDH Rationale

- With copay plans, members don’t know and can’t evaluate the financial implications of their health care decisions

- Individuals always spend their own money more effectively than they spend someone else’s

- Given the right incentives and the right tools, members will make cost-effective decisions about treatment options and providers

- Health plans provide ceilings on member responsibility for catastrophic events

Why Do We Have These Products?

- Most employers have received double-digit premium increases every year this decade
- Health plan premiums are most employers’ second largest compensation line item (after pay)
- Health premiums are becoming a larger and larger portion of employees’ total compensation
- Surveys show that employers are concerned and feel hopeless about controlling health care costs

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The Bottom Line

- Every employer should be looking at CDH
  - It's a viable approach to balancing an attractive insurance option with rising premiums
  - Until you understand it, you won't know when your company is ready for it
  - Each year, you should review what you offer against what other options you have
  - You need to look at CDH before you ***need*** to look at CDH

- Every employer should be offering at least one reimbursement vehicle (HRA, HSA, FSA)
  - You help employees reduce the impact of their out-of-pocket costs
  - You can save on payroll taxes
  - Introducing these programs allow you to blunt the impact of an increase employee out-of-pocket responsibility

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Health Reimbursement Arrangement (HRA)

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Health Reimbursement Arrangement (HRA)
HRA Defined

- A vehicle that allows employers to give employees tax-free reimbursement of certain out-of-pocket medical expenses that the employer has defined
  - An HRA is an IOU that an employer gives to each eligible employee
  - The employee can turn that IOU into cash only by incurring certain health plan out-of-pocket expenses

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Why Offer an HRA?

- Lower premium on underlying health plan
- It's an IOU from employer to employee that the employee can cash only with eligible expenses
    - Nationally, employers pay 50% to 60% of potential liability, a figure that varies based on a variety of factors, including HRA design, health plan design and group size
- HRA reduces the deductible risk for employees by having the employer share some premium savings to offset individual deductible expenses

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HRA Plan Design

- Employers have broad flexibility to design an HRA to meet their needs
  - Value of HRA
  - Range of expenses reimbursed
  - Year-to-year carryover of unused balances (and carryover cap)
  - Payment order (employee, FSA, HRA)

Who Administers an HRA?

- Usually a third-party administrator who can
  - produce and maintain plan documents
  - run plans in compliance with IRS rules
  - process financial payments
  - maintain accurate records
  - service customers

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HRA Models

- Non-integrated
  - No connection between health plan and TPA
  - Employees submit Explanation of Benefits (EOB) to trigger reimbursement or load a debit card
- Integrated
  - Health plan sends claims rollover file to TPA
  - File triggers reimbursement or loads debit card or substantiates swipe on pre-loaded debit card

Funding the HRA

- An HRA is a notional account, not backed dollar-for-dollar with cash
- TPAs require some form of imprest balance from which they pay claims
- The employer replenishes the fund based on the TPA's claims paid on its behalf
  - TPA sets frequency (weekly, monthly) and method (initiated by employer or TPA)

HRA Issues

- HRAs are subject to COBRA
- Certain owners cannot participate
  - Partners, LLC members, Sub S Corp owners
- Certain individuals enrolled in the health plan may not be HRA-eligible (federal Defense of Marriage Act for spousal definition)

Bottom Line – HRA

- Most HRA-eligible health plans introduce "consumerism" as a cost-containment vehicle
- Underlying premiums are lower
- Employer helps employees offset new responsibilities with tax-free money
- Employer retains HRA design control
- Employer owns and manages the plan, controlling eligibility and compliance

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Health Savings Account (HSA)

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Health Savings Account (HSA)
HSA Defined

- A Health Savings Account is a personal financial account that an eligible individual can establish and fund to reimburse eligible expenses with pre-tax dollars

- An HSA is <u>not</u> an employer-sponsored health plan subject to COBRA or ERISA

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Why Offer an HSA?

- Lower premiums on the health plan
- The HSA is not an employer-sponsored plan
- The HSA maximizes employee flexibility
  - Use it as an FSA (pay today's expenses tax-free) or an IRA (allow balances to grow tax-free)
  - Enjoy savings on many items not covered by the health plan (chiropractic care, vision, dental/orthodontic, OTC items, certain health plan premiums)
  - Employee contributions reduce taxable income

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The Power of an HSA

- Enjoy tax savings today <u>or</u> build HSA balances to maximize account balance
- Reimburse expenses at any future point
- Adjust contributions as needed
- Enjoy tax-free accumulations after maximizing contributions to qualified plans
- Roll over an IRA balance (taxed when distributed) to an HSA (tax-free distribution)

