

The Maine View

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Health Savings Accounts:

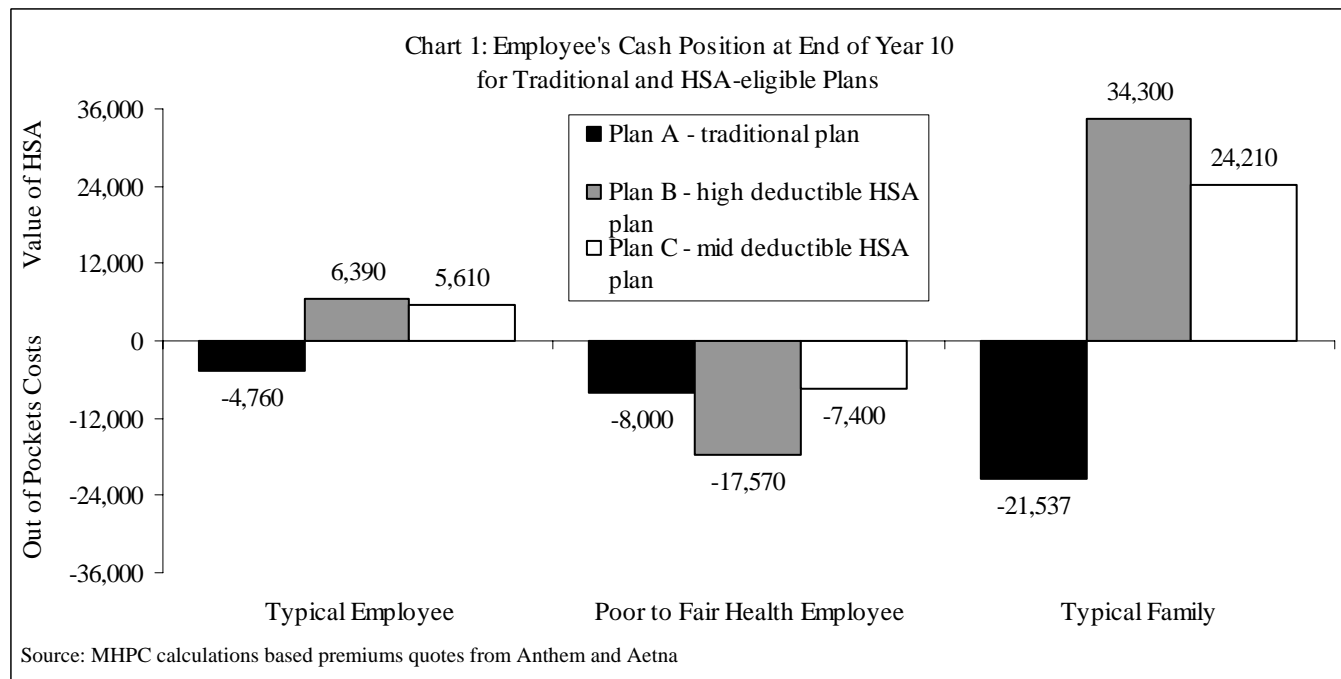
What they are, how they work, and why they are good for Maine

by Tarren Bragdon

Since enacted into law by Congress in 2003, Health Savings Accounts (HSA) have provided Americans with the opportunity to save pre-tax dollars for future medical expenses. This study takes a look at how the Health Savings Accounts are performing since their implementation two years ago (January 2004), and how Health Savings Accounts can work to lower the cost of health insurance premiums in Maine.

The key findings in this report include:

- Premiums for HSA-eligible plans are typically 28-35 percent lower than traditional health insurance premiums.
- HSA plans provide individuals the same discounted prices for health care services given to insurance carriers and large companies.
- HSAs put real money in the pocket of employees.
- The uninsured are buying HSA-eligible plans.
- HSA enrollment spans all demographics.
- HSA premiums are increasing at the rate of inflation, as opposed to their traditional counterparts that are increasing three times that rate.
- HSAs promote fiscally conscious health care consumers.
- In Maine, lower income families with HSAs contribute the same or more per household member as higher income families.
- Effective January 1, 2006, Mainers can deduct HSA contributions on their Maine income taxes.



