



PolicyPerspective

Reducing the Cost of Health Care: A Case Study on Health Savings Accounts

by Spencer Harris
Health Care Policy Analyst

Introduction

The debate over health care reform has sparked many new ideas over the future of the American health care industry, some good and some bad. However, there is widespread agreement that something needs to be done to rein in the rising costs of health care for Americans. Individuals and small businesses have particular concerns in this arena as their lack of market share affords them very little bargaining power. One relatively new method of cost containment has proven successful for our organization, the Texas Public Policy Foundation (Foundation): Health Savings Accounts (HSAs).

An HSA is a tax free savings account coupled with a High Deductible Health Plan (HDHP). These pre-tax dollars are used to cover your first dollar coverage, while the HDHP protects against catastrophic risk. The Foundation has found HSAs to be effective at controlling health care costs in a small business environment. Despite HSAs increasing in popularity, there are a number of challenges to their future. The newly enacted federal health law, the Patient Protection and Affordable Care Act (PPACA), reduces their effectiveness and threatens their existence. Not only does the PPACA threaten the ability of small employers like the Foundation to manage their health care costs, but it also removes one of the few proven programs that helps reduce national health care costs. Using the Foundation as a case study, this paper shows the effectiveness of HSAs and why they should remain as a vital part of a national health care strategy for reducing costs.

What Is an HSA?

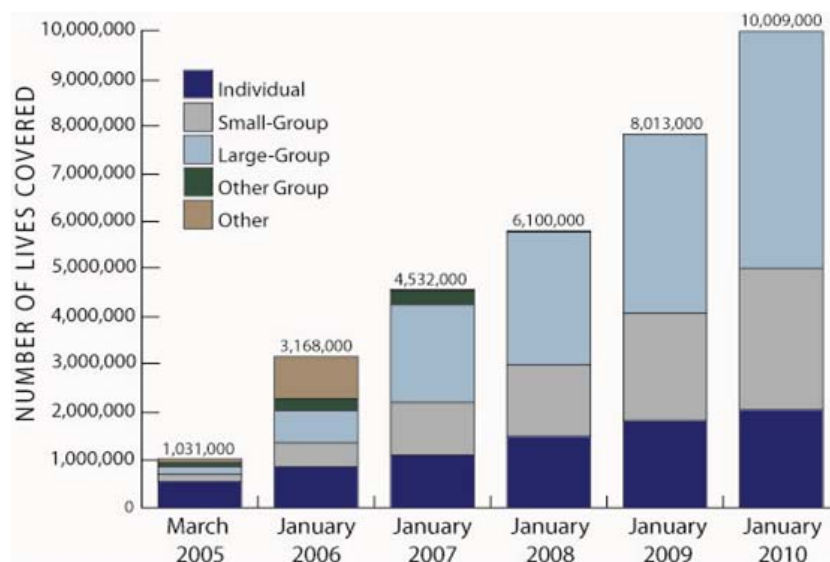
In 2003, the U.S. Congress created HSAs as a new type of health coverage plan for Americans. Employers and individuals may put pre-tax money into the savings account or either may fully fund the account. The individual may draw from the savings account for all health care needs below their insurance deductible. It empowers individuals control over their first-dollar coverage and removes the majority of the third party payment system from the equation. HSAs have proven remarkable at providing greater health care choices and controlling costs for both the individual and the employer.

Businesses and individuals have increasingly taken advantage of HSAs (as observed in Figure 1, next page). Greg Scandlen cited the growing popularity when he said, “Consumer-driven health care plans are being used by 22.7 percent of the privately insured population. This is an astonishing market share for an approach that began just six years ago.” (Scandlen, 2) HSAs have found particular success in Texas which now ranks fourth in the number of HSA plans in the private market.