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HSA Eligibility

- General eligibility rules to open and contribute to an HSA
  - No other health plan except a qualified High Deductible Health Plan
    - Can't enroll in a spouse's plan, Medicare or Medicaid
  - No traditional Health FSA or HRA (incl. spouse's)
    - Certain special FSAs or HRAs are allowed
  - Not someone else's tax dependent

HSA Eligibility

- Partners, LLC members and 2% owners of Sub S Corps are eligible (unlike HRA/FSA)

- They are subject to certain contribution restrictions
  - Can't receive tax-free employer contribution
  - Can't use pre-tax payroll deductions

- They can contribute personal funds and take a personal income tax deduction

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Qualified High Deductible Health Plan

- HSA plan designs are governed by legislation and IRS interpretation

	2008	2009
Min. Individual Deductible	$1,100	$1,150
Min. Family Deductible	$2,200	$2,300
Max. Individual OOP	$5,600	$5,800
Max. Family OOP	$10,200	$10,600

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Qualified High Deductible Health Plan

- All services are subject to deductible
- Health plans can cover select preventive services outside the deductible
  - Includes annual physicals, annual GYN, vision and hearing screenings, prenatal care, pap smear, mammogram, immunizations, routine blood work, routine urinalysis, certain disease screenings

HSA Eligible Expenses

- Eligible expenses (tax-free distributions)
  - Medical (deductible, copay, co-insurance)
  - Prescription drugs and OTC remedies
  - Chiropractic and alternative medicine
  - Dental/orthodontia
  - Vision hardware/LASIK surgery
  - Health insurance premiums while on COBRA, receiving unemployment benefits or enrolled in Medicare (B and D premiums) and most supplement plan
  - Long-term care insurance

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HSA Contributions Limits

	2008	2009
Individual <age 55	$2,900	$3,000
Individual age 55+	$3,800	$4,000
Family <age 55	$5,800	$5,950
Family one age 55+	$6,700	$6,950
Family two age 55+	$7,600	$7,950

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Employer HSA Contributions

- Employers can share premium savings through contributions to employees' HSAs
- There are some rules for employers to follow
- Employers can deduct their contributions
- All contributions are in cash and vest immediately
  - An employee who leaves the company takes all contributions with him

Funding the HSA

- Employers are <u>not</u> required to fund HSAs, though most share some or all of their premium savings with employees via HSA contributions
- Employees can contribute via pre-tax payroll
- Employee contributions reduce taxable income
- Employers who choose to contribute can set their own schedule (annual, monthly, etc.), as long as employees are treated comparably

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Who Administers an HSA?

- HSAs are personal trusts held by banks, insurers and other financial institutions
- HSA owners are responsible for keeping their plans in compliance with all regulations
  - Employee: Eligibility, contribution limits, distributions for eligible expenses, tax reporting
  - HSA administrator: Minimum balance, other checking-account rules

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Bottom Line – HSA

- HSAs maximize employee flexibility – to enjoy tax benefits now or later
- HSAs are a portable employee asset
- HSAs allow employees to blend health care and financial responsibilities
- HSAs are not employer-sponsored plans and usually aren't subject to COBRA or ERISA

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HRA or HSA?

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HRA or HSA?

- Employees are not financially sophisticated and don’t appreciate tax consequences
  - HRAs requires less knowledge and work by employees to receive program advantages

- Employees are looking for ways to reduce taxable income or increase tax-advantaged long-term savings
  - HSAs deliver these benefits – HRAs don’t

HRA or HSA?

- Employer wants to ensure that its money is reimbursing eligible expenses only
  - HRAs require substantiation to receive reimbursements
- Employer doesn't want to administer another employee benefit
  - HSAs aren't employer-sponsored plans, and employees are responsible for most compliance

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HRA or HSA?

- Employer wants to ease employees' transition to CDH
  - HRA plans look more like traditional HMOs, with office visit and Rx copays

- Employer wants to maximize premium savings to maximize contribution to employees' reimbursement accounts
  - HSA products generally have lower premiums

HRA or HSA?

- Employee turnover is high
  - While health plans are COBRA-eligible, an HSA itself is not and an HRA itself is a COBRA plan
- Many employees are owners
  - Owners can't enroll in an HRA, so an HSA makes more sense for them
  - Note: Employer can offer an HSA health plan, then provide an HRA for employees and have owners open their own individual HSAs

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Flexible Spending Account (FSA)

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What is an FSA?