What is a Health Savings Account?

A Health Savings Account is a savings account that is combined with a lower-premium, higher-deductible health insurance plan. The savings account allows for an individual or family to pay for out-of-pocket health care costs. Contributions are income tax deductible and withdrawals are tax-free, if used for health care – including medical, dental and vision expenses. The concept behind a HSA is that if consumers are controlling the purse strings, they will be more prudent purchasers of health care. Federal law restricts what plans are eligible to be matched with an HSA and the maximum level of HSA contributions, as shown in Table 1.

	Individual Plan	Family Plan
Deductible	\$1,050	\$2,100
Out of Pocket Maximum	\$5,250	\$10,500
Maximum HSA contribution allowed	Deductible or \$2,700, whichever is less	Deductible or \$5,450, whichever is less

Source: U.S. Internal Revenue Services.

How do HSA-eligible health insurance plans compare to traditional health insurance?

Premiums for HSA-eligible health insurance plans are typically 28-35 percent lower than traditional health insurance premiums, as shown in the Table 2.[1] Even factoring in employer-paid contributions to the Health Savings Account, HSA plans cost employers 13-20 percent less. For the employee, the savings is even more dramatic. HSA plans cost employees \$270 less per year for individual coverage and almost \$1,000 less for family coverage. This “reduced cost of entry” means that more employees can afford their share of employer-sponsored insurance and, therefore, more workers will opt for some health coverage through the employer.

How do HSA health insurance plans work for individuals receiving and paying for health care treatment?

Despite the higher deductible, HSA plans allow individuals to receive the same discounted price for health care services enjoyed by insurance carriers and large companies. Unlike the uninsured, those with HSAs do not pay the “cash price,” but rather pay the reduced price negotiated by insurance companies and large self-insured corporations. Table 3 simulates these cost savings.

	Individual Plan		Family Plan	
	Traditional PPO	HSA-eligible	Traditional PPO	HSA-eligible
Premium	\$4,150	\$2,700	\$11,090	\$7,909
Employee premium portion	\$603	\$431	\$2,641	\$1,664
Average employer HSA contribution	N/A	\$553	N/A	\$1,185
Total employer costs	\$3,547	\$2,850	\$8,449	\$7,337
Deductible	\$323	\$1,900	\$679	\$4,070
Out of pocket maximum	\$2,000 (est.)	\$2,551	\$4,000 (est.)	\$4,661

Source: Kaiser Family Foundation and Health Education and Research Trust.

	HSA-Eligible Insurance Plan	Traditional Insurance Plan	Uninsured
Receive Care from Health care Provider	Charge - \$100		
Insurer Discount	(\$30)	(\$30)	None
Insurer Payment	\$0 (unless deductible met)	\$50	None
Remaining Patient Balance	\$70, paid from HSA	\$20 (copay)	\$100

Source: MHPC calculations based on insurance industry estimates.

HSAs are great unless I get sick, right?

Wrong. Most people use less health care than they are paying in premium dollars. People often know how much they pay in health insurance premiums and what their cost sharing is. Cost sharing is typically a co-payment for office visits and prescriptions and coinsurance (a fixed percentage of total costs) for hospital expenses. However, most people have little idea of their total health care consumption in a given year (regardless of who is paying). Table 4 shows privately-insured adults’ health care expenses by age and self-reported health status for 2003, the last year figures are available.[2]

The figures in Table 5 show that the average adult under 45 years old and in good health will use less than \$700 in health care in a given year, while a younger adult in poor health using still less than \$1,000. A middle-aged adult in good health will

use less than \$2,000. It is only the 7 percent of all non-elderly adults (19-64) who report, in a given year, being in fair to poor health that use a significant amount of health care (just under \$5,000). Therefore, many people with expensive low deductible insurance are paying for coverage that they will likely not need or significantly use in any given year. The problem is not one of people being underinsured. The problem is that the vast majority of people are over-insured.

