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Health Reform Provisions that Could Impact Consumer-Driven Health Plans

The Health Care Reform legislation approved by the 111th Congress (H.R.3590, now Public Law 111-148, as amended by the budget reconciliation bill, H.R.4872) will likely have a modest impact on consumer-driven health plans and their associated health care accounts (i.e., Flexible Spending Account's (FSA's), Health Reimbursement Account's (HRA's), Health Saving Account's (HSA's) and Archer Medical Saving Account's (MSA's)). Earlier proposals that would have eliminated some of these options (particularly FSA's and HRA's) did not survive the legislative process. Below is a description of the provisions that were included in the final legislation.

Changes Impacting All Health Care Accounts (FSA's, HRA's, HSA's & Archer MSA's):

Over-The-Counter Prohibited: P.L. 111-148 includes a change in the definition of a "qualified medical expense" that impacts reimbursements and withdrawals under all types of health care accounts (i.e., FSA's, HRA's, HSA's & Archer MSA's). *Effective January 1, 2011*, expenses incurred for over-the-counter (OTC) medications will no longer be eligible for payment or reimbursement from any of the health care accounts. However, the law would still allow OTC medicines obtained with a prescription and insulin to be reimbursed or paid tax-free from these accounts. This is based on the calendar tax year, so regardless of when your plan year is, as of January 1, 2011, the new definition applies. This adds complexity for those with a non-calendar year plan.

Cadillac Plan Tax: The new law imposes an excise tax of 40 percent on employer-sponsored coverage that has a benefit value in excess of $10,200 for single coverage and $27,500 for family coverage (indexed annually). The benefit value of employer-sponsored coverage would include the value of the group health plan and contributions to employees' FSA's, HRA's and HSA's. This tax would be imposed on insurance companies, including self-insured plans and plans sold in the group market, and plan administrators. This provision is *effective January 1, 2018*.

Change Impacting only FSA's and HRA's:

Tax Code Amendment: Under H.R. 4872, the tax code was amended to extend tax excludable health reimbursements and coverage to children of employees who have not attained age 27 by the end of the calendar year. The children must still meet the definition of a qualifying child under Sec. 152(f)(1) to qualify for the exclusion. This provision is *effective upon enactment.* However, Sec. 125 and HRA plans will require an amendment to change the definition of whose expenses can be reimbursed through the plan. This amendment will allow for payment of premiums pre-tax through the Sec. 125 plan as well as reimbursement of medical expenses through the FSA for dependents up to age 26. If you do not amend your plan(s) then the premium for overage dependents must be paid on a post-tax basis and you cannot use the FSA or HRA to reimburse their expenses.

This does not change the tax code that controls HSA contributions or distributions. Therefore, you could have a non-tax dependent child enrolled in your high deductible health plan and the parent would not be able to use their HSA to reimburse for their expenses. Neither could a contribution be made to an HSA for them. Similar to a domestic partner enrollee, an employee plus one would be limited to the individual HSA contribution limit. We would not be surprised to see future tax code changes to address this conflict.

Changes Impacting Only Flexible Spending Arrangements (FSA's):

H.R.3590 imposes a new annual limit on contributions made by employees to flexible spending arrangements (FSA's) for health care. The legislation limits contributions to no more than $2,500 annually. The limit is indexed to inflation for future years. H.R.4872 delayed the effective date of this provision to *January 1, 2013*. If you currently allow more than $2,500 you will need to amend your plan for 2013 to comply. This limit will work the same way as the dependent care spending account limit of $5,000 per year. This is a calendar tax year limit so plans that are non-calendar will have additional complexity.

Changes Impacting Only Health Savings Accounts (HSA's):

Tax Penalty: *Effective January 1, 2011,* the tax penalty on HSA withdrawals that are not used for qualified medical expenses will be increased from the current 10 percent to 20 percent. The legislation also increases the penalty for non-qualified withdrawals from Archer MSA's.

