

Sample Law Firm LLP

Health Savings Account 10 Year Cost Analysis for Law Firm Partnerships

Tax Adjusted Cost Analysis of HSA Style Health
Insurance Relative to Traditional HMO and PPO Plans

Date:

HSAs for Law Firm Partners

Overview

Health Savings Accounts (HSAs) represent an intriguing health insurance solution for partners of law firms. As many health plan sponsors take a "wait and see" approach to HSAs and HRAs for their general employee populations, the tax treatment applicable to K-1 earners makes them particularly good candidates for early adoption of HSAs. While there are a number of issues to be addressed that are unique to each firm and impact the ultimate applicability of HSAs, there are four primary reasons why law firm partners should be interested in HSA style health plans:

1. **Lower Premiums:** Because law firm partners pay 100% of their personal health insurance premiums, they are particularly sensitive to health insurance premiums that will soon reach \$20,000 per year for full family PPO coverage. The high deductible health plan that is core to an HSA style approach will provide premium relief of 15%-30% (depending on plan design) and should deliver markedly lower annual increases over time.
2. **Tax Leveraging on Out of Pocket Costs:** Law firm partners are either precluded by statute or by discrimination testing requirements from participating in health care flexible spending accounts, or FSAs. As such, partners have no way of paying for expenses not covered by insurance with anything other than after tax income. Given the federal and state tax rates applicable to most partners, it takes essentially \$2 in earned income to pay for \$1 in medical expenses. HSAs give the partner the ability to pay for over \$5,000/year in family out of pocket costs with pre-tax income.
3. **Tax Deferred and Tax Free Savings:** Most law firm partners are looking for additional ways to shelter income and investment earnings from taxation. HSAs provide the ability for partners to put away over \$5,000/year on a pre-tax basis into a self-directed savings account that will operate similar to an IRA. The account will accumulate earnings on a tax-deferred basis and the principal and earnings can ultimately be withdrawn without taxation if used to pay for qualified medical expenses and certain health insurance premiums.
4. **Post Retirement Health Insurance Funding:** Planning for and funding health insurance for retired partners is a problematic issue for many firms. Most firms would like to, at a minimum, create an insurance bridge for retired partners who leave the firm prior to being eligible for Medicare. HSAs provide an opportunity for the partner to accumulate assets to fund their post retirement health care needs. Further, the lower cost nature of a HDHP should make it more palatable for the firm to offer at least one type of health plan option to retired partners.

About This Report

This report compares the tax-adjusted cost of HSA style coverage to both traditional PPO and HMO style health insurance plans. Comparing costs on a tax-adjusted basis is critical to this assessment because HSAs offer partners, for the first time, the ability to pay for out of pocket health care expenses with pre-tax income. The report compares the projected 10-year costs for high, moderate and low utilizers of health care services and does so for both full family and individual coverage options. In addition, the analysis shows the tax-adjusted cost impact for the aggregation of all partners in the plans studied, demonstrating the total dollars at stake across the partnership.

The analysis uses actual premium and plan design data to establish a baseline and uses a number of inflation, future plan design and tax rate assumptions (see report detail) to project the costs of the various approaches over time. The claim utilization assumptions represent either default assumptions proposed by ArlenGroup or reflect custom utilization profiling requested by the firm as part of the data gathering process. ArlenGroup advocates being conservative on all of the assumptions used in order to minimize the likelihood that potential savings from HSA style plans are overstated. Following are notes applicable to the more critical assumption factors:

- **Premium Inflation Assumption:** Differences in the anticipated future cost of health insurance have a significant and compounding impact on the long-term cost of purchasing health abundance. Early data provided by two of the leaders in consumer directed healthcare, Aetna and Definity Health, indicate that Health Reimbursement Account style consumer directed plans have delivered annual increases of 0-3% versus 12%+ for more traditional HMO and PPO style plans. This difference is attributed to both a decrease in utilization and more cost sensitive utilization of services when required.
- **Utilization Change Assumption:** Early data indicates that the combination of a high deductible health plan, the ability to accumulate money in a long-term savings account, and health care advocacy services reduce utilization of health care services. One study completed on a large Definity Health CDHP subscriber showed an 8% reduction in hospital and surgical procedures and an 18% reduction in physician office visits. These changes resulted in a net 12% reduction in overall utilization. In addition to reducing premium inflation (as listed above), the reduction in utilization reduces current year costs for both the claims payor and for the insured person. (Note: It is too early to know if the movement to high deductible plans is discouraging people from receiving required health care. Early data provided by Aetna shows that utilization of preventive and health-screening services is 16% higher than for non-CDHP populations).
- **High Deductible Premium Savings Assumption:** A very significant component of the evaluation is the reduction in premium dollars achieved by moving from a traditional PPO plan to a high deductible health plan. The actual premium savings will depend on many factors, including the level of benefits in the traditional PPO plan; the level of benefits in the HDHP plan; the inclusion or exclusion of prescription drugs under the HDHP; and the requirement to load the HDHP premium rates to address adverse selection in other plan

offerings. In general, most plan sponsors will see a 17% to 27% reduction in premium rates in moving from a traditional low deductible PPO to a HDHP.

- **Tax Rate Assumption:** One of the most attractive elements of HSAs for law firm partners is the ability to pay for out-of-pocket expenses with pre-tax income much the way employees have been able to use health care FSAs for many years. As such, the combined federal and state income tax rate assumption is an important element of the overall assessment, particularly for high and moderate users of health care services.
- **HSA Earnings Assumption:** HSAs provide the ability for account owners not only to contribute pre-tax income to the account, but also to accumulate earnings on a tax-deferred basis from self-directed investments within the HSA. As such, the assumption for net rate of return generated within the HSA is an important one. Net rate of return generated with the HSA should logically be lower in the early years to take into account both the current environment for low risk investments and the practicality that HSA administrative/investment fees (if any) will weigh more heavily on the net rate of return when the HSA has a smaller balance.

As with any long-term analysis of a new insurance/savings platform, it is not possible to guarantee that actual performance will meet the projections illustrated in this report.

Next Steps

This report is the first step in the HSA assessment process. The overall process would generally consist of the following steps.

1. Long-term study of cost effectiveness of HSA style program.
2. Survey of partners to establish interest in HSAs (optional)
3. Discussion of how, if and when the HDHP will be made available to non-partners and whether an HSA or Health Reimbursement Account (HRA) will be used for non-partners.
4. Evaluation of providers of the High Deductible Health Plan and of HSA account custodians.
5. Determination of final plan design and changes in availability of traditional HMO or PPO plans.
6. Development of partner communication campaign.
7. Enrollment and implementation.
8. Follow up communications.

High Deductible Health Plan + HSA Schematic

