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Individual or Group Coverage? Regulating Health Reimbursement Arrangements in Texas

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INTRODUCTION

Health Reimbursement Arrangements emerged along with Health Savings Accounts as a tool to provide individuals with tax-free funds to purchase health care. The United States Department of the Treasury has determined that employer funds in a Health Reimbursement Arrangement may be used to pay health insurance premiums as well as the cost of health care services. The Texas Department of Insurance, however, has determined that state law considers this arrangement equivalent to group insurance, subjecting carriers to the same regulatory requirements outlined for writing group coverage. While there are legitimate questions about the Department's interpretation of state law with respect to this issue, the Texas Legislature has the ability to define group coverage and clarify the state law in question.

HEALTH REIMBURSEMENT ARRANGEMENTS AND EMPLOYER-SPONSORED HEALTH INSURANCE

Texas' high rate of uninsured, combined with the growing financial pressure on employers providing health insurance to their employees, fuels the debate on health care policy in Texas. Across the country, the majority of people receive their health insurance through their employer, peaking at 164.4 million people with employment-based coverage in 2000, and falling to 159.5 million by 2004.[1] Of course, this link between employers and health insurance is a byproduct of federal tax policies that emerged out of World War II-era wage and price controls. As a result, health insurance coverage provided by an employer is not taxable, thereby giving a tax benefit to both employees and employers for participating in employer-sponsored insurance and distorting the market for individually purchased coverage.

Avoiding a massive overhaul of the tax code, the President and the United States Congress have extended to individuals some similarly beneficial tax advantages through the use of Health Savings Accounts (HSAs) and Health Reimbursement Arrangements (HRAs). While both HSAs and HRAs are intended to provide individuals the option to pay for health care with pre-tax dollars, they are structured differently (see sidebar). For a number of reasons, HSAs have been the darling of the consumer-driven health care movement, but HRAs offer one attractive feature that HSAs do not have: HRA funds can be used to pay health insurance premiums. Since an HRA relies solely on an employer contribution, in practice this really means that funds set aside by an employer can be used for individually selected and purchased coverage.

For employers, this may be welcome news. An employer might opt to provide funds in an HRA to employees, thereby limiting the employer's long term exposure to rising health insurance costs, not to mention relieving the employer of serving as a benefits coordinator responsible for selecting insurance coverage for all employees.

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HEALTH REIMBURSEMENT ARRANGEMENTS IN TEXAS

An August 2006 bulletin from the Texas Department of Insurance weighed in on the use of HRAs to pay health premiums. The department's intervention was an apparent response to one company's marketing efforts encouraging employers to drop their group coverage and establish an HRA through which employees would pay for individual coverage. In its final analysis, the Department ruled that an employer contribution to an HRA, which an individual employee in turn uses to purchase health insurance, is considered a group benefit and subject to the state's Insurance Code and all regulations on small employer coverage.

Specifically, the bulletin points to Section 1501 of the Texas Insurance Code, which defines a small employer health benefit plan. According to state statute, a plan is a small employer health benefit plan and subject to the Texas Insurance Code if the plan provides benefits covering two or more eligible employees and:

1. The employer pays a portion of the premium or benefits;
2. The plan is treated as an employer contribution/expense for purposes of the Internal Revenue Code; or
3. The health benefit plan is an employee welfare benefit plan, as defined under federal law.[2]

Based upon this statute, the Department then argues that an HRA is an employer contribution/expense according to federal law, and that employer reimbursements for insurance premiums through an HRA constitute an employee welfare benefit plan providing medical care. As a result, the Department states "if a health benefit plan issuer offers coverage in conjunction with an employer HRA or for which the premium is paid or reimbursed through an HRA, the coverage, even if provided through an individual health benefit plan, is subject to those same provisions [small employer health benefit plans], including any requirements regarding guaranteed issuance of coverage."[3]

Comparing HSAs and HRAs

	HSA	HRA
Who owns it?	Individual	Employer
Who funds it?	Both the individual and the employer may contribute	Employer
What type of corresponding health plan is required?	High deductible health plan	None required
How are unused balances treated?	Rolls over automatically each year	Employer determines whether funds rollover. Employer also determines whether any unused balances may follow an employee after leaving employer
Are premium reimbursements allowed?	No	Yes

Source: Council for Affordable Health Insurance and IRS

The Department further argues that under the Health Insurance Portability and Accountability Act, employer contributions to health insurance premiums constitute group coverage, regardless of whether the contributions for premiums are made "directly or indirectly, whether the policy is individual or group or whether the employer is a party to the insurance contract."[4]

