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HSAs: Need Only the Healthy and Wealthy Apply?

Health Savings Accounts (HSAs) became available in January 2004 as part of the Medicare Prescription Drug, Improvement and Modernization Act of 2003. These accounts were designed to fix the flaws in the original 1996 Medical Savings Account (MSA) legislation — making the program permanent and available to a wider population. Since its inception, there has been a groundswell of individuals attracted to HSAs, and by most accounts that interest will grow significantly in the next few years.

Naysayers Still Exist Despite the Evidence. For more than a decade, critics of consumer driven policies have claimed HSAs would only attract healthy people and lead to adverse selection, in which some plans end up covering a disproportionate number of sick people. Adverse selection drives up premiums, making policies unaffordable. The critics also assert that wealthy people will want HSAs, but not those with lower incomes.

Results from the Industry HSA Surveys

eHealthInsurance, which markets health insurance policies from more than 140 insurers in almost all of the states, began offering HSAs on January 1, 2004. For its first year of HSA sales, eHealthInsurance reported:¹

- The average age of those purchasing HSA plans was 40, whereas the average age of purchasers of non-HSA-eligible plans was 35.
- HSAs were equally attractive to individuals and families, with individuals purchasing 51 percent and families purchasing 49 percent (37 percentage points of those families had children).
- HSAs are being adopted by all income levels; people with incomes of \$50,000 or below purchased 40 percent of the HSA-eligible plans, and more than two-thirds of HSA-eligible plan purchasers were previously uninsured for more than six months.

In addition to the eHealthInsurance data, America's Health Insurance Plans (AHIP) surveyed its members selling HSA plans and found that through September 2004 — only nine months after they became available — of the 29 AHIP member companies that responded to the survey:²

- A total of about 438,000 people had established HSAs, with 346,000 in the individual market, 79,000 in the small group market, and 13,000 in the large group market.
- Among individuals choosing HSAs, 30 percent were previously uninsured and nearly half were over the age of 40.

Finally, a new survey by Watson Wyatt and the National Business Group on Health of 555 large employers found that 8 percent currently offer HSAs, and that 18 percent plan on offering them in 2006.³

¹eHealthInsurance. "Health Savings Accounts: The First Year in Review, January – December, 2004." February 15, 2005. Please see www.ehealthinsurance.com

²Teresa Chovan and Hannah Yool, "Health Savings Accounts Off to a Fast Start in the Individual Market," January 12, 2005. Please see <http://www.ahip.org/content/pressrelease.aspx?bc=1747303>.

³"Managing Health Care Costs in a New Era: 10th Annual National Business Group on Health/Watson Wyatt Survey Report 2005," March 17, 2005. Please see <http://www.watsonwyatt.com/research/render.asp?id=w-821&page=1>.

Clearly the recent HSA survey data prove the critics wrong. Middle-aged workers are more likely to choose an HSA, and lower-income workers often choose HSAs when given the chance. But it is also important to understand why the naysayers' arguments are so flawed.

High Deductibles and Adverse Selection.

Healthy people tend to want less-expensive policies that may have high deductibles or provide fewer benefits. People with medical conditions tend to want lower deductibles and more benefits to reduce their out-of-pocket exposure.

Because HSA plans come with high deductibles, critics claim that HSAs will only attract healthy people, leaving a disproportionate number of sick people in traditional insurance — and forced to pay very high premiums because the healthy people have switched to HSAs.

However, the criticism overlooks two important facts:

- People often switch to higher deductibles with auto or homeowners insurance, and no one claims that will destroy those markets.
- The role played by the Health Savings Account.

HSAs Reduce the Out-of-Pocket Cost of High-Deductible Plans.

An HSA is a savings account controlled by the insured person and used to pay for smaller and routine health care expenses below the deductible. The HSA law requires that account holders have a high-deductible health insurance policy to cover catastrophic medical costs such as prolonged hospitalization or a particularly unhealthy year.

HSA's reduce the out-of-pocket exposure of a traditional high-deductible policy because people can use money in their tax-free HSA, which is usually funded all or in part by the employer, to pay the costs below the deductible.

For example, an employer may provide employees with a \$3,000 deductible health insurance policy, while depositing \$2,000 in the tax-free HSA. [Note: the cost of HSA-eligible plans, including the HSA contribution, is often less expensive than a traditional insurance policy with a low deductible, which also makes them attractive to employers.]

The first time the employee needs medical care or prescription drugs, the money in the account is used to pay for it. The employee pays nothing out of pocket until the \$2,000 in the HSA has been exhausted. After spending the next \$1,000 out of pocket, in this example, the health insurance would kick in.

Under a traditional health insurance policy, by contrast, the employee might have a \$500 or \$1,000 deductible — with no HSA. The first time the employee or a covered family member goes to the doctor, the employee has to pay those costs out of pocket, up to the \$1,000 deductible. In other words, the employee has to spend \$1,000 out of pocket for each family member before insurance pays a dime.

Workers Are Doing the Math. So, under which plan does a sick person do better? Most will say it's the plan that provides the first \$2,000 to pay for care.

The fact is that middle-aged families — which, on average, are more likely to have higher health care bills than young workers — are choosing HSA plans, just as the eHealthInsurance and AHIP data show. And it isn't a mystery why: they're simply doing the math.

Are HSAs Only Attractive to the Wealthy? Clearly the data prove the answer is no, but again it is important to understand why.

An employer contribution of \$2,000 to an HSA is equal to 10 percent of a \$20,000-per-year worker's income; but it is 2 percent of a \$100,000-per-year household.

Assume both families spend \$1,000 from their HSA during the year, and so have \$1,000 left over. That's 5 percent of a lower-income worker's salary — a significant year-end bonus — which can roll over to the next year and grow with interest tax free. When combined with the \$2,000 deposited the next year, meaning there would be \$3,000 in the HSA, the family would effectively face no out-of-pocket costs, even if there were a number of health care related expenses that year.

Higher-income families can generally afford an extra \$500 or \$1,000 in unexpected medical or dental bills. Lower-income families can't, which is why HSAs are attractive to lower-income people — just as the data show.

One might counter that the self-employed have to fund the HSA out of their own pocket, there being no employer to fund it for them, making it likely that *they* would have to have higher incomes in order to have the additional funds to put in the HSA. However, the self-employed tend to be middle-class workers and not the wealthy, and thousands of them are switching to HSAs.

Getting the Incentives Right. There is also a reason why society benefits from HSAs. What HSAs accomplish is to change consumer behavior. They give consumers a reason to be value-conscious shoppers in the health care marketplace. They give patients a reason to discuss with their doctors both their medical options and the costs of those options. Do they want to try ibuprofen for \$5 or a brand name pain killer for \$80? If someone else is paying the bill, it makes little difference. If the money is coming out of the patient's HSA, he or she has a strong incentive to weigh the costs and benefits of each health care choice and to pay close attention to the doctor's recommendations.

When patients are paying more attention to the cost of health care and demanding value for their dollars, total health care spending will decline. And when spending declines, health insurance will be much more affordable, which will reduce the number of uninsured.

HSA Critics Haven't Been Right Yet. Critics have been predicting for more than a decade that HSAs — and their predecessor, MSAs — would destroy the health insurance market. They were wrong then; they are wrong today. It is time for the critics to look at the data and abandon their doomsday warnings. HSAs are here and they are doing very well, and they are changing the way people think about and shop for health care.

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