- A Flexible Spending Account allows employees to elect to direct a portion of their pay into a fund to pay for certain eligible expenses with pre-tax dollars

- An FSA has two components, and employees can choose either or both
  - Health FSA
  - Dependent Care FSA, or DCRA

Who Should Offer an FSA?

- Almost every employer, because employees can increase take-home pay without the employer's giving them a raise

- When an FSA doesn't make sense
  - High employee turnover
  - Cash-strapped employer
  - Company is extremely small
  - Company is composed primarily of owners

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Why Would an Employer Offer an FSA?

- Employees can increase their take-home pay without the employer's giving them a raise
- Employer can offset the impact of greater employee cost-sharing
- Employers avoid their portion of FICA taxes on every employee dollar elected
- The administration cost often is minimal (sometimes zero) net of the payroll tax savings

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Why Would an Employee Participate?

- Employees in effect give themselves a raise by paying with **pre-tax dollars**
- FSA elections **reduce taxable income**, which may impact eligibility for certain income-based programs and can impact future Social Security payments
- Employees can access their full Health FSA election at any time, easing cash flow

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Eligibility

- All employees eligible for benefits can participate in the FSA
  - Don’t need to be on the health plan
  - A family can have two FSAs and elect up to each employer’s maximum in the Health FSA
  - A family can have two DCRA accounts, but the IRS contribution maximum is per family, not per FSA plan
- Employee, legal spouse (DOMA) and dependents can reimburse through FSA
  - No domestic partners or same-sex married

How Does an FSA Work?

- Election limits
  - Health FSA: Employer sets the maximum contribution, balancing two factors
    - Employer FICA savings drive employers to set a high election limit
    - Employees can spend their entire election early in the year and leave employment without repaying the balance steers employers to a smaller limit
  - DCRA: IRS sets annual limit at $5,000 per calendar year
    - $2,500 if married filing separately

How Does an FSA Work?

- Employees make a binding election commitment before the beginning of the plan year into a Health FSA and DCRA

- They can't change this election unless they experience a qualifying event
  - Examples: Birth or adoption, marriage or divorce
  - Event must be consistent with election change

How Does an FSA Work?

- The employer takes the election from pay checks in equal installments throughout the plan year
- Employees can spend their entire <u>Health</u> FSA election at any time during the year
  - The employer must "front" the money
  - Employees pay it back throughout the year
  - If they leave employment, employees don't have to pay back the employer

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How Does an FSA Work?

- Employees cannot spend more from a DCRA than they have contributed year-to-date
  - This creates a cash-flow issue, as during the first week or two the employee must pay the provider and have money taken from his pay check before reimbursements can be used to fund weekly payments to providers

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What Expenses Are Covered?

- Health FSA: All expenses incurred by the employee, a spouse or dependent for these expenses (employer can narrow the list):
  - Medical copays, deductibles and co-insurance
  - Prescription drugs
  - Chiropractic and complementary medicine
  - Over-the-counter remedies
  - Dental/orthodontia
  - Vision prescription hardware and LASIK

What Expenses Are Covered?

- DCRA: Expenses for a child under the age of 13 (or elderly dependent) while the subscriber is working or participating in an educational program in his field
  - Day care
  - Before- and after-school programs
  - Summer day camp
  - Adult day care

Who Administers an FSA?

- A third-party administrator
  - Usually provides Health FSA debit card
  - Offers manual claims processing
  - Substantiates expenses to IRS standards
  - Maintains record of transactions
  - Enables participants to set up password-protected online access to transactions
  - Provides customer service

Bottom Line - FSA

- It's a great way for employees to save money
- It helps employees offset new cost-sharing or makes up for the absence of a group dental or vision plan
- There's no required underlying health plan
- All employees eligible for benefits can contribute (not just health plan enrollees)
- Employers save on payroll taxes

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Resources

Health Reimbursement Arrangement

- Original IRS guidance
  - http://www.irs.gov/pub/irs-drop/n-02-45.pdf
- Ongoing IRS guidance – Publication 969
  - http://www.irs.gov/publications/p969/ix01.html

Health Savings Account

- US Dept. of Treasury resources
  - http://www.ustreas.gov/offices/public-affairs/hsa/
- Good summary of HSA rules (log on and request e-copy of "HSA Road Rules")
  - http://www.hsainsider.com/
- Ongoing IRS guidance – Publication 969
  - http://www.irs.gov/publications/p969/ix01.html

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Flexible Spending Account

- List of eligible expenses
  - http://www.irs.gov/pub/irs-pdf/p502.pdf

- Ongoing IRS guidance – Publication 969
  - http://www.irs.gov/publications/p969/ix01.html

- And when in doubt . . . Google!

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