	Adults ages 19-44	Adults ages 45-64
Those reporting in good to excellent health		
Percent of all non-elderly adults (19-44)	55%	34%
Median annual health care expenses (all health care consumed)	\$663	\$1,943
Share of all health care expenses for all non-elderly adults	34%	43%
Those reporting in fair to poor health		
Percent of all non-elderly adults (19-44)	4%	7%
Median annual health care expenses (all health care consumed)	\$964	\$4,848
Share of all health care expenses for all non-elderly adults	4%	19%

Source: US Agency for Healthcare Research and Quality.

Total Health care Expenses	Adult (age 19-44)	Family of Four (all under 45)	Adult (age 45-64)
None	14%	12%	6%
\$1-\$500	30%	11%	14%
\$500-\$1,000	18%	11%	13%
\$1,000-\$2,500	21%	21%	23%
\$2,500-\$5,000	9%	17%	20%
\$5,000-\$10,000	5%	12%	13%
\$10,000-\$15,000	2%	4%	6%
\$15,000+	2%	11%	7%
Mean	\$682	\$2,096	\$2,101

Source: US Agency for Healthcare Research and Quality. Medical Expenditure Panel Survey.

How do my health care expenses change over time?

For the vast majority of people, health care expenses in one year are little indication of health care expenses in the following year. A person may break a leg or have an operation one year. However, typically an individual or family does not have chronically high medical bills every year. Chart 2 shows how health care expenses vary over time for individuals and families with various ages and health status.[3] The average amount of health care expenses for all 10 years is equal to the average for adults in the older category (45-64 years old), except the family example which is for a typical family with everyone under 45 years old.

What is important to note is how health care consumption varies dramatically from year to year. The impact of such variations will then be examined to consider the effect of an HSA-eligible insurance plan.

What do HSAs mean for a Maine business providing health insurance to its employees?

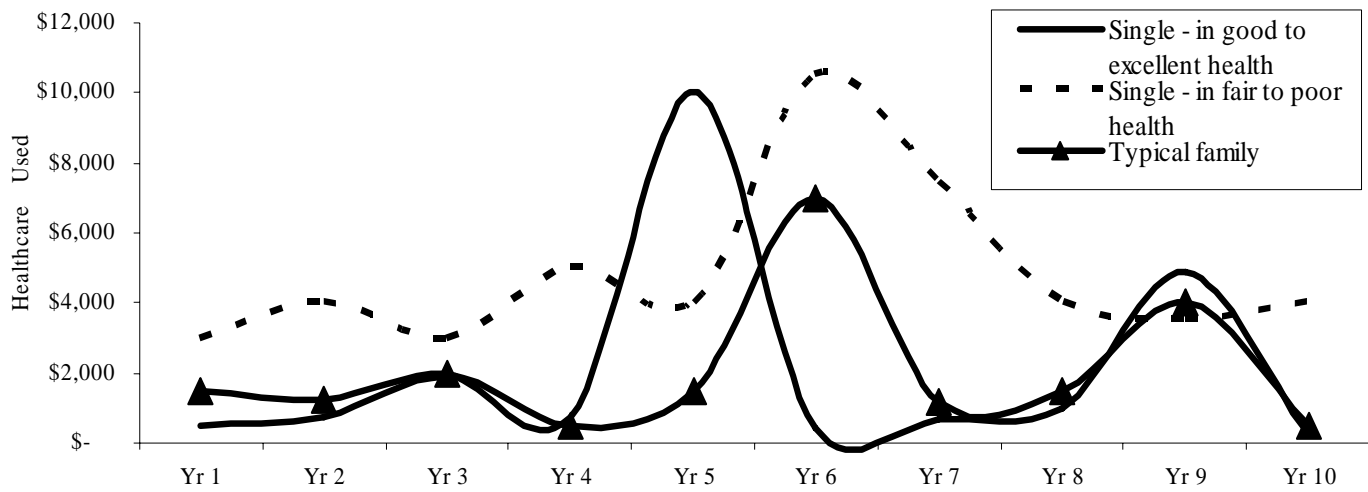
Table 6 provides a case example of employer and employee costs for HSA and non-HSA insurance plans. Consider a Maine business that currently pays 100% of costs for employees with employee-only coverage and 90% for family coverage for a very comprehensive, low deductible plan (Plan A – traditional plan) costing \$389 a month for single coverage and \$1,116 for family coverage. For the same cost per year, that business could provide offer two different HSA-eligible plans (Plan B – high deductible HSA plan and Plan C – mid deductible HSA plan). Below is a table showing the benefit details and costs for Plans A, B and C. Again, all plans cost the same to the employer. Plans B and C have no cost to the employee for family coverage, whereas the current plan (Plan A – traditional plan) costs \$1,400 per year. All premiums used are actual quotes from Maine insurers for a Maine small business.