Studies have validated HSAs ability to contain costs. In May 2009, the American Academy of Actuaries published a monograph on consumer directed plans that showed a 12 to 20 percent savings in the first year and a rate of inflation in subsequent years of 3 to 5 percent, or roughly half that of traditional plans. (American Academy of Actuaries, 9)

900 Congress Avenue
Suite 400
Austin, TX 78701
(512) 472-2700 Phone
(512) 472-2728 Fax
www.TexasPolicy.com

Figure 1: Growth of HSA/HDHP Enrollment from March 2005 to January 2010



Source: 2010 America's Health Insurance Plans HSA/HDHP Census

Analysis of the Texas Public Policy Foundation's Health Care Costs, 2004-2010

The Foundation is a 501(c)(3) organization with approximately 25 employees. Several employees have numerous dependents. It switched from a traditional insurance plan (PPO) to an HSA program in 2005. Table 1 (next page) shows the Foundation's and its employees' health care costs from 2004 (the last year on a traditional PPO) through 2010.

Switching to an HSA restructured how the Foundation and its employees pay for health care. For the Foundation, instead of paying only the monthly premium, it also contributes to each employee's savings account. This aspect of HSAs—along with the ability to choose different deductibles and levels of coinsurance—provided the Foundation with flexibility that it has been able to use to the benefit of the Foundation and its employees.

Table 1 also shows that the employee insurance premiums that the Foundation paid dropped significantly upon switching to an HSA plan, from \$270.98 in 2004 to \$223.06 in 2005. Today, that premium stands at \$163. This means that the Foundation has available \$1,295 per year per employee—that it used to pay to insurance companies—to contribute to

the employee's HSA, reduce its health care costs, or a combination of both. As will be seen, the Foundation has chosen to put all of this money, and more, into the employee's HSA.

Under the 2005 HSA plan the employee had a \$1,000/2,000 (Individual/Family) deductible and a 20 percent coinsurance that had an out of pocket maximum of \$4,300 and \$8,400 for an individual and family, respectively. The Foundation paid \$223.06 per month for employee premiums and offered no contribution to employee HSAs.

In 2006 the Foundation renewed their plan with the same company as 2005. However, some adjustments were made to the structure of the plan. Under the renewal, employees had a \$1,050/2,100 deductible with a 20 percent coinsurance that had the same out of pocket maximum as in 2005. The monthly premium costs went down to \$216.98 per employee per month for the Foundation. Also, the Foundation, for the first time, began contributing to the employees' HSAs at a rate of \$79.97 per month.

Table 1: Texas Public Policy Foundation's and Employees' Health Care Costs, 2004-2010

	2004	2005	2006	2007	2008	2009	2010
Foundation Monthly Premium Cost Per Employee	\$270.98	\$223.06	\$216.98	\$191.63	\$182.89	\$225.61	\$163.00
Employee Spouse-only Additional Premium Cost	\$370.43	\$189.77	\$213.33	\$229.95	\$219.46	\$203.25	\$220.00
Employee Family Additional Premium Cost	\$658.54	\$484.87	\$461.40	\$421.58	\$402.35	\$496.84	\$443.00
Foundation Monthly HSA Contribution	N/A	\$0	\$79.97	\$79.03	\$125.00	\$125.00	\$125.00
Foundation Total Monthly Cost Per Employee	\$270.98	\$223.06	\$296.95	\$270.66	\$307.89	\$350.61	\$288.00
% Change from 2004	N/A	-17.68%	9.5%	-0.1%	13.6%	29.3%	6.2%
% Change from Previous Year	N/A	-17.68%	33%	-8.8%	13.7%	13.8%	-17.8%

Source: Author's calculations based on Texas Public Policy Foundation records

The result was that in 2006, the Foundation's total cost per employee was slightly higher than in 2004. Yet both the Foundation and the employee benefitted. The Foundation benefitted because its total cost was below what it would have been had it stayed with a traditional plan. The employee benefitted because a significant portion of the money that the Foundation had been paying to health insurance companies was now being paid to the employee, through HSA contributions. Employees were able to begin building up savings in their accounts.

In 2007, the Foundation switched to a new company's HSA plan when the renewal rate quote was a 12 percent increase in costs to the Foundation. Under the new plan, a decrease of 11 percent in average premium costs per employee was realized. This allowed the Foundation to increase its deposits into employee's HSAs by the amount of the decrease while costs remained budget neutral.

The Foundation's new insurance plan covered 100 percent of expenses after the deductible, which increased to \$2,500. This meant that while first dollar exposure for employees increased, overall exposure to risk was cut by approximately 40

percent, from \$4,300 to \$2,500 for an individual. For families, the exposure to first dollar coverage increased \$2,800, but the overall potential exposure to risk decreased by \$3,400.

