

## Healthy, Wealthy and Wise

*As more and more affluent clients start managing their medical costs, advisors may be asked to provide a second opinion on the choices.*

By Donald Jay Korn

April 1, 2007- Shopping might be considered the great American pastime. So why not shop around for the best medical treatment at the best price?

Such reasoning is increasingly becoming reality. So-called consumer-directed health plans (CDHPs) tripled in 2006, according to the *National Survey of Employer-Sponsored Health Plans* from Mercer Health & Benefits. The actual numbers may look scant--6% of all employers offer such a plan, and 3% of all covered employees are enrolled in such plans--but the growth of these plans is impressive.

What's more, 37% of "jumbo employers" (those with 20,000 or more employees) already offer CDHPs. As more employers offer these plans, clients may ask planners' advice on enrolling. In addition, self-employed clients and those who are employers may want to evaluate these plans for themselves and for their employees.

CDHPs usually come in one of two forms: Health Savings Accounts (HSAs) or Health Reimbursement Arrangements (HRAs). Both generally begin with high-deductible health insurance. Because coverage won't kick in until the insured individual or family has spent a considerable amount out of pocket, patients may become consumers of healthcare, shopping carefully and spending sparingly.

"To have an HSA, you must own an eligible high-deductible health insurance policy," says Bill Steffen, who has a financial services firm in Bradenton, Fla. In 2007, a policy's deductible must be at least \$1,100 for individual coverage and at least \$2,200 for family plans. Out-of-pocket costs, including copayments and the deductible, can't be more than \$5,500 for individuals or \$11,000 for families. (Deductibles and maximum outlays rise each year to keep up with inflation.)

"An HRA is a different animal," says Tracey Baker, vice president of Cooper, Jones & McLeland, a financial planning firm in Fairfax, Va. In theory, HRAs may be combined with any type of health insurance. But as a 2006 report from the U.S. General Accountability Office (GAO) put it, "Although employers are not required to couple an HRA with a high-deductible health plan, in practice the two are typically combined." As Baker points out, HRAs are entirely employer-funded, which might explain why low-cost, high-deductible policies are favored.

Using numbers from 2004, the GAO found that employers commonly contribute \$500 to \$750 annually for individual HRA coverage and \$1,500 to \$2,000 annually for family HRAs. After employees spend those amounts on healthcare, they are usually responsible for paying a bridge amount out of pocket before reaching their deductible. In 2005, bridge amounts averaged \$1,078 for individuals and \$2,130 for families.

So, in determining if CDHPs are suitable, planners should start by evaluating whether high-deductible coverage makes sense. Raising the deductible lowers the premium, but is the savings enough to justify the added cost before the policy pays benefits?

"That often depends on how someone is using health benefits," says Baker, co-author of *Navigating Your Health Benefits For Dummies*, sponsored by a partnership between Aetna and the Financial Planning Association. "If someone has a chronic illness and is likely to use up the deductible each year, a high-deductible health plan may not make sense. For someone who is very healthy, such plans might make perfect sense."

The GAO reached similar conclusions in another report on HSA-eligible health plans published last year. After studying employer plans, the GAO found that HSA-eligible plan enrollees would incur higher annual costs than enrollees in traditional preferred provider organization (PPO)

plans for extensive use of healthcare, but would incur lower annual costs than PPO plan enrollees for low to moderate use of healthcare.

## A HARD SELL

High-deductible policies are often suggested for other forms of insurance (auto, homeowners), and some planners feel this logic should apply to healthcare. "You don't need insurance to pay for door dings on your car, so you shouldn't rely on insurance for small medical bills," Steffen says. "You can save huge amounts in premiums if you buy pure health insurance. It's like buying term life insurance."

Nevertheless, high-deductible health insurance is by no means an easy sell. "People have grown up with upfront benefit plans for healthcare," Steffen says. "They love cheap doctor visits. However, those lower-deductible policies may give up more on the back end, with higher out-of-pocket limits."

Comparisons with home and auto insurance might not be precise, at least when it comes to client perception. "A consumer might go five or 10 years and never use the benefits of those types of insurance," Baker says. With a high-deductible health plan, it's more common to pay for some services that would have been covered in a lower-deductible plan.

"Some people hate the idea of paying \$60 for a doctor visit that might have cost only a \$20 copay with a traditional plan," says John Starling, head of a financial services firm in Little Rock, Ark. "I respond that they're paying \$250 or \$300 a month less for insurance--a good tradeoff." In fact, the GAO found that HSA-eligible plan premiums averaged 35% less than traditional premiums for single coverage and 29% less for family coverage.

"My client was paying \$1,100 a month for coverage for a group plan with a \$500 deductible," Starling says. "He owned the company so he was paying the full amount. Not only was he paying over \$13,000 in premiums, his total exposure was around \$20,000 a year, counting the deductibles, coinsurance and copayments."

