Business Insurance

Retiree health care options expand

May 05, 2008

By JERRY GEISEL

WASHINGTON—Features that make it attractive for employers to offer health savings accounts and health reimbursement arrangements to employees also make them appealing as retiree health care funding vehicles, an expert says.

For employers who contribute to HSAs or HRAs, the costs are predictable; for employees, there are tax breaks such as tax-free accumulation of earnings and tax-free distributions taken to pay for health care expenses.

While neither arrangement will provide all that is needed to cover health care expenses after retirement, HSAs and HRAs are among the most tax-effective vehicles to accumulate savings, said Brad Kimler, executive vp with mutual fund giant Fidelity Investments.

Speaking last month at the 5th annual World Health Care Congress in Washington, Mr. Kimler said employers face a retiree health care coverage dilemma.

On one hand, old-style retiree health care plans have become unaffordable and many employers have terminated the plans, which often extend coverage for younger retirees or supplement Medicare for older retirees. However, without employer-provided coverage, some employees may be unable to afford to retire and will stay on the job longer than either they or their employers would like, potentially blocking advancement of younger employees.

HRAs and HSAs can be an attractive middle ground between providing coverage that may prove unaffordable or offering no coverage at all.

"Employers are taking a step back…and looking at what is the most effective mechanism" to help fund retiree health care coverage, Mr. Kimler said.

That middle ground—approaches that incorporate HRAs or HSAs—is attracting employer interest.

Earlier this year, Ford Motor Co. put in place an HRA-linked program for nonunion retirees. For both pre-Medicare and Medicare-eligible retirees, Ford each year contributes $1,800 per retiree, plus an additional $1,800 for a retiree's spouse, to an HRA. In the case of pre-Medicare-eligible retirees, Ford continues to provide retiree health care plans, though its contribution is capped at what it paid in 2006 with future increases born by retirees.

Fidelity's HRA is designed differently. Under the program set up last year, Fidelity provides employees with a $3,000 annual credit in an HRA. Employees can draw from the account after turning 55 to pay for retiree health care expenses on a tax-free basis. Employees vest in the credits after 10 years of service.

Fidelity began to consider such a program based on employee surveys that found an overwhelming majority of employees said they didn't know how they would pay for retiree health care expenses.

HSAs also can be retiree health care funding vehicles. To the extent that employees haven't used accumulated contributions and investment earnings to pay for health care expenses while working, those funds will be available to pay retiree health care expenses on a tax-free basis.

HSAs "can be useful tools" for retiree savings, Mr. Kimler said.

Still, some employees probably won't conserve HSA assets to have funds available when they retire. Some may believe they don't have to save up for retiree health care expenses.

"Some people think Medicare covers everything. They don't budget for health care," said Beth Bierbower, vp-innovation at Louisville, Ky.-based Humana Inc., who also spoke at the session.

At the same time, rapidly growing HSAs have been under congressional scrutiny.

Tax legislation passed last month by the House of Representatives requiring the substantiation of distributions from HSAs would increase paperwork and costs for enrollees and give them fewer choices in which to open and maintain their accounts, experts say.

Under the legislation, banks would have to report unsubstantiated distributions on tax forms, making HSA enrollees automatically subject to income taxes and, in certain cases, penalties.

To meet these requirements, HSA enrollees would have to fill out claims forms and provide receipts in many cases. Currently, HSA enrollees can take distributions with no questions asked as to their purpose.

Handling that paperwork "will impose a much higher cost structure" for banks, Mr. Kimler said.

Those higher costs will lead some smaller banks to exit the market and reduce competition for enrollees' accounts, Ms. Bierbower.

"We think that competition is healthy," she said.

Both Ms. Bierbower and Mr. Kimler questioned the need for the substantiation requirement. Individuals now must report HSA distributions on an IRS tax form. As with other information reported on tax reforms, individuals who misstate the use of HSA distributions face penalties if their tax returns were audited and the IRS caught those misstatements, Ms. Bierbower said.

On the plus side, the White House has warned that President Bush would veto an HSA substantiation requirement, reducing the chances that the proposal will become law, at least in the near-term.

Amid that legislative development, HSAs continue to grow. A survey released last week by America's Health Insurance Plans said enrollment in high-deductible health insurance plans linked to HSAs leaped 35% last year to 6.1 million (see story, page 1).

Additionally, an earlier survey by Mercer L.L.C. found that 9% of employers with at least 500 employees offered HSAs in 2007, up from 6% in 2006, while the 6% of employers offered an HRA program both years.