

Stepping Carefully: Avoiding Legal Traps and Pitfalls in HSA Implementation and Administration

The Consumer Driven Healthcare
Summit

September 14, 2006

Agenda

- **A Little Background on CDHC**
 - FSAs, HRAs, and HSAs
 - Impact on health care delivery
- **HSA Compliance Issues and Hurdles**
 - A primer on HSAs (and why they are different)
 - HSA implementation traps

Components of Consumer Driven Health Care

- Sensitize health care consumers to real cost of health care by shifting financial responsibility
 - Provide an account (HSA/HRA)
 - Reduce 100% coverage and co-pay arrangements
- Educate consumers as to relative value/quality of health care providers and services
- Preserve negotiated network/discount arrangements

Types of Consumer Driven Healthcare Vehicles

- FSA (Flexible Spending Arrangement) – Proposed 125 Regulations
 - Highly regulated (eligibility, taxation and use)
 - Nominal
 - Adjudicated
 - Time-restricted
- HRA (Health Reimbursement Arrangement) – IRS Rev. Rul. 2002-41 and Notice 2002-45
 - Flexible within limits
 - Nominal
 - Adjudicated
- HSA (Health Savings Account) – Section 223 of Tax Code and Guidance
 - Eligibility and taxation regulated, but use flexible
 - Real Accounts
 - Non-adjudicated

Impact of CDHC on Health Care Delivery

- **Employer/Plan Sponsors**
 - Employee perception (is this a takeaway)?
 - Will CDHC really reduce health care costs/utilization?
- **Health Care Providers**
 - Employees will have choice . . . what will this do to my accounts receivable ?
- **Health Insurers**
 - Do I have product that qualifies ?
 - What ancillary services do I want to offer (trust, education tools, access tools, etc) ? With whom ?
 - What is the adverse selection and impact on cash-flow ?
- **Financial Institutions**
 - Will there be money to manage? . . . If not, how can revenue be generated (account and interchange fees) ?
 - Can we get another entity to do HSA customer service, account reconciliation/maintenance, etc. ?

HSA_s

A Guide to Avoiding Implementation Traps for Employers, Trustees and Health Plans

Trap #1: ERISA (And How to Avoid It)

- ERISA Headaches
- HSA Product Availability Issues
 - Will custodian/trustee service an ERISA plan?
- DOL Guidance (Applicability)
- Steps to Avoid ERISA
- Additional Issues and Questions (to think about)

ERISA Headaches

- Headaches if ERISA applies . . .
 - Form 5500
 - SPD and Plan Document
 - COBRA ??
 - Code's COBRA provisions do not apply but ERISA (DOL) may
 - HIPAA Privacy issues
 - Claims procedures
 - Generally, claims are self-adjudicated
 - Fiduciary Requirements
 - Code's Prohibited Transaction Rules apply whether ERISA's prohibited transaction rules apply or not

ERISA Applicability

- Prior to April 7, 2004, no guidance issued by DOL on either MSAs or HSAs
- Original view was that HSAs would be treated like IRA's
- IRAs that satisfy the following four "Safe Harbor" conditions are not subject to ERISA:
 - No contributions are made by the employer
 - Pre-tax contributions are employee contributions for DOL purposes
 - Participation is completely voluntary
 - The employer does not endorse the program (but can publicize the program and collect contributions via payroll deduction)
 - The employer receives no consideration other than reasonable compensation for services actually rendered (Labor Reg. 2510.3-2(d))
 - Same requirements apply to voluntary group insurance

ERISA Applicability

- DOL issued Field Assistance Bulletin (“FAB”) 2004-1:
 - Establishes “safe harbor”
- DOL found that employer contributions were less significant in determining whether ERISA applies to HSAs so they tweaked the safe harbor to allow for employer contributions without triggering ERISA

ERISA Applicability

- **Revised Safe Harbor for HSAs**
 - Employers may contribute to an HSA without triggering ERISA so long as the employer satisfies all of the following conditions:
 - Participation is completely voluntary
 - No restrictions on account holder's ability to move funds to another HSA trustee
 - Allows employer to limit its contributions to 1 HSA trustee or a specified group of HSA trustees
 - No restrictions on use of funds other than *those permitted by code*
 - Does not make or influence investment decisions
 - No “endorsement” by employer
 - Does not receive *any* payment or compensation

Steps to Avoid ERISA

- Include clear disclaimer regarding HSA status as an individual financial account – NOT an employer sponsored benefit plan
 - Review vendor materials
 - Review enrollment materials
 - Carefully draft HSA summaries
- Do not impose limitations on HSA portability
- Be wary of implementing distribution restrictions
- Ensure no outside compensation to employer related to HSA

ERISA: What About . . .

