Just What the Doctor Ordered: Is It Time for Your Bank to Start Offering a Health Savings Account (HSA)? Here's What You Need to Know About This New Product

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by Mark R. Baran and Rachel Juhas

***Editor's Note**: Some banks have recently begun promoting something new called a health savings account (HSA). Since financial institutions seem to be ideally positioned to capture this growing business, some observers predict that HSAs will develop into a huge new market.* ABA Bank Marketing *asked a law firm that specializes in banking issues to explain what HSAs are and how banks can benefit by offering them.*

In recent years, the ever-increasing cost of health insurance has left many consumers and employers desperate for lower-cost coverage options. As a result, employers are moving away from expensive defined-benefit plans to alternatives that offer higher deductibles in exchange for a reduction in premium costs. The health savings account (HSA) grew out of this quest for choice. The HSA was designed as a tax-efficient way for consumers with high-deductible plans to pay for health costs accrued before the insurance kicked in. These high-deductible plans are touted as being more affordable for both employers and consumers—as well as for having the potential to reduce the number of uninsured and underinsured Americans.

In 2003, the Medicare Modernization Act paved the way for expansion of the consumer-directed health plan industry by authorizing the creation of HSAs. These instruments are tax-advantaged accounts for healthcare that combine the benefits of traditional IRAs, Roth IRAs and 401(k) plans. Contributions to HSAs are either tax-deductible or, in the case of an employee, excluded from income. Withdrawals used to pay for qualified medical expenses at any time are tax-free.

Some refer to HSAs as the "tax trifecta" in benefit plans—the tax breaks are available for amounts contributed, earnings within the plan, and upon distribution for qualified medical expenses. The only catch is that HSAs are available only to consum-

Illustration by Jim Frazier, www.images.com ers enrolled in high-deductible health plans (HDHPs), and contributions are limited to a statutory amount. Nonetheless, given the powerful tax benefits, experts estimate that *HSAs will be the largest growth area within the consumer-directed health insurance market.*

Since insurance carriers continue to offer a variety of HDHPs, and more employers are adopting them, both employers and their employees currently are searching for qualified HSA trustees. As a trusted adviser experienced with IRAs, banks are uniquely qualified to perform the HSA trustee role, and the HSA statute specifically authorizes banks to serve as trustees. But the industry has been reacting slowly to new HSA market opportunities. With more consumers enrolling in HDHPs every day, banks can no longer afford to ignore this emerging sector of the healthcare economy.

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What are HSAs?

HSAs are savings accounts designed to help individuals take more control of their healthcare expenses. Eligible individuals, or anyone acting on their behalf, may contribute a set amount of money to an HSA each month. Who is eligible? Anyone who has been enrolled in an HDHP as of the first day of the month, is not age 65 or older, and does not participate in or is not covered by another health plan. A HDHP may not have an annual deductible of less than $1,000 per year for individuals or $2,000 for families. For each month that an individual is eligible, he or she is entitled to contribute the lesser of one-twelfth of the annual deductible under the HDHP plan, or the statutory maximum of $2,650 for individuals and $5,250 for families. In addition to these statutory contribution limits, individuals age 55 and over are entitled to contribute an additional "catch-up" amount. These catch-up contributions, which are limited to $600 in 2005 and will increase by $100 annually until 2009, are designed to allow older individuals the opportunity to compensate for higher healthcare costs.

Eligible individuals may make contributions to their HSAs as early as the first day of the taxable year, and may contribute in any frequency or amount desired and approved by the plan trustee. Trustees may place reasonable limits on the beneficiaries, including imposition of minimum deposit amounts or minimum balance requirements. The contribution limits apply in aggregate to all HSAs held by an individual and must be further reduced by any contributions the beneficiary makes to an Archer Medical Savings Account (accounts designed to pay the costs of routine medical expenses for employees of small businesses and self-employed persons). Beneficiaries are also entitled to roll over certain accounts into HSAs without regard to the contribution limit. However, beneficiaries are entitled to only one such rollover per year, and trustees are not required to accept the rollover amounts.