This highlights how the flexibility of HSAs can help employees. Total exposure was significantly reduced, and the employer contributions to the HSAs of almost \$1,900 over two years provided 76 percent of the amount to pay the deductible, if needed. For employees the risk was reduced even further as the Foundation increased contributions in light of the savings, a decision each small business must make for themselves.

The results for Foundation employees were far better under HSAs, with lower costs, more control, and less risk exposure. Additionally, employee pre-tax contributions provided a greater ability of the employee to cover medical costs. Over time, as savings increased, the first dollar risk decreased as the overall risk has decreased from the beginning. The Foundation's experience is reflected in Greg Scandlen's statement, "Savings vary depending on many factors, but generally adopting a higher deductible saves consumers or employers 25 to 40 percent in the price of premiums." (Scandlen, 4)

The flexibility that HSAs provide allowed the Foundation to adapt their health care plans to a changing economic environment.

Overall, Foundation monthly health care cost per employee went from \$270.98 in 2004 to \$288.00 in 2010, an increase of only 6.2 percent. At the same time, the national average of employer-sponsored health insurance premiums increased 32.3 percent. (Kaiser)* Additionally, the Foundation's current \$288 in total costs is well below the national average of \$345.83. (Kaiser)

HSAs gave the Foundation flexibility in determining how much of the health care savings it realizes versus how much of the savings it passes along to its employees through contributions to their HSAs. Under its traditional health insurance plan, the Foundation paid for each employee's monthly premium, which was higher than its subsequent premiums for the HSA plan. The Foundation has been able to choose whether to keep the savings in premium costs or to increase its employer contributions to the employee's savings account.

Between 2009 and 2010, the Foundation, like many small businesses, again faced rising health care costs along with a tight budget period. During this time the national average of employer expenditures increased 4.2 percent. However, during the same time period, Foundation premium costs went down 17.8 percent, but these premium decreases came at the cost of higher deductibles. The Foundation decided to keep the savings associated with the lower premiums. The flexibility that HSAs provide allowed the Foundation to adapt their health care plans to a changing economic environment.

Health Care Law and HSAs

The PPACA erodes the flexibility and benefits of HSAs and might even completely eliminate them over time. The most debilitating impact is not a regulation directly on HSAs. Un-

der the PPACA all health insurance plans must have an actuarial value of above 60 percent. An actuarial value is a calculation of the total value of a system of payments, such as an insurance policy, in relation to the risk posed. Depending on the rules the Secretary of Health and Human Services creates on how to calculate actuarial value, this regulation could make many types of high deductible health plans, including HSAs, illegal.

A press release by HSA Consulting Services, says, "If [employer] contributions are not included, HDHPs, many of which have actuarial values below 60 percent [...] based on insurance coverage alone, could no longer be sold." (HSA Consulting Services, 2-3) If these plans are done away with, HSAs will be gone as well. Kathryn Nix at Heritage Foundation says, "All presidential assurances to the contrary, you can't keep what no longer exists—not even health coverage you like." (Nix)

The PPACA also limits the amount of money that can be contributed to an HSA to \$2,500 annually per employee. This is less than the \$3,000 limit in 2009, and makes it more difficult for employees to build up balances to meet future health care needs.

Also, the penalty on monies used outside their defined medical expenditures was increased from 10 percent to 20 percent, serving as a further deterrent for employee contributions to the savings account. This regulation would have little impact if the money in the account is used for its intended purpose. However, it is still indicative of the law's over-regulation of HSAs, and could reduce the amount of money people put into HSAs for fear of needing to get funds in the case of an emergency.

