



POLICY BRIEF

Health Care Reform that Works **An Update on Health Savings Accounts**

by
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by Dr. Roger Stark
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Key Findings

- 101,200 people in Washington have HSAs.
- Nationally, 6.1 million people are covered by HSA-type plans.
- None of the negative predictions made by HSA opponents have proven true.
- HSAs have helped reduce the number of uninsured.
- HSAs promote preventive care and have helped slow the rise in health care costs.
- HSA participants represent all income levels and age groups, and surveys show that HSA users are better-informed users of health care.
- Washington policymakers can make important changes to state law to make HSAs more affordable for state residents.

Introduction

Health Savings Accounts (HSAs) have been available since January 1, 2004. They originated as a provision to the Prescription Drug, Improvement, and Modernization Act (Medicare Part D), signed into law in December 2003.¹

At the time of their enactment, HSAs were highly controversial, with critics saying they would skim off the healthiest and wealthiest people, leaving older and sicker people to

¹ “Summary of HR 1, Medicare Prescription Drug Improvement, and Modernization Act, Public Law 108-173,” CMS Legislative Summary, April 2004, www.cms.hhs.gov/MMAUpdate/downloads/PL108-173summary.pdf.

be covered by high-cost traditional insurance. This view held that HSAs would cause a “death spiral” or “race to the bottom” in the traditional health insurance market, driving up costs and greatly adding to the number of uninsured.

Critics also said HSAs would drain needed political momentum from what they argue is the true long-term solution: a socialized health care system based on universal coverage.

Now that HSAs have been in place for over four years, the answers to these criticisms are available. It turns out none of the predictions made by critics have come true. The data shows HSAs have helped reduce the uninsured population; almost one-third of people who acquire these individual accounts previously had no health coverage.

This paper examines the other claims made by critics of HSAs and provides an update on the popularity and current utilization of these individual accounts.

Background

The core idea behind HSAs dates back to the experiment with Medical Savings Accounts (MSAs) in the 1990s. Congress passed the Health Insurance Portability and Accountability Act (HIPAA) in 1996 which, among other things, established an experiment allowing 750,000 MSAs to be sold in the individual health insurance market. In addition, the Balanced Budget Act of 1997 provided a test market for MSAs in the Medicare program.

The basics of the MSAs were that a person would have a high deductible, catastrophic insurance plan and a separate tax-advantaged IRA-like savings account to cover routine health care expenses. The law allowed these plans to be offered only to individuals and small businesses with fewer than 50 employees. Because of lack of marketing, the federal cap on the number of people who could participate, and poor participation by insurance companies, MSAs never became widely popular.

In contrast, the better-designed HSA concept is growing rapidly in popularity.

HSAs allow individuals more control over their health care expenses and thereby help hold down rising health care costs. Like an MSA, an HSA comes with a high deductible insurance plan which functions as a catastrophic safety net. The insurance policy is coupled with a tax-free savings account that gives patients complete control over routine health care spending.

When a person’s total health expenses reach a certain level, say \$2,500, in any given year the catastrophic insurance policy kicks in and payments no longer need to be made out of the savings account. Any money remaining in the account at the end of year rolls over to the following year, so the total amount of money in a person’s HSA can grow to thousands of dollars in just a few years.

There is no federal cap on how many people can receive HSA coverage. Every resident of the United States under age 65 is eligible, or about 264 million people. When an HSA holder reaches age 65, money in the account can be used for any purpose, such as

buying a long-term care insurance policy, or to supplement daily living expenses in retirement. Following is a summary of how HSAs work.²

Summary of HSA Fundamentals

- All U.S. residents under age 65 can own an HSA.
- Money in an HSA is the account holder's private property; it can travel from job to job and from state to state.
- Money in an HSA can be inherited by heirs or spouses.
- Every HSA must be accompanied by a high deductible health insurance plan.
- An HSA allows an annual tax-free contribution equal to the amount of the insurance policy deductible between \$1,100 and \$2,900 for an individual, and \$2,200 and \$5,600 for family.
- Contributions to an HSA may come from any source, such as self, an employer or family member.
- HSA money may be spent tax-free on any qualified medical expense, without pre-approval from an employer, government agency or insurance company.
- Unspent funds can be rolled over from year to year.
- Money sitting in the account accumulates interest tax-free.
- Similar to an IRA, money spent from an HSA on non-medical items before retirement is taxed at the federal income tax rate plus a 10 percent penalty.
- After retirement, money spent on non-medical items is taxed at federal income tax rates without an added penalty.
- All yearly contributions to HSAs are indexed to inflation.³

HSA update for 2008

HSAs became legal on January 1, 2004, and by March 2005, more than one million people were participating.

