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## The Promise and the Pitfalls of Health Savings Accounts

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HEALTH savings accounts, a sort of I.R.A. for health care, let people set aside money tax-free to pay for medical expenses, both now and later. But the accounts have been controversial since their introduction in January 2004.

Depending on whom you ask, they are either a wonderful tool to help Americans become wiser, more price-conscious health care consumers, or just another way for employers to pass along more health care expenses to their workers. Critics also contend that the accounts are basically a tax-shelter gimmick for people who are healthy and wealthy enough to invest in them but don't have to rely on them to cover their care costs.

Most businesses have not yet offered the accounts as an option in their insurance plans. But as health costs continue to climb, some businesses and individuals are more curious to try the idea. Since they were established under the 2003 law that set up a prescription drug benefit for Medicare, more than 425,000 accounts have been established, according to a survey of administrators by Inside Consumer-Directed Care, a newsletter based in Washington, and more than 50,000 are being opened each month.

Nearly a year and a half into the experience, however, it is becoming clear that while the accounts may be a reasonable option for some people, there are potential drawbacks.

A health savings account must be paired with a health plan that meets certain criteria, including a deductible of at least \$1,000 for individuals and \$2,000 for families. Some employers offer them, although individuals can also apply for a qualifying health plan and open one of these accounts on their own.

Individuals can deposit money into their accounts to cover the deductible and other medical expenses, and employers can also deposit money for employees. Generally, the account balance earns interest, though some accounts allow holders to invest the money in mutual funds or other vehicles.

If an employee leaves his job, the money in his health savings account stays with him. And these accounts, unlike flexible spending arrangements, have no "use it or lose it" rule, so the funds roll over from one year to the next. An account holder pays no tax on withdrawn funds as long as they are used to pay for qualified medical expenses. If the money is used for any other expenses, it is subject to income tax and, for those under 65, to a 10 percent penalty.

Some people are discovering downsides to the accounts. Ric Joyner, president of the National Association of Professional Benefits Administrators, says he has received frequent calls from companies and individuals interested in setting up the accounts. But lately, Mr. Joyner, who is also president of [eflexgroup.com](http://eflexgroup.com), a benefits administration company in Madison, Wis., says he has been getting calls from people complaining that their account balances are shrinking even though they have

not used the money.

"The money they're setting aside for health care is being eaten up by fees," he said.

Typically, the companies that administer the accounts charge a set-up fee of around \$20, plus a monthly fee of about \$2 or \$3. They may also charge an annual fee, as well as a transaction fee every time a customer writes a check or uses the account's debit card. Some charge a fee to close an account.

American Health Value, an administrator of health savings accounts, charges a one-time, \$15 fee to open an account, and \$36 annually to administer it. There is also a \$2.50 monthly service charge, which is waived if the balance is more than \$2,500.

In the early years of an account, when the balance is typically low, fees can take a relatively big bite out of the total. A new customer with American Health Value who deposited \$1,000 during the first year, for example, could expect to pay \$45 in fees (\$15 to set up the account and \$30 for 12 months of service charges at \$2.50 each). That \$45 far exceeds the \$7.50 that the customer would have earned in an interest-bearing account, based on the 0.75 percent now being paid on balances of up to \$1,000.

"Unless employers are putting a bunch of money in, I really don't see how these balances are going to get much bigger," said Gary Claxton, vice president of the Kaiser Family Foundation, a health care research and education company in Menlo Park, Calif. Some companies permit an account holder to invest the balance in stocks or mutual funds, though a certain minimum balance - say, a few thousand dollars - may be required to do so. Such investments, of course, offer a chance for greater returns - but also the risk of losing money.

There are also ceilings, indexed to inflation, on annual contributions: in 2005, it is the lower of the deductible or \$2,650 for individuals and \$5,250 for families. Account holders who are 55 or over can also make catch-up deposits. In 2005, the ceiling is \$600; it rises gradually to \$1,000 in 2009.

But even if you deposit the maximum amounts and don't touch the money to pay for health care before you are 65, you won't accumulate enough to cover medical expenses in old age, according to an analysis by the Employee Benefit Research Institute, a nonprofit research organization based in Washington. In a model created by the institute, a 55-year-old who set aside the annual maximum - as well as catch-up contributions - starting in 2004 would save \$44,000 in 10 years, assuming a 5 percent return. If that person lived to 80 and had retiree health coverage, he would need anywhere from \$137,000 to \$337,000 to cover premiums and out-of-pocket medical expenses, according to the institute's analysis.

Investing in a health savings account at an earlier age won't solve the problem, said Paul Fronstin, the institute's director of health research and education and a co-author of the report.

"The gap is only going to get larger," he said, "because of the way that health care costs are increasing compared to how much you can put in."

THE amount saved is not the only concern. There are other wrinkles that can trip up consumers. For example, health savings accounts cannot be used with many flexible spending arrangements offered by employers.

In addition, some states have laws that conflict with health savings accounts. Those laws may require,

for example, that certain types of medical care be covered under plans before the deductible is applied. States have until Jan. 1 to bring their laws into line with the federal law, and many have done so already.

Prescription drug coverage poses a problem for many people who are considering whether to open health savings accounts. Starting in January, many prescription drug expenses in qualified plans will be subject to the deductible. Now, consumers typically pay only a portion of the drug costs from the outset.

Mr. Joyner said the idea of paying more out of pocket for prescription drugs made his employees reject the idea of health savings accounts. "They didn't like it that there wasn't going to be a drug card," he said.

Many major insurers and banks now offer the accounts to individuals and companies. But details like fees and investment options vary widely, as do the basics of the accompanying health plans. "The biggest drawback about H.S.A.'s is that they can be very confusing," said Martha Priddy Patterson, a director for Deloitte Consulting.

Because these accounts are still relatively new, and changing fast, the best advice may be to read the fine print before opening one.