This client switched to an HSA-eligible policy from Golden Rule Insurance in Indianapolis that costs only \$300 a month, with a \$5,650 deductible. "The premium savings are \$800 a month, or \$9,600 a year," Starling says. "His out-of-pocket exposure is thousands of dollars lower too."

Starling concedes that this was an unusual situation because unhealthy individuals had pushed up the group rate. "Generally I see families saving around \$300 a month--\$3,600 a year--in premiums by going from a traditional plan to high-deductible health insurance," he says.

When evaluating such plans, advisors should realize that high-deductible policies that do not comply with the HSA rules might cost less than HSA plans. "The Treasury Department has held down the maximum out-of-pocket costs for HSA plans," says Bob Hurley, vice president of strategic initiatives at eHealthInsurance, an online health insurance agency based in Mountain View, Calif. "That's been the primary driver of the higher costs for HSA policies." That is, some other high-deductible plans leave consumers exposed to greater outlays for medical bills, so their premiums are lower than those that are HSA compliant.

In Los Angeles, for example, eHealthInsurance reports that a family of four might pay \$291 a month for an HSA-qualified plan with a \$6,000 deductible and a \$10,000 out-of-pocket maximum. For a plan that's not HSA qualified (with the same \$6,000 deductible but with a \$14,000 out-of-pocket cap), that family might pay \$253 a month.

An HSA-compatible policy can certainly cost the same or less than a non-HSA plan. "You have to compare health plans with the same benefits and out-of-pocket limits," says Richard Collins, CEO of Golden Rule Insurance Co. in Indianapolis. "Otherwise, you're comparing apples to oranges." He adds that a comparison between HSA and non-HSA plans also should consider the tax savings offered by HSAs. Owners of these accounts may get upfront deductions, tax-free investment earnings and tax-free withdrawals for qualified healthcare expenses.

"The IRS list includes opportunities for large medical, dental and vision expenses," Steffen adds. "Items such as braces, lasik eye surgery, maternity, fertilization, acupuncture,

chiropractor services, Medicare Part B premiums, long-term care insurance premiums, home nursing needs, dental care, eyeglasses, contact lenses, over-the-counter drugs and even band-aids are considered eligible expenses."

Moreover, a law passed last year expands the opportunities for clients to build up their HSAs. In 2007, the maximum contribution is \$2,850 for anyone with an individual HSA and up to \$5,650 for family plans. Previously, the contribution limit was capped by the size of the deductible.

Suppose that John Jones has an HSA-eligible family plan with a \$2,500 deductible. For 2006, John's maximum contribution was \$2,500. (Contributions can be made until April 17, 2007.) This year, John can put \$5,650 into an HSA and deduct \$5,650 on his tax return. If he is 55 or older, he can contribute an extra \$700 for 2006 and \$800 for 2007.

HRAs also offer tax benefits. In a 2002 Revenue Ruling, the IRS affirmed that employer contributions to HRAs are not taxable income to employees. HRA account balances can accumulate from year to year, without "use it or lose it" pressure. But HRAs are typically not portable--employees do not own the accounts and cannot retain unspent funds when they change jobs. "Employees may be able to roll an HRA to a Retiree Reimbursement Account," Baker notes, which can pay for healthcare in retirement.

Even though people can't contribute to an HSA once they reach age 65, those accounts may also serve retirees. The GAO found that about 45% of tax filers reporting HSA contributions noted that they withdrew funds that year, indicating that 55% aren't using HSAs for current spending. They seem to be letting HSAs accumulate, untaxed, for future needs.

"Healthcare expenses will be a serious issue for many retirees," Baker says. If an HSA has grown to thousands of dollars, that account can be tapped, tax-free, to pay some medical bills not covered by Medicare or other health plans.

"Another strategy is to treat an HSA as an IRA after age 65," Steffen says. "At that age, the 10% penalty on premature distributions no longer applies, so money can be used for purposes other than healthcare. Nonqualified distributions are subject to income tax, but the money will not go unused."

## RESEARCH REQUIRED

According to the GAO, enrollees in HSA-eligible plans generally had relatively high incomes: 51% of tax filers reporting an HSA contribution had an adjusted gross income of \$75,000 or more, compared with 18% of all filers under age 65.

HSA owners may be healthy and wealthy, but they don't seem to be serious healthcare shoppers, at least not yet. "Few participants reported researching cost before obtaining healthcare services, although many researched the cost of prescription drugs," the GAO asserts. As CDHPs spread and information on medical costs becomes more available, that may change. For now, clients in these plans will have to be satisfied with lean premiums and invigorating tax breaks.

*Senior Editor Donald Jay Korn has been writing about investments, and tax and estate planning for Financial Planning since 1985.*

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