Since then the number of people participating in HSAs has increased six fold, with 6,118,000 persons covered as of January 2008.⁴ This represents 3.4 percent of all individuals in the country under age 65 who are enrolled in private health plans.

² "The How-To Guide to Health Savings Accounts," by Liv Finne, Washington Policy Center, June 2005, at www.washingtonpolicy.org/Centers/healthcare/policybrief/06_finne_pocketguide.pdf.

³ For 2008, the annual minimum HSA deductible contribution for individuals is \$1,100 and \$2,200 for families.

The states with the highest percentages of participants are: Minnesota (9.2 percent), Louisiana (9.0 percent), and Washington, D.C. (8.7 percent). The states with the lowest percent of enrollees are: Hawaii (0.1 percent), Massachusetts (0.9 percent), and New Mexico (0.9 percent). In Washington the percentage of participants is 2.5 percent, representing 101,254 people.⁵

The fastest growing segment for HSAs for the year leading up to January 2008 was the small-group market, comprised mostly of small businesses. That market saw HSA utilization increase by almost 80 percent in one year. Still, most HSA holders are in the large-group market, mostly large employers, with a one year increase of 30 percent from January 2007 to January 2008, and a total enrollment of 2,770,000 people.⁶

In 2007, 39 percent of large-group companies offered HSAs to their employees, and that number increased a further 47 percent in 2008. Analysts predict that by 2009, more than half, 54 percent, of large employers in the United States will offer HSAs. In addition, the percentage of large-company employees participating in HSAs increased from 10 percent in 2007 to 15 percent in 2008, a 50 percent increase in one year.

HSAs help slow rising health care costs

There is now clear evidence that HSAs are helping to hold down rising health care costs. For employers with at least half their employees enrolled in HSAs, health care costs rose only 3.6 percent in the past two years. For companies that did not offer HSAs, the cost of providing health care coverage rose nearly twice as fast, by seven percent, during that same time period.⁷

HSAs represent a tax-free way people can save money, and opponents have worried that people would use them only as a supplement to retirement savings, rather than to improve their health. The data shows, however, that participants are using these dollars to pay for their health care expenses. During 2007, 83 percent of HSA accounts had an average annual balance of \$2,500 or less, while only seven percent had a balance over \$5,000.⁸

The average amount spent in one year from an account was \$1,080, in 2007.⁹ The longer a person has an HSA, the faster tax-free savings can accumulate. Within five years, depending on yearly health care expenses, an HSA can accumulate a minimum of \$5,500 for an individual, or \$11,000 for a family.

⁴ “January 2008 Census Shows 6.1 Million People Covered by HSA/High Deductible Health Plans,” Center for Policy Research, America’s Health Insurance Plans (AHIP), April 2008, at www.ahipresearch.org/pdfs/2008_HSA_Census.pdf.

⁵ Ibid, page 10.

⁶ Ibid, page 4.

⁷ “More Companies, Workers Adopt Consumer-Directed Health Plans [CDHPs], Nearly Half of Employers Now Have CDHP,” Watson Wyatt Worldwide/National Business Group on Health, March 13, 2008, at <http://www.watsonwyatt.com/news/press.asp?ID=18805>.

⁸ “January 2008 Census Shows 6.1 Million People Covered by HSA/High Deductible Health Plans,” Center for Policy Research, America’s Health Insurance Plans (AHIP), April 2008, page 2, at www.ahipresearch.org/pdfs/2008_HSA_Census.pdf.

⁹ Ibid, page 11.

Even if half the money contributed to an HSA each year is spent on health care services, after five years a family would still have \$5,500 available in the account, plus a traditional insurance policy to cover high-cost medical emergencies. The data shows that HSAs do not represent barrier to accessing health care. Instead the opposite trend has emerged. Funds in an HSA provide resources that allow people to access needed health care services.

Not just for the healthy and wealthy

Critics have also said that only the young and healthy would take advantage of owning an HSA, leaving older and sicker people in the traditional health insurance pool. Surveys of actual HSA holders, however, show that almost half of all those who purchase an HSA are over 40 years old. In fact, one insurance carrier reports 70 percent of its HSA subscribers are over 40.

Almost half, 46 percent, of all HSA purchasers are from families with incomes of less than \$50,000 per year. Similarly, 38 percent of HSA owners live in homes with a value of less than \$125,000, and 27 percent of HSA subscribers have a net worth of less than \$25,000.¹⁰

Washington's state government is offering HSAs to its employees, whose average age is higher than that of workers in the private sector workforce. Also, state workers, while well paid, are not generally considered wealthy people.

