Why HRAs may work better than HSAs for School Districts, Counties, Cities and Other Local Governmental Employers

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Trend: High-Deductible Health Plans in governmental organizations.

School districts, counties, cities and other governmental employers around the country are moving toward High-Deductible Health Plans (HDHPs) to help cut Health Insurance spending. Many of these HDHPs are offered with a Health Savings Account (HSA).

At National Insurance Services (NIS), our clients throughout the country have found Health Reimbursement Arrangements (HRAs) to be a better fit than HSAs for their employees, regardless of the plan design or insurance carrier they choose. This white paper will help you understand the advantages of an HRA over an HSA.

In a nutshell: the differences.

An HRA is very similar to an HSA. Both plans allow employers to deposit funds on behalf of the employee. Both plans help increase an employees' personal responsibility for the financial side of health care decisions. Both plans are designed so that funds carry over year-to-year including post-employment and retirement. And both plans earn interest tax-free and are used tax-free for qualifying medical expenses.

However, there are many subtle differences between the two plans. Once you understand these differences, it will become clear that the HRA far outweighs the HSA in terms of benefits to administrators, boards and employees.

Common myths about HRAs

There is a lot of misinformation in the marketplace about HRAs. After implementing HRAs in over 523 public sector organizations in seven states since 2002, NIS' experience with HRAs has proven beneficial for employers seeking information.

Myth:
HRA funds do not carry over from year-to-year

Fact:
When you use one of our funded HRAs, the unused funds can carry over year-to-year, even into post-employment. The carry-over amount can be customized to meet your particular circumstances. For example, your plan could stipulate that all the unused funds or just a portion of the unused funds will carry over. Customizing your plan in this way is as simple as checking a box on the implementation form.

Myth:
HRAs cannot earn interest

Fact:
Funded HRAs earn interest. If an HRA is funded through a trust or VEBA, the HRA funds can be held in an interest-bearing account, with interest allocated to participants' HRA accounts based on their balances.

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HRA (Health Reimbursement Arrangement)	HSA (Health Savings Account)
Employer can contribute (Employee can still contribute to a full medical FSA)	Employee and Employer can contribute (Employee can only use FSA for dental and vision expenses)
Can be used with any type of Health Insurance plan design	Can only be used with an IRS-qualified High-Deductible Health Plan (HDHP)
All employees and retirees can participate	Some employees are not eligible to participate
Employer has the option to share in a portion of the unused funds	Employer cannot share in any portion of unused funds
Employee and Retiree can use the funds for Medical Insurance premiums	Typically, Retiree cannot use the funds for Medical Insurance premiums, except in limited circumstances
Fixed-interest accounts	Individual bank accounts earning negligible interest (fees often surpass the earned interest)
No conflict of interest with the Medical Insurance provider	Potential conflict of interest if the Medical Insurance carrier also provides the HSA

But what about employee contributions to HSAs?

Although HSAs allow for employee contributions and the HRA does not, the employee HSA contribution comes at the expense of eliminating contributions to a FSA plan for medical expenses. Studies have shown that when an employer makes a contribution to a HSA, employees tend not to. And for those that do, the average contribution is less than they had previously contributed to the FSA. The HRA allows the employee to continue to make contributions to the FSA plan and new rules allow up to $500 annually to be carried over.

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Six reasons the HRA may work better than the HSA for Schools, Counties, Cities and other local governmental employers.

1. HRAs have no restrictive plan design requirements.

An HSA, according to IRS rules, must be used in conjunction with an HSA-qualified HDHP. Currently, an HSA-qualified HDHP is defined as requiring a $1,250 single plan deductible/$2,500 family plan deductible or higher. For an explanation of the differences between an HSA-qualified HDHP and a traditional increased-deductible plan, see Appendix A on page 7.

With an HRA, you are free to mold and shape a plan that works for your group. Any plan, no matter how high or low the deductible, can be used with an HRA. Additionally, there are no contribution limits. See Case Scenario #1 on page 6.

2. With HRAs, all employees are eligible to participate.

HRAs are open to everyone, both employees and retirees. HSAs are more limited. For example, an employee is generally prohibited from participating if they are also covered by a spouse's non-qualifying HDHP or non-modified Flexible Spending Plan.

This eligibility problem can also affect the actualization of the projected savings. Why? Because those employees (usually 15% or so) who are also covered by a spouse's non-HDHP or non-modified FSA must drop their spouse's coverage in order to participate. This, in turn, creates higher claims for those who were using two plans in the past; thereby, increasing claims on your new plan. More claims equal higher rates. Anticipated savings may be reduced or lost.

3. HRAs have carry-over flexibility that allows employers to save more.

With the HRA, you have options. For example, if a balance remains after the plan year, you can design your plan so that the employer shares in a portion of the unused funds. See Case Scenario #2 on page 6.

With an HSA, once the employer provides the contribution, there is no opportunity to share in the unused funds.

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4. HRAs can be used for Medical Insurance premiums.

