Employee HSAs, HRAs and FSAs: Issues for Benefits Counsel
Navigating the Compliance Requirements Regarding Account Administration, Funding, and Benefits

THURSDAY, JANUARY 31, 2013
1pm Eastern    |    12pm Central   |   11am Mountain    |   10am Pacific

Today’s faculty features:
Christine L. Keller, Principal, Groom Law Group, Washington, D.C.
Elizabeth Kappenman, Senior Counsel, Wells Fargo & Company, Minneapolis
Richard Stover, Principal and Consulting Actuary, Buck Consultants, Secaucus, N.J.

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Overview of HSA, HRA and FSA Trends

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201-902-2684
Richard.Stover@buckconsultants.com
Growth of HSA-Qualified High-Deductible Health Plan Enrollment, Covered Lives (Millions), March 2005 to January 2012

March 2005: Individual 1.0
January 2006: Small Group 3.2
January 2007: Large Group 4.5
January 2008: Individual 6.1
January 2009: Large Group 8.0
January 2010: Large Group 10.0
January 2011: Large Group 11.4
January 2012: Large Group 13.5

Sources: AHIP Center for Policy and Research, 2005 – 2012 HSA/HDHP Census reports.

* For this census, companies reported enrollment in the large- and small-group markets according to their internal reporting standards, or by state-specific requirements for each state. The "Other Group" category contains enrollment data for companies that could not break down their group membership into large- and small-group categories within the deadline for reporting.

** The “Other” category was necessary to accommodate companies that were able to provide information on the total number of people covered by HSA/HDHP policies but were not able to provide a breakdown by market category within the deadline for reporting.
<table>
<thead>
<tr>
<th>Month</th>
<th>Individual</th>
<th>Small Group</th>
<th>Large Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 2005</td>
<td>64%</td>
<td>17%</td>
<td>19%</td>
</tr>
<tr>
<td>January 2006</td>
<td>42%</td>
<td>25%</td>
<td>33%</td>
</tr>
<tr>
<td>January 2007</td>
<td>26%</td>
<td>25%</td>
<td>49%</td>
</tr>
<tr>
<td>January 2008</td>
<td>25%</td>
<td>30%</td>
<td>45%</td>
</tr>
<tr>
<td>January 2009</td>
<td>23%</td>
<td>30%</td>
<td>47%</td>
</tr>
<tr>
<td>January 2010</td>
<td>20%</td>
<td>30%</td>
<td>50%</td>
</tr>
<tr>
<td>January 2011</td>
<td>21%</td>
<td>24%</td>
<td>55%</td>
</tr>
<tr>
<td>January 2012</td>
<td>18%</td>
<td>22%</td>
<td>59%</td>
</tr>
</tbody>
</table>

Sources: AHIP Center for Policy and Research (May 2012).
Note: Columns may not sum to 100 percent due to rounding.
Percentage of Firms Offering HDHP/HRAs and/or HSA-Qualified HDHPs, 2005 – 2011


## 2012 HSA/HRA HDHP Features for Employer Plans

<table>
<thead>
<tr>
<th></th>
<th>HDHP/HRA</th>
<th>HDHP/HSA</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Single</td>
<td>Family</td>
</tr>
<tr>
<td>Premium</td>
<td>$5,271</td>
<td>$15,169</td>
</tr>
<tr>
<td>Employee Contribution</td>
<td>$949</td>
<td>$4,184</td>
</tr>
<tr>
<td>Deductible</td>
<td>$1,923</td>
<td>$3,666</td>
</tr>
<tr>
<td>Out-of-pocket Limit</td>
<td>$3,203</td>
<td>$6,131</td>
</tr>
<tr>
<td>Employer Account Deposit</td>
<td>$970</td>
<td>$1,840</td>
</tr>
</tbody>
</table>

Source: Kaiser Family Foundation (2012)
Healthcare Flexible Spending Accounts (FSAs)

- 85% of large employers offer FSAs
- 20-25% of employees participate in FSAs
- Average employee contribution - $1,500
- Average account forfeiture - $60-$80
Employee HSAs, HRAs and FSAs: Issues for Benefits Counsel

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Minneapolis
January 2013
HSAs - Generally