Low burden on HSA trustees

The regulatory burdens for HSA trustees are minimal. Trustees are not responsible for determining whether an individual is eligible to donate in a given month, nor must they monitor contributions to ensure an individual has not exceeded the personal contribution limit. Trustees are limited only in that they may not accept amounts in excess of the highest possible contribution any eligible individual could contribute in a given year, namely the statutory maximum for families plus the annual catch-up contribution. Eligibility, therefore, is determined on a monthly basis by the HSA account holder, though HSA trustees may require certification of eligibility from the account owner.

Trustees are also not responsible for monitoring distribution of HSA funds to ensure they are used solely for medical expenses. Indeed, beneficiaries may withdraw funds for any reason, medical or not, provided they pay all applicable taxes and penalties associated with nonmedical expense withdrawals. Finally, HSA trustees may employ a number of convenient options for customers, including the use of debit, credit or stored-value funds, which further reduces administrative burdens.

As with IRAs, HSA assets may be invested in bank accounts, annuities, certificates of deposit, stocks, mutual funds and bonds. HSAs opened at FDIC member institutions will be protected by up to $100,000 in deposit insurance. Restrictions on investments are the same as for IRAs. Thus, no part of HSA funds may be invested in life insurance contracts or in collectibles, and beneficiaries may not engage in prohibited transactions.

The IRS reporting requirements for HSAs are also relatively light. HSA trustees and beneficiaries have shared IRS reporting responsibilities. Beneficiaries must maintain documentation and substantiate that withdrawn funds were used for qualified medical expenses; beneficiaries are also responsible for reporting excessive contributions. Employer contributions to an HSA should be reported on the employee's W-2 form. Trustees, on the other hand, are solely responsible for filing two IRS forms: Forms 5498-SA and 1099-SA. Form 5498-SA is used to report contributions and receipt of funds through an account rollover. Form 1099-SA is required to report all distributions made from the account, whether paid to account beneficiaries or directly to a medical service provider.

What are the rewards of offering HSAs?

The growing popularity of consumer-directed healthcare through HDHPs makes HSAs an attractive new product for banks. Banks are one of the few institutions named in federal HSA implementation regulations as authorized to serve as HSA trustees, and the HSA administrative structure is not coincidentally similar to the IRA system. Experience as an IRA trustee or custodian will no doubt provide banks with a competitive edge.

Despite the relatively low regulatory burden and huge market potential, banks have been slow to respond to the HSA trend. Experts point to a lack of retail HSA products. Many consumers already enrolled in HDHPs are unable to set up HSAs within their existing banks. With a little effort, HSAs could easily become a valuable part of the total package for a bank consumer—joining IRAs, 401(k) plans, and checking and investment accounts already offered to individuals and employers.

HSA deposits are an important new source of liquidity and are long-term, stable, low-cost investments. Additionally, unlike with prior medical savings accounts, unused HSA funds can be rolled over from year to year, allowing these relatively small annual contributions to grow substantially over time, and perhaps ultimately be used for retirement purposes. These growing funds can be reinvested by banks, thus representing an even larger source of potential income. Banks are permitted to charge HSA beneficiaries start-up and account-maintenance fees, and while these fees are typically quite low—between $50 and $75 per account setup and between $25 to $30 a year in annual maintenance fees—in the aggregate, they have the potential to represent real income to banks.

More importantly, HSAs will help strengthen existing relationships with both individual and corporate customers. Banks can use much sought-after retail HSAs as a way to bring individual customers in the door and cross-sell other deposit and lending products. Despite the great potential for HSA investment in the individual customer market, experts estimate that the vast majority of HSAs will be established by insurance carriers and corporate or small-business employers, who will likely be among the largest purchasers of HDHPs.

HSAs may be extremely useful for banks who desire to build or solidify existing relationships with business customers. Recent data shows that more and more corporations are establishing and contributing to HSAs on behalf of their employees, and insurance companies are expanding HDHP offerings nearly daily. These business clients are actively seeking HSA trustees, and there is no reason your bank should not offer HSA services.

To summarize: HSAs are here to stay. The accounts continue to grow in popularity and are sought by healthcare consumers, employers and HDHP insurers. HSA administration offers banks a relatively low-cost means of generating income and creating liquidity. Perhaps more importantly, HSAs provide banks with the invaluable opportunity to bring new clients in the door and to strengthen relationships with existing customers. ■

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