The numbers show that the benefits of owning an HSA appeal to people of all ages and income groups. They are not just for the young or the wealthy.

However, HSAs are making health care consumers more cost conscious. Over 80 percent of HSA subscribers report that they are more aware of health care costs than they were before, and nearly 40 percent now use the internet as a resource for finding a doctor and to research price, benefits and claims information.¹¹

HSA plans often include preventive care

Another concern of HSA critics was that account owners would defer preventative care in an effort to save money, would become sicker as a result, and would end up costing the system far more than people who have traditional employer-based coverage.

The data shows the reverse to be true. HSA holders are far more involved in managing their own health status, are better informed and are more likely to see a doctor when necessary, than are holders of traditional policies. Surveys now show that utilization of preventative measures is 30 percent higher among HSA owners, compared to people with standard health insurance.¹²

¹⁰ "Health Care Consumerism: Myth versus Fact," by Ronald E. Bachman, Georgia Public Policy Foundation, November 17, 2006, at www.gppf.org/article.asp?RT=&p=pub/HealthCare/Consumer-DrivenHealthCare/HSAMyths061117.htm.

¹¹ Ibid, page 3.

¹² Ibid, page 2.

Many HSA plans include first dollar coverage for preventive care. This means the insurance company pays for preventive care without requiring the policy holder to pay the full deductible first. It is typical for an HSA plan to include \$300 or more a year in preventive coverage, which HSA holders can use to pay for annual physicals, drugs, well-child care, child and adult immunizations, smoking cessation programs, weight loss programs, vision and hearing tests, and screenings for cancer and a wide range of other diseases.

Insurers have every incentive to pay for preventive care, immunizations and health screenings. Catching health conditions early means it is less likely an HSA holder will become seriously ill, incur costs that exceed the insurance policy deductible, and thus file costly medical claims against the insurance company.

Market data shows that HSA and HDHP coverage is affordable. For individuals, premiums for such policies start as low as \$127 per month; for families as low as \$318 per month.¹³

Recommendations

As noted in this study, participation in HSA and HDHP plans is not as high in Washington as it is in other states, indicating that the tax and regulatory climate here makes these plans more expensive than they need to be. Washington policymakers can take four concrete steps to make consumer-directed plans a better deal for state residents:

- Repeal community rating and guaranteed issue laws, and reduce the number of health care mandates;
- Enact a low-cost, low-mandate plan that can go with individual and employer-provided HSAs;
- Introduce HSAs into the state Medicaid system, to provide a permanent, personal and portable health benefit to low-income families, to help lift them out of poverty;
- Reduce the state tax on insurance premiums.

Conclusion

Although they were controversial at first, four years of real-world experience shows that HSAs are a success, enjoy growing popularity and have increasing enrollment with each passing year. HSA participants represent all socio-economic levels in society and consumer surveys show that owners are becoming informed users of health care. Surveys also show

¹³ “January 2008 Census Shows 6.1 Million People Covered by HSA/High Deductible Health Plans,” Center for Policy Research, America’s Health Insurance Plans (AHIP), April 2008, page 6, Table 4, at www.ahipresearch.org/pdfs/2008_HSA_Census.pdf.

that most HSA owners are satisfied with their coverage, and would not choose to go back to traditional third-party coverage.¹⁴

A four-state survey that included Washington found that 70 percent of respondents would seek out information about prices and availability of health care services when given the opportunity to do so. The survey found that HSA holders using online research to find out about costs and care options is similar to the way consumers routinely shop for high-cost durable goods.¹⁵

The evidence indicates that HSA users, by becoming smarter health care consumers, are helping to hold down rising health care costs.

The experience with HSAs shows policymakers that one of the solutions to out-of-control health care spending is to allow individuals more control over their health care dollars. HSAs have proven to be an excellent policy tool for putting more patient-directed spending into our health care system, with lower costs and higher patient satisfaction as a result.

¹⁴ “BCBSA [Blue Cross Blue Shield Association] consumer Survey Shows High Rate of Satisfaction with HSAs, Cites Increased Reliance on Decision-Support Tools,” BNET Business Network, U.S. Newswire, September 2005, at http://findarticles.com/p/articles/mi_hb5554/is_200509/ai_n21857463, and “High Deductible Health Plan Consumers Report Satisfaction, Higher Levels of Engagement of Health Care Choices,” PRNewswire-FirstCall, July 16, 2008, at www.tradingmarkets.com/.site/news/Stock%20News/1763222/.

¹⁵ “Regence survey says medical shopping may work, CEO Ganz: Competition could pressure health-care providers to drop prices, raise quality,” by Peter Neurath, *Puget Sound Business Journal*, December 14-20, 2007.

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