- Described in section 223 of the Internal Revenue Code.
- A funded account, similar to an IRA.
- In order to contribute to an HSA, an individual must be covered under a "high-deductible health plan" ("HDHP") and may not participate in any other non-HDHP, subject to certain exceptions.
- Bank or insurance company serves as HSA custodian/trustee.
- Employers may be involved with these accounts, or individual may open one without employer’s involvement.
Eligibility – Basic Rules

- Covered by an HDHP
- No other non-HDHP coverage
- Not enrolled in Medicare
- Cannot be claimed as a dependent on someone else’s tax return
Eligibility – Impact of FSA/HRA Coverage

• An HSA Account Holder may generally not contribute to an HSA if he or she is also covered by a Health FSA and/or HRA except where:
  o FSA and/or HRA are limited-purpose arrangements that only pay or reimburse vision and dental expenses, or preventive care benefits; or
  o FSA and/or HRA only pay or reimburse medical expenses after the minimum annual deductible of the HDHP has been satisfied.

• Spousal FSA
  o IRS would require spouse’s FSA to exclude individual from coverage under the FSA in order for the individual to retain status as an HSA-eligible individual.
Contributions – 2013 Contribution Limits

<table>
<thead>
<tr>
<th>Contribution Limit</th>
<th>Single Coverage</th>
<th>Family Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contribution Limit</td>
<td>$3,250</td>
<td>$6,450</td>
</tr>
<tr>
<td>Catch-up Contribution Limit (age 55 or older)</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

- Limits may need to be prorated if individual is not HSA eligible for entire year or if individual switches from family to single coverage (or vice versa) during the year.
- *Last month of the year rule:* Exception to proration requirement, but testing period applies.
- Special rules for married individuals
Contributions – Method of Contributing to HSAs

- Contributions may be made by an individual on an after-tax basis, with a corresponding deduction available.
- An employer may offer an HSA option as part of its cafeteria plan, allowing an individual to make HSA contributions on a pre-tax basis.
- Employers may structure employer HSA contributions through a cafeteria plan, or make contributions without using a cafeteria plan. Different testing rules apply depending on method chosen.
Contributions – Using a Cafeteria Plan to Fund an HSA

• Cafeteria Plan contributions not subject to:
  • Withholding from wages for income tax
  • Federal Insurance Contributions Act (FICA),
  • Federal Unemployment Tax Act (FUTA), or
  • Railroad Retirement Tax Act.

• Must be reasonable for an employer to believe at the time a contribution is made that such contribution will not exceed the HSA limits that apply to a particular employee.
Distributions

• Must be used for Qualified Medical Expenses
• Insurance premiums are generally not eligible expenses, with a few exceptions
• Individual monitors; no substantiation required by trustee/custodian or employer
• If distributions are not for qualified medical expenses, the distribution is included in income and a 20% additional tax applies. Additional tax does not apply in case of death, disability or attainment of age 65
• Debit card serves as distribution tool
Carryovers and Portability

• Amounts in an HSA carry forward from year to year
• No “use it or lose it” rule
• Individual owns the account and can keep the account even if insurance coverage or employment changes.
• Individual can roll or transfer account dollars to another.
• Result: Can spend dollars now or save dollars for use in retirement.
Administration by Custodians/Trustees

HSA custodians/trustees must:
• File required returns with the IRS (Forms 5498-SA and 1099-SA)
• Enter into a Custodial/Trust Agreement with the Account Holder
• Monitor against the maximum contribution limit
• Only accept cash contributions, valid rollovers, or HSA funding distributions
• Track the Account Holder’s age
• Not restrict the Account Holder’s ability to roll over amounts from the HSA
Administration by Custodians/Trustees

However, a custodian/trustee is not required to:

- Monitor an individual’s contribution limit
- **Monitor if funds are used for qualified medical expenses**
- Allow Account Holders to return mistaken distributions
- Allow *any* distribution - limits on frequency and amount are ok
- Accept rollover contributions or trustee-to-trustee transfers
Reporting Requirements – Custodian Obligations

• Form 5498-SA – Reports contributions to an HSA (issued in May)
• Form 1099-SA – Reports distributions from an HSA (issued in January)
Applicability of ERISA