To get around the issue of direct or indirect payment, the Idaho Department of Insurance released a bulletin in July 2007 staking out a position which the Texas Department of Insurance has also articulated as a possible remedy for the situation in Texas. Idaho's bulletin suggests that "if the employer simply offers employees an increase in wages in lieu of offering a health plan, with no special conditions, restrictions or requirements that the increase be used to purchase health coverage and the employer does not claim a federal tax benefit for providing health coverage, any individual policies purchased with the increase would likely not be considered a group health plan for purposes of HIPAA."[5]

ANALYSIS AND RECOMMENDATIONS

The Department's analysis means that a carrier selling health insurance to an individual using employer reimbursement funds to pay the premiums would also need to guarantee coverage to any other employee of the firm at the same rate. Although few will criticize the "small group reforms" passed by the Texas Legislature in 1997, the resulting requirements for guaranteed issue and what is effectively community-rated coverage have been the culprit behind the health insurance death spiral in many states. As a general policy matter, such regulations ought to be avoided. The Department's bulletin states that "issuing health benefit plan coverage on an individual, non-guaranteed issue basis to employees of employers will result in the same type of risk-based coverage discrimination that HIPAA and Texas law were enacted to eliminate."[6] At another time it would be appropriate to debate whether eliminating risk-based coverage discrimination was either the actual or appropriate goal of both HIPAA and the Texas reforms, but the overriding issue in this case is whether the product purchased with an HRA 1) qualifies as a health benefit plan and 2) whether the anti-discrimination provisions are satisfied with equitable treatment of HRA contributions.

While there would be no argument that the HRA is itself a benefit, it is unclear whether the definition of a group health benefit extends to the individual uses for the funds in the HRA. As J.P. Wieske of the Council for Affordable Health Insurance pointed out in a January presentation at the Foundation's Policy Orientation, it would not make sense to tell a person who purchased individual coverage and later took a job where the employer reimbursed them for this coverage, that their one-time individual policy suddenly became group coverage merely because employer funds are now used to pay the bills.[7]

Again demonstrating the equally nonsensical distinction is a similar situation: a person purchasing individual coverage paid for with funds in an HRA would be considered to have group coverage until they no longer used the HRA to pay for coverage, perhaps because they ran out of funds in the account, left their job, or chose not to use the HRA for this purpose, at which time their formerly group coverage would be portable and become individual coverage.

The Department's bulletin accurately notes that "prior to small group reform in Texas, carriers were not obligated to issue coverage to all members of an employer group, which

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often made persons with adverse health risk factors unable to obtain coverage."[8] While true, this statement fails to consider the implications of a system that treats both good and bad health risks the same. Small employers with high-risk employees may offer coverage that, while guaranteed, comes at a high price to compensate for expected losses—perhaps too high of a price for some low-risk, low wage employees who choose to keep the cash and go without the insurance coverage. Even more people choose to go bare as many healthy individuals opt out of health insurance rather than pay the higher premiums it takes to cover their expensive, high-risk peers. This predictably creates challenges for small employers trying to keep enough people in the pool, while ratcheting up the price as the healthy subsidizers are opting out of the pool.

For employers confronted with decisions about whether to continue providing expensive health insurance coverage for employees or going bare altogether, HRAs offer an affordable alternative to costly insurance policies. This scenario in mind, the question really becomes whether the Department's ruling on HRAs eliminates a possible option for employers interested in providing employees—both sick and healthy—with an economical benefit employees can use at their own discretion. No doubt there are a number of employers willing to make some contribution to a health benefit broadly, but they have little interest in being the human resources benefits manager and going through the annual hassle of managing the health insurance selections for all of their employees.

To allow small employers this option, it appears the Texas Legislature would need to clarify existing state statute to expressly allow individuals to purchase health insurance through an HRA, and clarify that this arrangement is not subject to small group requirements.*

Whether the contribution to the HRA and any resulting purchase of health insurance with HRA funds runs afoul of federal HIPAA anti-discrimination laws is less clear. A sure answer would require federal clarification. However, there are differences in interpretation and practice among the states. Few states have formally prohibited such arrangements as directed by the Texas bulletin. Whether states have chosen to be silent, or simply not formalized their objection, the uneven interpretation among the states offers no clear answer either. Accordingly, unless the federal government specifies that HRA purchased health insurance is in violation of HIPAA, states will likely continue to permit the practice.