For employees that have health care expenses over 10 years as noted in Chart 2, Chart 1 (on the first page of this report) shows that the employee's cash position at the end of year 10. Even an employee in poor health does better with a mid-deductible HSA (Plan C), than with a low deductible traditional plan (Plan A). For typical individuals and families, the value of the HSA after ten years is significant – up to \$32,000. HSAs put the “benefit” in health benefit, as they mean real money in the pocket for employees. Inherent in the tangible HSA benefit is a greater sense of value to the employee, whereas with a traditional insurance plan (like Plan A), employees simply have access to a product that they may or may not use extensively in any given year and, therefore, may give it little value.

Whose dream is being built?

HSAs allow individuals to trade in costly, traditional health

Chart 2: Example - Annual Amounts of Healthcare Used
Various Types of Employees



Source: MHPC example based on median figures from U.S. Agency on Healthcare Quality and Research, 2003 figures.

Table 6
Case Example: Employer and Employee Costs for HSA and non-HSA Insurance Plans

	Health Plan Details					Premium		HSA	Total Annual Cost	
	Coverage	Monthly Premium	Deduct.	Coins	Max Out-of-Pocket	ER Share	EE Share	ER Contrib.	ER	EE
Plan A - traditional	Family	\$1,166	\$500	20%	\$1,600	90%	10%	\$-	\$12,597	\$1,400
\$250/\$500 deductible	EE only	\$389	\$250	20%	\$800	100%	0%	\$-	\$4,666	\$-
Plan B - high deductible HSA	Family	\$605	\$8,000	10%	\$10,000	100%	0%	\$5,332	\$12,597	\$-
\$4,000/\$8,000 deductible	EE only	\$204	\$4,000	10%	\$5,000	100%	0%	\$2,218	\$4,666	\$-
Plan C - mid-deductible HSA	Family	\$732	\$4,000	10%	\$6,000	100%	0%	\$3,818	\$12,597	\$-
\$2,000/\$4,000 deductible	EE only	\$244	\$2,000	10%	\$3,000	100%	0%	\$1,740	\$4,666	\$-

Source: MHPC calculations based on actual quotes and plans from Anthem Blue Cross and Blue Shield and Aetna Maine.

insurance plans for lower-cost, higher-deductible plans. Individuals can deposit the premium’s savings (and more, if desired) into their HSA. If they have significant health care expenses in a given year, they can withdraw money tax free from their HSA. If they do not, they can keep the savings and let the savings account build over time.

HSAs change the notion of whose dream is being built. With a HSA, the individual is paying only for health care services they use while growing savings to be used for future expenses. With a comprehensive health insurance plan, the individual is paying for health care benefit that they may or may not use and have no mechanism to save for future expenses. The money spent on unused health care is going to the insurance com-

pany’s bottom line instead of future health care costs for the individual insured.

Who are buying HSA-eligible plans?

1. The uninsured

According to a recent survey by America’s Health Insurance Plans, the previously uninsured are buying HSA plans.[4]

- 31% of purchasers of HSA-eligible individual insurance plans were previously insured (these are sole proprietors, the self-employed and individuals not purchasing insurance through their employer)
- 33% of small businesses providing HSA-eligible health benefits did NOT previously offer any offer health insurance coverage to their employees

2. The young, old, sick, healthy, poor and wealthy.

According to industry surveys, those individuals buying HSA-eligible plans represent all demographics.

- 44-50 percent are 40 years or older (44-45 percent for the large and small group markets and 50 percent for the individual market)[5]
- 69 percent are families with children (28 percent with 4 or members of the household)[6]
- 29 percent have incomes below \$50,000 (20 percent less than \$40,000)[7]

How do HSA premium increases compare to other insurance plans?