- Employer limits payroll to single HSA option
- Employer contracts with HSA vendor to restrict debit card withdrawals to medical expenses
- Employer pays HSA custodial fees to selected vendor(s)
- Employer is itself an HSA custodian/trustee and uses its own product
- Employer is offered “incentives” on ERISA products (e.g., health coverage) for selecting HSA custodian/trustee

Trap #2: Discrimination Traps

- Tests Applicable to HSAs
 - Comparability
 - Application of the cafeteria plan exception
 - IRS guidance on comparability rule

HSA Comparability Rule

- What is the HSA “*Comparability Rule*”?
 - Failure to comply results in excise tax on aggregate amount of contributions made by employer during the year
 - If an employer makes contributions to an individual’s HSA, it must make contributions for all “comparable participating employees” and the contributions must be
 - The same amount or
 - The same percentage of the HDHP deductible
 - Comparable participating employees are the following employees with HSAs who have the same level of HDHP coverage (e.g., single/family)
 - Part-time employees
 - Full-time employees
 - Certain Former employees
 - Employer may restrict HSA contributions to those who participate in the Employer’s HDHP

HSA Comparability Rule

- What is the “*Comparability Rule*”?
 - If an employer makes contributions to an individual’s HSA, it must make contributions for all “comparable participating employees” and the contributions must be
 - The same amount or
 - The same percentage of the HDHP deductible covering the employee
 - Comparable participating employees are employees with HSAs who have the same level of HDHP coverage (e.g., single/family)
 - Part-time employees are measured separately
 - Employer may restrict HSA contributions to those who participate in the Employer’s HDHP
 - Failure to comply results in excise tax on aggregate amount of contributions made by employer during the year

HSA Comparability Rule

- Comparability rule requires employers to actually make “comparable” contributions during calendar year but “comparable” contributions determined on a monthly basis
 - Rule looks at amount actually contributed (not just amounts “made available”)
 - Allows variations based on service during the year so long as everyone received the same monthly pro-rata amount
 - Employer agrees to contribute \$100 per month to employees’ HSAs. Employee A is employed the entire calendar year and receives \$1200 in HSA contributions. Employee B is only employed for 3 months and receives \$300 in HSA contributions.
 - Although A and B received different total amounts for the year, they received the same pro-rata monthly amount (\$100)

HSA Comparability Rule

- Comparability rule **DOES NOT APPLY** to HSA contributions “made through the cafeteria plan”
 - When are contributions “made through the cafeteria plan”?
 - Presumably employer contributions are considered made through the cafeteria plan if “but for” test satisfied.
 - *But For Test*: The employer contributions to the HSA would not have been made but for the employee’s pre-tax salary reduction election under the cafeteria plan

HSA Comparability Rule

- Effect of comparability rule on
 - Matching contributions (e.g., employer agrees to make an HSA contribution up to a specified amount equal to the employees' HSA contributions)
 - Impermissible generally
 - Comparable employees will receive different matching amounts if they elect to contribute different amounts
 - However, permissible if “made through the cafeteria plan”
 - E.g., Employer agrees to make an HSA contribution equal to the employees' pre-tax salary reduction HSA contributions
 - HSA as bonus or incentive for participating in disease management or health assessment
 - Impermissible generally under comparability rule
 - Permissible if made through the cafeteria plan

HSA Comparability Rule

- **Other Recurring Issues and Concerns**
 - No CBA exception to Rule
 - PT/FT
 - Part year employees
 - Last day of year vesting rule prohibited
 - Family coverage (plus kids issue)
 - What if HSA is never opened
 - What if opened with “other” trustee ?

Trap #3: Non-Qualifying HDHP

- **What is a Qualifying HDHP ?**
 - Deductible carryover rule
- **Benefits below HDHP deductible**
 - The “Three P’s”
 - Rx coverage and transition rule (or lack thereof)
 - What is “preventive care” ?
 - IRS Grace Period Guidance and Notice 2005-86

Trap #4: Disqualifying Coverage

- **General Rule**
 - No coverage below deductible except for “three p’s”
- **Traps for the unwary participant**
 - Employee “plus kids” issue under “family coverage” rule resolved favorably in Rev Rul 2005-25
 - FSA coverage
 - Impact of carryover and IRS Notice 2005-86
 - Executive medical (other than preventive)
 - Employer sponsored clinics
- **What to do if an employee for whom contributions have been made is ineligible ?**
 - Handling excess contributions
 - Permissibility of recoupment

Trap #5: Distribution Traps

- Impact of timing of HSA establishment on eligible expenses
 - HSA must be established BEFORE medical expenses are incurred
 - Enrollment glitch for 2005 and beyond
- Withdrawing funds before/in excess of eligible expenses
 - Repricing dilemma and putting funds back in an HSA
 - Can expenses and distributions be “netted” ?
 - Year-end traps