However, the changes proposed to all health insurance policies could have potentially adverse affects on high deductible health plans (HDHP's) that currently make people eligible to contribute to HSA's. Some of the impact may not be known until regulations implementing the final provisions are written.

Preventive Services: H.R.3590 sets new requirements for all insurance policies, including HDHP's. For example, all insurance policies will be required to provide first dollar coverage for preventive care services.

In addition, the preventive services must be covered without any cost-sharing (e.g., copayments) or application of any deductibles. While HDHP's are currently allowed to provide first dollar coverage of preventive care services, and most do, in the future all HDHP's will be required to do so. These provisions will go into effect in 2014.

The U.S. Preventive Services Task Force (and the Secretary of HHS) will define the scope of preventive care services in the future. This could create a potential challenge for HDHP's to the extent that the preventive services prescribed by the USPSTF conflict with current IRS guidance on what constitutes "preventive care" for HSA purposes.

Minimum Actuarial Value: Another new requirement for all insurance policies is that they provide a minimum actuarial value for the benefits covered. The minimum actuarial value must be at least 60 percent. However, it is important to look more closely at how "actuarial value" is defined. The new law uses a different definition than the American Academy of Actuaries in that a plan's actuarial value would be measured only by comparing the percentage of covered benefits paid by the insurance plan relative to an identical plan with zero cost-sharing (i.e., no deductibles, copay's or coinsurance). Conversations with congressional staff also suggest that a plan's actuarial value would be determined assuming that an average or "standard" population would enroll in the plan, not taking into account any self-selection that may occur due to plan design features like deductibles, etc.

It is also not clear whether a plan's actuarial value would include employer or individual contributions made to the individual's HSA. The final legislation requires the Secretary of HHS to issue regulations on this matter. Based on an analysis by the Congressional Budget Office, it would appear that the Secretary should conclude that HSA contributions must be included.

Including the contributions in the calculation of a plan's actuarial value would make it easier for more HDHP's to meet the minimum actuarial value requirement. If contributions are not included, many

HDHP's could no longer be sold in the future. Including contributions in the actuarial value calculation can increase a plan's value by 10-20 percentage points (or more), depending on the size of contributions.

Out of Pocket Expenses: The new law requires all insurance plans to include limits on out-of-pocket expenses using the current law limits for HSA's (i.e., $5,950 for individuals with self-only coverage and $11,900 for individuals with family coverage in 2010) and adjusted annually for inflation. The out-of-pocket limits will go into *effect in 2014*.

Deductible Limits: The legislation includes a provision that would prevent small employers (under 100 employees) from offering plans with deductibles greater than $2,000 for singles and $4,000 for families. The limits on deductibles are indexed to the percentage increase in average per capita premiums.

Employers may offer plans with deductibles higher then $2,000 / $4,000 if the employer offers a flexible spending arrangement (FSA) that reimburses the difference between the higher deductible and $2,000 / $4,000. This provision will go into *effect in 2014*.

Medical Loss Ratio: The new law imposes a "medical loss ratio" requirement that may create challenges for HDHP's. For example, the new law will impose a lower standard of 80 percent on small employer and individual insurance policies, and a higher standard of 85 percent on large employer policies.

Although some of the details on how this provision will work will not be known until the Secretary of HHS issues regulations, it is clear that the high medical loss ratio requirements are not appropriate for plans with high deductibles. It is hard to imagine most high deductible plans paying such a high percentage of premium revenues on medical claims.

Young Invincible Policy: The law creates a new "young invincible policy" that provides first dollar coverage for three primary care visits but no other coverage until the individual reaches current law HSA cost-sharing limits. These policies would be limited to those 30 years or younger and individuals exempt from the individual mandate due to affordability or hardship. These policies would provide an additional coverage option for younger individuals desiring to comply with the individual mandate under the law. However, it does not appear that these individuals would be eligible to contribute to HSA's.

Should you have any questions or concerns regarding this piece, please feel free to contact your SML Account Team.