HSA premiums are increasing at the rate of inflation. Traditional insurance plan premiums are increasing two to three times faster than inflation. Table 7 shows the results of a recent Deloitte & Touche survey, premium increases for health plans.[8] The survey revealed that in 2005, HSA health insurance plans grew at less than half the rate of all other types of plans, and are projected continue that trend in 2006.

	2005	2006 (projected)
HSA-plans	2.80%	2.60%
HMO plans	8%	7.40%
PPO plans	7.20%	7.50%
Traditional (indemnity) plans	6.40%	6.60%

Source: Deloitte & Touche survey.

How many businesses offer HSA-eligible plans?

Nationwide, there are 3 million people with HSA-eligible health insurance plans in the individual, small group and large group markets. Of new purchases of health insurance, HSA plans accounted for:

- 23 percent of all new individual purchasers.
- 11 percent of all new small group purchasers.
- 7 percent of all new large group purchasers.[9]

Of all businesses:

- 22 percent have a HSA plan in place (2005).
- An additional 21 percent will be offering one within the next two years (2006-2007).
- And another 51 percent are reviewing them and may offer one if attractive to employees and cost effective.[10]

Given the examples shown previously in Chart 1, it seems that many businesses and, more importantly, many employees will find this an attractive, cost effective option.

Do HSAs change consumer purchasing patterns of health care services?

Analysis shows that HSAs encourage individuals to be more prudent health care consumers. An in-depth study by CIGNA of 42,200 first-time users of HSA and other similar consumer-driven plans, compared to 140,000 users of traditional health insurance, revealed that those with an HSA consumed medical services more prudently with greater use of preventive care and medication compliance.[11] Table 8 reveals the findings.

Most noteworthy, the study found “cost savings were observed across all categories, with the most pronounced savings occurring among medium [\$1,000-\$8,000] to heavy users of care [\$8,000+]...This early data suggests that the change in health care decision-making encouraged by a consumer-driven plan doesn’t end once a consumer satisfies the deductible or reaches the out-of-pocket maximum.” HSAs encourage people to be wise consumers of medical care, whether they are spending their money or the insurance company’s.

	HSA and consumer-driven plan users
Total trends	
Total medical claims (less drugs)	-8%
Inpatient medical care	-5%
Outpatient medical care	-12%
Number of outpatient visits/admissions (more visits, but lower cost)	Increased
Preventative care	
Diabetes medication compliance	18%
Asthma medication compliance	8%
High cholesterol medication compliance	23%
Heart medication compliance	18%

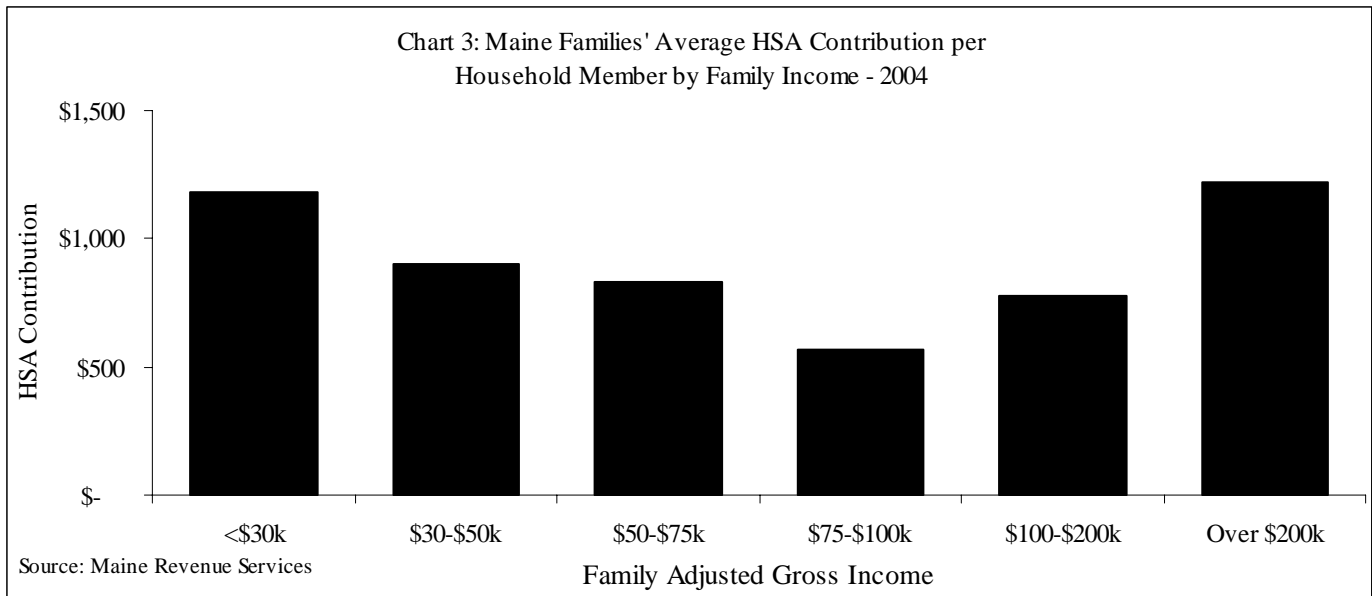
Source: CIGNA Survey.