Trap #6: Integration With Cafeteria Plan

- What cafeteria plan rules apply ?
 - Code Section 125 non-discrimination rules
 - Modified election rules apply
 - HSA salary reduction election may be changed at any time for any reason so long as the change is not effective sooner than the first day of the month following the date the election change is made
 - IRS has hinted that monthly election changes **MUST** be allowed
 - Cafeteria plan election allowed mid year to add HSA
 - Changes to other benefits (such as Health FSA) only permitted if otherwise allowed under Section 125 (or the plan)
 - Negative elections permitted
 - Issues with FSA coverage
 - Carryover traps

Trap #7: Employee Cash-flow Concerns

- HSA funds generally only available once deposited
- Coverage can be “accelerated” under cafeteria plan
 - Employer may advance amounts up to employee’s salary reduction amount so long as the following conditions are satisfied:
 - Advances equally available to all other participants
 - Employee repays employer
- HSA-related loans
 - HSA cannot be security (deemed distribution)

Trap #8: Prohibited Transaction Rules

- Tax Code (as well as ERISA) prohibits most transactions between a plan (*i.e.*, the HSA) and a disqualified person (*e.g.*, any HSA service provider)
- Exception exists for necessary service provided for reasonable compensation
 - Disclosure issues
- Application to
 - HSA vendors paying for services
 - HSA vendors paying a referral fee
 - Alliance arrangements between carriers, TPAs, and financial institutions

Trap #9: HSA Structure (No Commingling)

- What is an HSA “*Qualified Trust*”?
 - Created in the United States
 - Only receives cash (except Rollover Contributions)
 - Maximum annual amount that the trustee can accept for any HSA is \$5250 + applicable additional contribution for those age 55 and older
 - The Trustee is a “*Qualified Trustee*”
 - No part of the trust assets is invested in life insurance contracts
 - Investments limited to those investments that would otherwise be permitted for an IRA
 - The assets of the trust are not commingled with other property except in a common trust fund or common investment fund
 - The assets of the account are non-forfeitable
 - This requirement prohibits restrictions on HSA distributions by contributing employers?

Trap # 10: Other Compliance Concerns

- HIPAA Privacy
- COBRA and HSAs
- Federal Tax Reporting
 - Helpful guidance in Form 969
 - HSA Participant
 - Must File Form 1040 (1040A and 1040EZ not allowed)
 - Form 8889
 - Trustee/custodians
 - Form 5498
 - Form 1099-SA
- State income and employment tax issues

Addendum

Basics of Consumer Driven Vehicles

Health Flexible Spending Accounts

- FSA (Flexible Spending Arrangement) – Proposed 125 Regulations
 - Typically funded with employee pre-tax salary reductions (but sometimes subsidized with employer contributions)
 - Open Plan Design
 - Not required to be offered with any other particular type of coverage
 - Employer has discretion to determine eligibility
 - Typically a notional account (funding works like an ASO)
 - Claims paid from employer's general assets
 - Claims substantiation required/distributions restricted to medical expenses
 - *Use-it-or-lose-it rule applies (no carryover)*
 - Promotes unnecessary spending at the end of the year
 - IRS has recognized limited 2 ½ month “grace period”
 - Regulatory compliance (ERISA, COBRA, HIPAA, tax rules)

Health Reimbursement Arrangements

- HRA (Health Reimbursement Arrangement) – IRS Rev. Rul. 2002-41 and Notice 2002-45
 - Employer-funded reimbursement account
 - Employee pre-tax contributions not permitted
 - Open plan design
 - Not required to be offered with any other particular type of coverage
 - Nevertheless, often offered with a plan with a “higher” deductible
 - Employer has discretion to determine eligibility
 - Generally a notional account (funding works like an ASO)
 - Claims paid from employer’s general assets
 - Claims substantiation required/distributions restricted to medical expenses
 - Unused funds may carry over
 - Participants have incentive to use HRA wisely in order to limit out of pocket expenditures in the future
 - Contrast to Health FSA use it or lose it rule
 - Regulatory compliance (ERISA, COBRA, HIPAA, tax rules)

Health Savings Accounts

- HSA (Health Savings Account) – Section 223 of Tax Code
 - Individual account funded by anyone (employer, family member, your speaker)
 - Restricted plan design
 - Can only be offered to those with qualified high deductible health plan and generally no other non-high deductible health coverage
 - Compare and contrast to Health FSA/HRA
 - Any “Eligible Individual” may establish HSA
 - Tax-advantaged IRA-like trust
 - No claims substantiation / distributions allowed for any purpose
 - More relaxed regulatory compliance (ERISA, COBRA, HIPAA?)