Finally, the minimum loss ratio (MLR) requirement that small group and individual plans must keep threatens the existence of HDHPs. A minimum loss ratio is the ratio of money from a policy holder that is spent on health care payments to overhead and profits. HSA Consulting Services observes, "It is hard to imagine most high deductible plans paying such a high percentage of premium revenues on medical claims." (HSA Consulting Services, 3) On Novem-

* All references to Kaiser are based on the author's calculations from data in Kaiser Family Foundation surveys.

ber 22, 2010 Secretary Sebelius announced that MLR ratios will be determined by market share. This means that a plan that is above the MLR could weigh against a plan below the MLR, likely where HDHPs reside, and make the company compatible with law. The issue with this is that it effectively makes HSAs a burden to a company's compliance, and in an environment increasingly controlled by the government it is unlikely a company will risk staying noncompliant for long. Moving in the opposite direction of the increasing demand for HSAs, the Obama Administration's new health care law is primed to do irreparable damage to HSAs.

Recommendation: State Employees and HSAs

HSAs have proven their value. Congress must reverse policies that threaten their existence and instead adopt policies that encourage their expansion. However, at the present HSAs remain a viable product, and the Texas Legislature must take advantage of the benefits by authorizing an HSA option for its state employees. This will give Texas state employees more freedom of choice in their health care decision, and can assist in driving down the cost of providing health insurance for the state. Indiana has provided this choice to its state employees and is saving \$20 million in 2010 alone. (Daniels) "In 2010, over 70 percent of Indiana's 30,000 state workers chose it. ... One study calculates that Indiana's total costs are being 'reduced by 11 percent solely due to the HSA option.'" (Young, 5)

Conclusion

By switching to an HSA and then shopping for the best policy, the Foundation has been able to contain its employee costs. It has also reduced employee exposure to health care costs, while full family coverage has been made increasingly affordable. These results could reasonably be achieved by other organizations and businesses.

HSAs are in danger under the new health care law, and if they are done away with individuals, businesses, and state and local governments will lose a valuable tool to keep costs low and coverage high.

The debate continues on how to control health care spending for America's small businesses, but The Foundation has been able to keep costs down and benefits up for the past five years by switching to HSAs. While many small businesses have kept costs down by cutting benefits, the Foundation has been giving more control and less exposure to Foundation employees without skyrocketing costs. However, HSAs are in danger under the new health care law, and if they are regulated out of existence with individuals, businesses, and state and local governments will lose a valuable tool to keep costs low and coverage high. ★

References

American Academy of Actuaries. *Emerging Data on Consumer Driven Health Plans*. May 2009. Print.

Cannon, Michael. "Obamacare's Price Controls Threaten HSAs." *Cato @ Liberty Blog*. 24 May 2010.

Daniels, Mitch. "Hoosiers and Health Savings Accounts: An Indiana experiment that is reducing costs for the state and its employees." *The Wall Street Journal*. March 2010.

HSA Consulting Services. "Health Reform Provisions that Could Impact Consumer-Driven Health Plans" Editorial. 7 January 2010.

Kaiser Family Foundation. *Employer Health Benefits Annual Survey*. 2000-2010.

Nix, Kathryn. "Side Effects: Like Your HSA? Enjoy it While You Can." *Heritage Foundation Blog*. 9 June, 2010.

Scandlen, Greg. "Ten Ways Consumer-Driven Health Care is a Proven Success." *The Heartland Institute*. January 2010.

Young, Liz. "Health Savings Accounts for State Employees and Retirees." *Texas Public Policy Foundation*. April 2010.

About the Author

Spencer Harris joined Texas Public Policy Foundation in 2010 as a Health Care Policy Analyst. His research focuses on identifying patient-centered, free market solutions for our state's health care challenges. No stranger to Texas public policy, Harris worked in the House of Representatives for Rep. Warren Chisum where he covered health care issues, immigration issues, and the Licensing and Administrative Committee. Harris is a native Texan, born and raised in Houston. He graduated from Texas A&M University with a degree in History and Anthropology. He enjoys hunting, fishing, music, reading, and all things outdoors.

Texas Public Policy Foundation

The Texas Public Policy Foundation is a 501(c)3 non-profit, non-partisan research institute.

The Foundation's mission is to promote and defend liberty, personal responsibility, and free enterprise in Texas by educating and affecting policymakers and the Texas public policy debate with academically sound research and outreach.

Funded by hundreds of individuals, foundations, and corporations, the Foundation does not accept government funds or contributions to influence the outcomes of its research.

The public is demanding a different direction for their government, and the Texas Public Policy Foundation is providing the ideas that enable policymakers to chart that new course.