An HSA will not be subject to ERISA if the employer satisfies the criteria established by the Department of Labor in two Field Assistance Bulletins (2004-01; 2006-02).
## Applicability of Banking Laws

<table>
<thead>
<tr>
<th><strong>Banking Laws</strong></th>
<th><strong>State Laws</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.A. Patriot Act (CIP)</td>
<td>Trust</td>
</tr>
<tr>
<td>Regulation P – Gramm Leach Bliley Act Regulations on Privacy Protections</td>
<td>Escheatment</td>
</tr>
<tr>
<td>Regulation CC – Funds availability</td>
<td>Garnishment/Creditor</td>
</tr>
<tr>
<td>Regulation D - Reserve Requirements</td>
<td>Bankruptcy</td>
</tr>
<tr>
<td>Regulation DD – Truth in Savings</td>
<td>State deposit laws</td>
</tr>
</tbody>
</table>
ACA Direct Impact on HSAs

• The cost of over-the-counter drugs, other than insulin, are not be eligible for reimbursement as a qualified medical expense under HSAs, HRAs, and health FSAs unless prescribed by a physician.
• Increases penalty from 10% to 20% for non-eligible medical expense withdrawals.
Employee HSAs, HRAs and FSAs: Issues for Benefits Counsel

January 25, 2013

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Health FSA

What is a Cafeteria Plan?

- A written plan described in Code sec. 125
- Maintained by an employer for the benefit of its employees
- Allows employees to choose between cash and certain “qualified benefits”
- Subject to non-discrimination rules
- Subject to participant election rules
Health FSA

Qualified Section 125 Benefits

- Accident or Health Plans (including Health FSA),
- Long-term Disability Plans,
- Group Term Life Policies,
- Accidental Death And Dismemberment Policies,
- Dependent Care Assistance,
- Adoption Assistance,
- 401(k) Plans,
- Elective, Paid Vacation Days, and
- Health Savings Accounts.
Health FSA  
*Who Can Be Covered?*

- **Permitted:**
  - Employees (and their dependents under Code secs. 152 or 105(b))
  - Former employees

- **Not permitted:**
  - Self-employed individuals
  - Partners
  - Shareholders in s-corporations who hold more than 2% of stock
  - Same-sex spouse, domestic partner, non-dependent
Health FSA

Definition/Key Rules

- If the amount that an employee can receive as a benefit is less than 5 times the premium that the employee paid, the arrangement is an FSA.
- Uniform, 12 month period of coverage
- Reimbursements for medical expenses only (but not health insurance premiums)
  - Substantiation required
- Use it or lose it rule
  - 2 ½ month exception
  - Additional relief under consideration
Health FSA

Administration

- Salary reduction agreement
- Participant elections
  - Must be for future period
  - Irrevocable except for:
    - Changes in marital status;
    - Changes in number of dependents;
    - Changes in employment status; and
    - Cases where the dependent satisfies or ceases to satisfy eligibility.
  - “Cost and Coverage” rules do not apply
Health FSA

**Consistency Rule**

- An election change must:
  - Be on **account of & correspond with** a change in status event that effects **eligibility** for coverage.
  - Eligibility: an increase or decrease in the number of an employee’s family members or dependents who may benefit from coverage under the plan.
Health FSA

Tax Treatment of Benefits

- Health FSA: employer-provided health care plan ($2,500 limit in 2013)
- Salary reduction and employer contributions to FSA are tax-free for federal income tax and FICA purposes
- If debit cards used, substantiation generally required or reimbursements may be includable in wages
Health FSA

Other Legal Requirements

- ERISA group health plan
  - COBRA (special rule)
  - Claims Procedures
  - Reporting and Disclosure Rules

- Health Plan for HIPAA privacy purposes

- Generally HIPAA “Excepted” Benefit exempt from Health Care Reform (but be careful if employer contributions)
Health Reimbursement Account (“HRA”)  

- 2002 IRS guidance establishes
- Defined contribution health plan
- No employee funding
- No choice of coverage
- May cover family expenses
- Who may participate
  - Employees, spouses, dependents
  - Not for self-employed, contractors, etc.
- Eligible expenses
- No linkage with salary-reduction plan
HRAs

