Health Savings Accounts (HSAs) are not entirely new, but are receiving greater attention today in relation to high-deductible health insurance plans and the Affordable Care Act. They are often viewed as a strategy for reducing healthcare costs and for encouraging individuals to take greater responsibility for their health and the cost of care.

WHAT IS A HEALTH SAVINGS ACCOUNT (HSA)?

Think of an HSA as a tax favored medical spending and retirement account. HSAs are established to receive tax favored cash contributions by or on behalf of eligible individuals. Cash (or investments into permitted securities) in an HSA may accumulate over the years or be distributed on a tax-free basis to pay or reimburse qualified medical expenses. Qualified medical expenses are specifically defined by the IRC. HSAs are wholly owned by individuals, making them portable and any (unused) cash or investments in the accounts roll over each year. There is “no use it or lose it” rule for HSAs.

WHERE DO HSAs FIT IN THE CURRENT ENVIRONMENT OF HEALTHCARE REFORM?
HSAs play a major role in the current healthcare reform environment. The so-called “metal tiers” (bronze silver, gold and platinum) were created in the ACA as a means to determine and classify the actuarial value of health insurance policies that meet Qualified Health Policies standards as defined by the ACA and the United States Department of Health and Human Services.

In effect, HSA-compatible health insurance policies meet the minimum standard levels set by the ACA in most cases and thus have been embraced by Health and Human Services as one form of the bronze and silver policies. In addition, because these so-called HSA-compatible policies have potentially lower actuarial values, they may not expose companies who sponsor health plans for their employees to the so-called Cadillac Tax. The Cadillac Tax begins in 2018 and is an excise tax imposed by the ACA on insurance policy benefits that exceed certain ACA-established thresholds. The potential savings for employers may be significant. In plain English, if a law compels individuals to own a health insurance policy, individuals are most likely to choose the lowest cost, highest value policy they can. In many cases, that means an HSA.

1 Medicare Prescription Drug Improvement and Modernization Act (2003)

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Conversely, part of the ACA’s aim was to “bend the cost curve of insurance.” One way the “cost curve” may be slowed or reduced is to encourage (through incentives or disincentives) companies to offer lower cost, lower actuarial value policies to the employees. HSAs and their corresponding health insurance policies are congruent with that aim.

These policies generally cost much less than traditional, actuarially rich policies and so the savings may be passed on to employees through employer contributions to employee HSA accounts or in the effect of a lower cost to each employee, or both.

Finally, there are some good examples popping up around the country on a state level where the HSA concept is being used to help with other government sponsored entitlement programs.

More and more individuals are likely to be covered by HSA-compatible polices in the future. One can only hope that employers and individuals continue to contribute to HSAs and that individuals continue to use them for qualified medical expenses.

**HOW CAN AN HSA BE AN INVESTMENT FOR AN EMPLOYEE**

HSAs may be one of the most tax-efficient investment accounts currently in the marketplace today. They may be considered an investment for individuals (employees) in a number of ways.

Any money contributed by an employer enters the employee’s account tax free. Accumulations in the account grow tax free (in most states) and, if used for qualified medical expenses, are distributed from the account free from federal taxation. This effect is called “triple tax free treatment,” so the accumulation and spending phases of an HSA are an efficient investment.

In addition, any investment that is permitted in an Individual Retirement Account (IRA) is acceptable for an HSA, including longer-term investments such as stocks, bonds or mutual funds, to name a few. The annual maximum contribution to an HSA in any given year is determined by the IRC, and proceeds taken from the HSA for qualified medical expenses are not taxed.

Individuals might consider paying for current qualified medical expenses from taxable accounts while saving receipts over time, withdrawing funds later and, thus, allowing the HSA to increase in value.

**HOW CAN AN HSA PROGRAM BENEFIT EMPLOYERS?**

The legislation that created HSA accounts was developed by a group of individuals who favored market forces and tax incentives as protagonist agents for change. Thus employers were given tax breaks as an incentive to make cash contributions to their employees’ HSAs, thus creating a vehicle for investment. The employer’s contributions into an employee’s HSA are exempt from Social Security (FICA) and unemployment (FUTA) taxes. Further, every dollar contributed voluntarily by an employee, through payroll deduction, is also exempted from those taxes, saving the employer money.

Various studies have shown that, while change of any nature, especially change associated with health benefits, is frightening, over time, employees have embraced their HSAs and, as predicted, treat the money in the account as their own, because, of course, it is. They spend those dollars as their own and thus any investment made by an employer into HSAs will be rewarded with more reasoned expenditures by those same employees.