Importantly, the funds contributed to the HRA are for qualified medical expenses, which may, but are not required to, include health insurance premium payments. Employers can treat employees equally in contributing to the HRAs to comply with antidiscrimination requirements in HIPAA, and also reflect the precedent set with respect to uniform employer contributions as required for HSAs. As long as employers do not require employees to purchase health insurance with their HRA, the benefit to the employee is the contribution for health

* At the time of this printing, a request for an opinion from the Texas Attorney General was pending, which could obviate the need for legislative action. However, assuming the Attorney General's opinion concurs with TDI interpretation, legislative action would be necessary to allow HRAs to reimburse for individually purchased coverage.

care in general, not a health insurance premium payment in particular.

The Department raises legitimate concerns about the impact of such an insurance structure on the state's high risk pool. The risk pool is comprised of people who are unable to get coverage through the private market, but are not eligible for public programs. While it is entirely possible that the risk pool may be under greater pressure to absorb these additional people, the real impact is far from certain. On the one hand, the risk pool has significant problems today that should be addressed to ensure the pool's sustainability. At the same time, it is unclear that the Department's position will avoid the added cost to the risk pool, as employees who no longer have a health insurance option from their employer may well turn to the risk pool for coverage. In either case, the risk pool should be revisited separate and apart from any decision on employer contributions to an HRA.

Of course, the proposed remedy floated by both the Idaho Department of Insurance and the Texas Department of Insurance is particularly problematic. Merely "grossing up" an individual's income will only require employees to pay taxes on the additional income before using the money to purchase insurance. Furthermore, concerns that an HRA would mean "sick people 'would be locked out of insurance completely' if a company dropped group coverage in favor of an HRA,"[9] would remain unsatisfied in this arrangement, as individuals would still be shopping in the individual market. Without wholesale tax reform, allowing individuals the option of buying individual coverage with non-taxable funds in an HRA may be the only way to allow individuals purchasing coverage in the individual market to enjoy the benefits of purchasing insurance with the same tax benefits as those receiving employer-sponsored coverage.

Finally, as employer-sponsored insurance continues to fracture, HRAs can be a viable option for employers looking to contribute something to health benefits. For small employers, the problem is particularly acute, as evidenced by the Employer Health Benefits Survey of 2007, only 59 percent of small firms offered health benefits in 2007, which is 10 percent lower than it was in 2000.[10] HRAs may be one of the best opportunities for employers to provide health benefits to employees, while beginning to break down the barriers to portability for employees. Of course, while the funds cannot be used for health insurance premium payments, HSAs may prove to be the best option for individuals looking for affordable coverage with an opportunity to save for health care expenses. In fact, as the number of people receiving employer-sponsored insurance declined, individually purchased coverage increased from 16.1 million nonelderly people to 17.4 million.[11] The best way to meet the needs of this growing population of 17 million people is with a robust individual market, rather than attempting to preserve the model of employer-sponsored insurance.

TalkingPoint:

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ENDNOTES

[1] James Robinson, "The Commercial Health Insurance Industry in An Era of Eroding Employer Coverage," *Health Affairs*, Vol. 25, No. 6 (Nov./Dec. 2006) 1476.
[2] Texas Insurance Code, Section 1501.003
[3] Texas Department of Insurance, Commissioner's Bulletin #B-0028-06.
[4] Ibid.
[5] Idaho Department of Insurance, Bulletin 07-9, http://www.doi.state.id.us/laws/07_9.pdf.
[6] Texas Department of Insurance, Commissioner's Bulletin #B-0028-06.
[7] JP Wieske's presentation to the Texas Public Policy Foundation's 6th Annual Policy Orientation for the Texas Legislature, "The Texas Health Insurance Market" (9 Jan. 2008) http://www.texaspolicy.com/audio/2008-PO-panels.html.
[8] Texas Department of Insurance, Commissioner's Bulletin #B-0028-06.
[9] Chad Terhune, "Employers Turn to Alternative for Insuring Staff," *The Wall Street Journal* (30 July 2007) A1.
[10] Kaiser Family Foundation and Health Research and Education Trust, "Employer Health Benefits: 2007 Summary of Findings."
[11] James Robinson, "The Commercial Health Insurance Industry in An Era of Eroding Employer Coverage," *Health Affairs*, Vol. 25, No. 6 (Nov./Dec. 2006) 1476.

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