The Basics

- Funded by employer only. No employee contributions, ever.
- Account generally belongs to the employer – not portable.
- Reimburses participants for medical expenses covered by Code § 213(d), including health insurance premiums.
- Employer contributions excluded from employee’s income.
HRAs

The Basics

- No maximum contribution limit (subject to normal rules of deductibility).
- No “use it or lose it” rules – amounts in HRA may be carried over year-to-year.
- Is an ERISA-covered plan. Employer contributions may be held in trust, or paid from employer's general account.
  - COBRA (unique issues in case of divorce/dependent loss of eligibility)
  - Claims procedures
- Is a Health Plan under HIPAA Privacy Rules
HRAs

Who Can Be Covered?

- Current Employees
- Former Employees
- Spouses and dependents
- Domestic partners (if fair market value of coverage is imputed to employee)
HRAs

Plan Design Flexibility

- Employer controls:
  - Timing and amount of contribution;
  - Amount (if any) that may carryover year-to-year, and any maximum on carryover;
  - Whether amounts are forfeited upon termination of employment;
  - Vesting schedule (if any) for amounts not subject to forfeiture;
  - Whether to offer with high deductible health plan (no requirement to do so).
Health Care Reform

FSAs & HRAs

- OTC Drug Reimbursements need a prescription (except insulin)
- $2,500 Limit for FSAs
- HRAs- need to consider rule prohibiting annual and lifetime limits on essential Health Benefits
  - DOL FAQs issued 1/24/2013 discuss "integrated"
- Subject to Cadillac Tax in 2018
Group Discussion
Health Care Reform: Actuarial Value
Actuarial Value

\[
\text{Actuarial Value} = \frac{\text{EHB costs reimbursed by the plan}}{\text{Total EHB costs covered by the plan}}
\]

- If a health plan is expected to reimburse, on average, 80% of the eligible EHB covered under the plan, the AV of that plan is 80%.
- An individual covered by the plan would pay, on average, the remaining 20% through plan features such as deductibles, copayments, and coinsurance.
- AV can be considered a general measure of health plan generosity – the higher the AV, the more generous the coverage provided by the plan.
Exchange Plan Options

- **Platinum**: 90%
- **Gold**: 80%
- **Silver**: 70%
- **Bronze**: 60%
Actuarial Value Calculator

- Calculator developed by HHS
  - [http://cciio.cms.gov/resources/regulations/index.html#pm](http://cciio.cms.gov/resources/regulations/index.html#pm)
- Claims data reflecting the population expected to enroll in the individual and small group markets in 2014
- HSA and HRA deposits
  - Employer HSA and HRA deposits credited to actuarial value
    - Adjusted to reflect the expected spending for health costs in a benefit year
    - Credit is only being given in the AV calculation for the amount expected to be used, on average, in the year of the contribution
  - Employee and individual HSA deposits not credited to actuarial value
Actuarial Value Calculator Results

<table>
<thead>
<tr>
<th>Provisions</th>
<th>Best Possible HSA Design</th>
<th>Typical Design with No Employer Deposit</th>
<th>Typical Design with $540 Employer Deposit</th>
<th>Sample Silver Design</th>
<th>Worst Possible HSA Design</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Deductible</td>
<td>$1,250</td>
<td>$1,250</td>
<td>$1,250</td>
<td>$2,000</td>
<td>$6,250</td>
</tr>
<tr>
<td>Er HSA Deposit</td>
<td>$0</td>
<td>$0</td>
<td>$540</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Coinsurance after Deductible</td>
<td>100%</td>
<td>80%</td>
<td>80%</td>
<td>80%</td>
<td>100%</td>
</tr>
<tr>
<td>Out-of-pocket Limit</td>
<td>$1,250</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$6,250</td>
<td>$6,250</td>
</tr>
<tr>
<td>Actuarial Value</td>
<td>85.2%</td>
<td>74.3%</td>
<td>81.8%</td>
<td>68.7%</td>
<td>58.4%</td>
</tr>
<tr>
<td>Metal Level</td>
<td>~Platinum</td>
<td>~Silver</td>
<td>Gold</td>
<td>Silver</td>
<td>Bronze</td>
</tr>
</tbody>
</table>