Over time, healthcare expenditures (think claims) may be reduced, for example, as individuals begin to ask for generic alternatives to prescribed drug therapies, or avoidance of the emergency room on a Saturday for non-emergency needs. HSAs can be an investment into behavioral change for employees. HSA-compatible policies, by legislation, pay for preventative care for policy holders, and studies have shown that HSA owners use more preventative care options than non-HSA owners. HSAs are an investment by the employer into the accounts and into the future of its employees’ healthcare choices.

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2 Medicare Prescription Drug Improvement and Modernization Act (2003)  
3 Seventh Annual Choice Fund Experience Study, Cigna, 2012
WHAT ARE THE CURRENT TRENDS RELATED TO HSA BALANCES HELD BY CONSUMERS? ARE THESE ACCOUNTS REALLY LOOKING LIKE SIGNIFICANT PORTIONS OF INDIVIDUAL CONSUMER INVESTMENT PORTFOLIOS? WHAT DO YOU PREDICT FOR THE FUTURE?

A recent study by one firm, Devenir, a recognized industry authority, noted that balances reached $19.3 billion by the end of 2013. It is important to note that there were no balances in these accounts at the beginning of 2004 and so the growth of balances has far outpaced many banking products over the years.4

The same study noted that the average balance per account holders reached $2,356 for the same period. Many are savers and investors, but many are not and spend the majority of their balances every year.

Also, HSAs follow the traditional eighty/twenty percent rule, in general. Twenty percent of owners hold eighty percent of the money. It’s important to note that the predecessor to HSA was the Medical Savings Account or MSA. Owners of those accounts typically have a much greater amount of money in their accounts due to the length of time they have existed.

Providers should be aware that balances in HSAs may grow throughout the year and therefore could influence the scheduling of procedures by patients, leading many to schedule their procedures later in the year, such as between September and December.

In sum, HSAs are likely to become a significant portion of an individual’s portfolio, if not in terms of the overall amounts, then in terms of the safety net they provide.

ANY RECOMMENDATIONS FOR HOW MUCH AN EMPLOYEE SHOULD “INVEST” IN AN HSA ON AN ANNUAL BASIS?

An employee should fully fund the account to the limits of the IRC for a number of reasons:

- First and foremost, an employee can typically cover any deductible amount with contributions and should do so as an economic way to offset risk.
- Second, the amount an employee contributes from payroll is before tax, providing an advantage in terms of overall earning potential.
- Third, money may grow tax free and may be used tax free for qualified medical expenses.

At a minimum, employees should always keep enough cash to cover current year deductible exposure and use the account to take advantage of the tax treatments for funding expenses.

Money in may be money out tax free if used correctly. Employees may consider taking funding from a taxable account, making a deposit and then a withdrawal to pay for qualified medical expenses, for example. Contributions taken from a taxable account can be deducted from gross income so long as the contributions do not exceed the yearly maximum.

ARE HSAS IMPACTING CONSUMER BEHAVIOR? IF SO, HOW?

There are some experts who are now pointing to the HSA experience as a driver in the reduction of overall medical expenses (the cost curve). Other studies are showing that HSA owners act more responsibly with their money, because they realize it is their money; seeking generic therapies and demanding cost transparency from providers, for example.5 Still others see better preventative care measures, smoking cessation and weight reduction as a result of the connection individuals are making between benefit and the cost of benefit. HSAs are having a profound impact on individual consumer behaviors in these regards.6

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4 Year-End 2013 Devenir HSA Research Report, for the period 12/31/12 to 12/31/13
5 “2013 Employer-Sponsored Health Care: ACA’s Impact,” by the International Foundation of Employee Benefit Plans
6 The Employee Benefit Research Institute, July 2013 and consensus of studies conducted throughout the years 2006 to 2013 by Cigna, Aetna, various Blues Plans and WellPoint
WHAT IS THE GREATEST EFFECT ON PROVIDERS?
Providers are facing a change in the way that individuals pay for their care. That is, the advent of HSAs creates a need for providers to assess patient liability and propensity to pay up front based on available funds. Banks can work with providers to help them face these new challenges. The saying goes “all that is old is new again.” Going back to pre–Second World War days, patients were always in tune with their individual responsibilities because the advent of “all-in-one policies” had not occurred yet. We are simply going back to an age of personal responsibility, and, while no change is easy, I predict that this one will be worthwhile for us all in the end.

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James (“Jim”) Gandolfo is the Healthcare lead for PNC’s Treasury Consulting Group (TCG). TCG provides a variety of support to both industry and PNC’s Treasury Management professionals related to comprehensive solutions for commercial payments, receivables and information management.

Gandolfo received bachelor of science degrees in both political science and history from Radford University in Radford, Virginia. He holds a variety of FINRA licenses, including Series 6, 7, 24 and 63. He is chairman of the American Bankers Association’s HSA Council and is a member of the board of directors of the HSA Coalition.

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