What are the income tax implications of a HSA?

HSAs allow individuals to have out of pocket health care expenses income tax free, from the very first dollar they spend. Individuals with traditional health insurance or with no insurance can only deduct medical expenses in excess of 7.5 percent of their adjusted gross income; but only if they itemize their deductions. Table 9 displays the tax implications.

Who is contributing to a Health Savings Account in Maine?

The State of Maine closely tracks who in state has an HSA since, in 2004 and 2005, it taxed individuals making HSA contributions. Chart 3 shows HSA contributions by adjusted gross income within Maine in 2004 (the first year became available).



That year, 591 Maine residents contributed to an HSA. The 2005 figures will be available in late 2006.

This information reveals that HSAs are not just for the wealthy in Maine. In fact, lower income families contribute the same or more per household member as higher income families.

was just one of six states that charged state income taxes on HSA contributions.[12] For many taxpayers in Maine, this meant an additional \$85 tax for every \$1,000 HSA contribution made. On March 29, 2006, the Maine Legislature passed and the Governor signed a supplemental budget that includes a provision that gives Maine income taxpayer the same tax break on their HSA as people in 44 other states.[13] **Beginning January 1, 2006 (this year), Mainers can deduct HSA contributions on their Maine income taxes.**

However, Maine’s individual insurance market is expensive due to the costly regulations of guaranteed issue and community rating. Almost all 44,000 people in Maine’s individual market are buying a high deductible plan and, therefore, are potentially candidates for a HSA-eligible plan. The Maine Legislature should repeal these costly insurance regulations and allow more affordable health insurance plans to be sold – both HSA plans and traditional plans as well.

Conclusion

Health Savings Accounts provide an affordable health insurance option that works well for most, if not all, Maine individuals and families – young or old, sick or healthy. Health Savings Accounts encourage consumers to be more prudent health care purchasers; support increased utilization of preventative health care services; provide for the accumulation of significant assets over time; and dramatically reduce premiums.

Table 9
Income Tax Implications of Various Types of Health Insurance Coverage

	HSA-Eligible Plan	Traditional Insurance Plan	None - Uninsured
Employee Portion of Premiums	Tax deductible if an individual is self-employed or uses a Section 125 plan through employer or if premiums in excess of 7.5 percent of AGI		No premiums, therefore not deductible
Out-of-Pocket Health care Expenses	All costs fully tax deductible when paid with HSA	Only deductible for expenses in excess of 7.5 percent of adjusted gross income (AGI) (e.g., if had \$5,000 in costs with an AGI of \$50,000, then could only deduct \$1,500)	

Source: Internal Revenue Services.

What can the State of Maine do to encourage HSAs?

Maine insurance law already allows for HSAs in the individual and small group market. However, **by the end of 2005, Maine**

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Methodology

For calculating the effects of traditional versus HSA-eligible plans, MHPC assumed that all health care expenses were subject to each plan's respective deductible and then the fixed coinsurance until the maximum out of pocket maximum was met, for each year.

Employees out-of-pockets costs (or HSA balance) were then added together for each of the ten years.

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