Notes:
- Based on 2013 HSA limits. Only employer HSA contributions count towards AV; not individual.
- For metal plans de minimis differences of +/- 2% in AV allowed.
Minimum Value

Minimum Value = \frac{\text{Costs reimbursed by the plan}}{\text{Total costs covered by the plan}}

- If an employer does not offer health coverage that has a “minimum value” (MV) of at least 60%, its employees who enroll in an Exchange plan may be eligible to receive a federal premium subsidy or qualify for reduced cost sharing.
- If a health plan is expected to reimburse, on average, 60% of the covered expenses under the plan, the MV of that plan is 60%.
- Employer could be subject to a $3,000 penalty for each full-time employee who receives subsidized Exchange coverage.
- Guidance required on the definition of minimum value.
Minimum Value Calculator

- Calculator being developed by HHS
  - Similar to AV Calculator
- Claims data reflecting the benefits offered and populations covered under large employer plans
  - Reflect the fact that large employer plans are not required to offer EHB
- Alternatives for determining minimum value
  - Design-based Safe Harbor Checklists
  - Actuarial Certification
- HSA and HRA deposits
  - Treatment similar to actuarial value
Premium Tax Credit

**Household income < 133%* FPL**
- May be eligible for Medicaid; depending on State action with Medicaid expansion
- Or may choose employer plan if available

**Household income between 133%* and 400% FPL**
- Subsidy may be available: For a family of four income up to $92,200; Single employee $44,680
- If employer plan is not available eligible for subsidized exchange coverage
- If employer plan is available but not affordable or minimum value, eligible for subsidized exchange coverage

**Household income > 400% FPL**
- Eligible for unsubsidized exchange coverage
- Or may choose employer plan if available

*138%, effectively, due to required additional 5% for Medicaid eligibility calculation*
## Limitation on Cost Sharing – 2014 HHS Proposal

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>100-150% of FPL</td>
<td>67%</td>
<td>94%</td>
<td>$2,250</td>
<td>65%</td>
</tr>
<tr>
<td>150-200% of FPL</td>
<td>67%</td>
<td>87%</td>
<td>$2,250</td>
<td>65%</td>
</tr>
<tr>
<td>200-250% of FPL</td>
<td>50%</td>
<td>73%</td>
<td>$5,200</td>
<td>19%</td>
</tr>
</tbody>
</table>

**Notes:**
- Based on variations in design to standard silver plan.
- In 2014 the maximum OOP limits are based on the projected 2014 HSA limits - $6,400/$12,800. ($6,250/$12,500 in 2013.) Indexed after 2014 at increase in market premium rates. (HSA limits indexed at CPI.)
- Limitation on cost sharing will not apply to 250-400% of FPL. Reduction in OOP will not apply.
- Proposed 2014 OOP limits higher than statutory limits to allow for inaccuracies in estimates and unique plan designs.
- Individuals between 100% and 200% of FPL may not be eligible for HSA plans on the Exchanges due to required actuarial value.
## Limitation on Cost Sharing – 2014 HHS Proposal

<table>
<thead>
<tr>
<th>Provision</th>
<th>Over 250% FPL</th>
<th>200-250% FPL</th>
<th>150-200% FPL</th>
<th>100-150% FPL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Deductible</td>
<td>$2,000</td>
<td>$2,000</td>
<td>$550</td>
<td>$150</td>
</tr>
<tr>
<td>Coinsurance after Deductible</td>
<td>80%</td>
<td>90%</td>
<td>90%</td>
<td>95%</td>
</tr>
<tr>
<td>Out-of-pocket Limit</td>
<td>$6,400</td>
<td>$5,200</td>
<td>$2,250</td>
<td>$2,250</td>
</tr>
<tr>
<td>Target AV</td>
<td>70.0%</td>
<td>73.0%</td>
<td>87.0%</td>
<td>94.0%</td>
</tr>
<tr>
<td>Actual AV</td>
<td>68.6%</td>
<td>72.9%</td>
<td>86.6%</td>
<td>93.8%</td>
</tr>
<tr>
<td>Silver</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Notes:
- Individuals under 200% of FPL will not be eligible for HSAs.
- Based on HHS estimated 2014 HSA limits.
- De minimis differences of +/- 1% in AV allowed for limitation on cost sharing.