One of the disadvantages of HSAs is that funds can generally **only** be used for eligible health care expenses like deductibles, co-pays, prescription drugs, eyeglasses, dental expenses and other medical expenses. While the HRA can be used for these same expenses, **funds can also be used tax-free to reimburse Medical Insurance premium payments**. In fact, eligible HRA premium payments include Retiree Health, Dental, Vision and Long-Term Care Insurance, as well as Medicare B, C, D and Medicare Supplements. Accumulated HRA balances may make it easier for employees to afford to retire since Medical Insurance is one of the barriers to early retirement.

5. HRAs generally have no conflict of interest.

Often, Medical Insurance carriers offer an HSA plan in combination with their HDHP. While there are advantages to this scenario, there are disadvantages too. For example, whenever you change insurance carriers you may be leaving a trail of HSA accounts behind. Using an HRA that is not tied to any carrier may give you more flexibility to change insurance carriers. Additionally, you may be able to better evaluate the plan's costs and savings if your HRA is administered separately.

6. HRAs give you local plan control.

There are no board of directors or other cumbersome governance to restrict your flexibility with an HRA. Your plan reflects what has been agreed to between employer and employee.

Bonus: Increased responsibility for health care choices.

Americans are savvy consumers of almost everything except healthcare. This lack of consumer awareness creates runaway claims that drive premium increases. With an HRA, employees feel an increased sense of personal responsibility for their healthcare choices that may drive down claims, bending the cost curve.

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Case Scenario 1: Indiana School Corporation

An Indiana School Corporation needed to cut costs on their current health insurance plan that featured a $200 family deductible with a $1,000 out-of-pocket maximum.

A HDHP with HSA option was available that brought the family deductible up to $4,000 with an $8,000 out-of-pocket maximum. The savings would have allowed the corporation to offer $1,500 toward an HSA and still save 12% on their Health Insurance.

The HDHP with HSA failed because there was little interest. The significantly higher deductible exposure, out-of-pocket maximums, as well as the IRS-mandated plan design were all met with opposition.

So, they tried again. This time they proposed a smaller leap from their current plan: a $1,000 family deductible plan with a $4,000 out-of-pocket maximum packaged along with the same $1,500 employer contribution, except in an HRA instead of an HSA. The result? A voluntary agreement between the employer and employee groups!

In the end, the corporation saved 7% ($160,000) and because the employees paid 25% of their insurance premium cost, the employees also saved over $600 in paycheck deductions and enjoyed a $1,500 HRA to fund their deductible and any out-of-pocket costs.

Case Scenario 2: Wisconsin School District

A Wisconsin district's $0 family deductible health insurance plan was experiencing annual 20% increases.

In an attempt to lower costs, the district brought in new carriers every one to two years hoping the competition would drive down the price. It was a lot of work with minimal success.

The district considered a HDHP with HSA but knew that the switch to an IRS-defined $2,500 deductible plan would not go smoothly. And once it became known that prescription drugs would not be covered until the entire family deductible was met, outspoken opponents came forward.

Then they found out about HRAs and how flexible the plan design can be and shared this with their employee groups. The result was a voluntary agreement to increase the deductible on the current family plan to $2,000, leaving much of the prescription drug plan the same.

This saved the district enough to fund each HRA with $2,000. They further agreed that any unused HRA funds at the end of the plan year would be split 80/20 between participant and employer (this would not be possible using an HSA).

At the end of the first year, 20% of employees with chronic diseases and health situations maxed out the $2,000 deductible but were able to use their $2000 HRA fund to cover their costs. For those who did not max out the deductible, they carried over as much as $1600 (80% of $2,000) to be used in future years including post-employment retirement.

The school district's share of the carry over averaged $440 per employee, and the increased consumer-minded spending lead to renewals of less than 4% over the next four years.

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Appendix A

Four things you should know before you implement a HDHP with an HSA

An IRS-defined HSA-qualified HDHP is not a typical insurance plan with just an increased deductible. Some of the major differences are listed below.

	Traditional Health Insurance Plan	Typical HSA-qualified HDHP
Deductibles	With a family plan, if one person in the family meets a defined amount, the plan will begin to pay for that person even if the entire family deductible has not been met.	With most HDHPs, families must meet the entire deductible before the plan will begin to pay for any individual family member. (Exception: The family plan can be written with a $2,500 "embedded" single deductible.)
Prescription Drugs	A portion of the cost of the prescription drug is covered regardless of whether the individual has met the deductible or not.	Prescription drugs are generally not paid for until the entire deductible is met.
Eligible Participation	Some (usually 15%) of your employees participate in both your health plan **and** their spouse's plan. This benefits employers because these employees have lower claims; therefore, the organization has lower premiums.	Participants who are also covered by a spouse's non-HDHP or non-modified FSA, are not eligible to participate in an HSA. This may results in more claims on your plan and increased premiums. Anticipated savings may be reduced or lost.
Plan design is outlined by IRS rules	IRS rules are more flexible. Plan can be custom designed to fit the agreement between employee groups, boards and administrators.	The IRS rules are more rigid with regard to plan design.

A funded HRA works much the same way as an HSA, but it does not require an IRS-defined HDHP. Therefore many of the issues listed above may be avoided.

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