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Health Reimbursement Arrangements (HRA) 101

Customizing and Controlling Your Employee Health Benefits Plan... Creating Happy Employees

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The HRA – New Tools, New Rules

"It is not the strongest that survive or prosper, nor the most intelligent, but the one most responsive to change." unknown

The winds of change are blowing in the philosophy and design of employer sponsored health plans. Multiple years of 20 plus percent premium increases and a declining ability of employers to absorb or pass on these increases has made the status quo impossible to maintain. As a result, the forces are in play and the stage is now set for a paradigm shift in the operation of employer sponsored health plans.

Enter the Health Reimbursement Arrangement (HRA). With this tool, employers now have a means of changing the nature of how benefit plans are designed. Our purpose here is to detail why and how the HRA is becoming the currency for major change in the market place of employer sponsored health and welfare plans.

What is an HRA – Health Reimbursement Arrangement or Account?

Employer funded reimbursement under Section 105 of the IRC has been available for years. However, in June, 2002, the IRS created new options by releasing new regulations and a new name (HRA). This, combined with a confluence of market pressures, has created a powerful tool that can transform a group benefit plan.

An HRA is a qualified employer funded medical reimbursement plan under which reimbursement for qualified health care expenses is not wages for the employee or the employer. Based on Section 105 of the Internal Revenue Code (IRC), employers have great latitude in plan design. Employers can define both entry and exit rules, the scope and amount of reimbursement available, its relationship to a Section 125 FSA, and if and how any unused dollars carry forward. As a qualified plan, the HRA requires a Summary Plan Document (SPD), discrimination testing and a 5500 for groups with more than 100 participants.

Transforming the Delivery of Health Care?

Our current health care delivery system is in trouble and has become a widely recognized reality. At the risk of over simplifying a very complex and recursive set of problems, many have named at least two contributing factors that employers have the ability to address which will create and advantage. These two factors are:

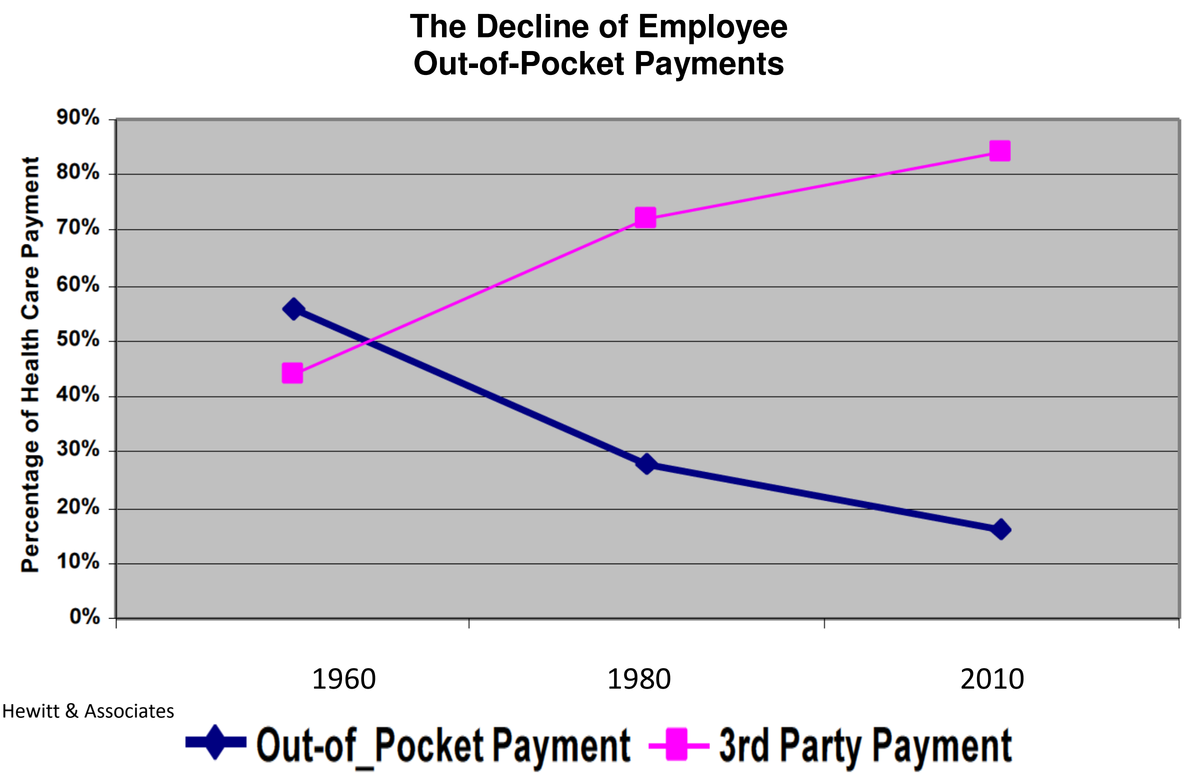
1) Restoring consumerism in the purchase of health care.

2) Restoring health insurance as insurance rather than pre-paid medical. The HRA is a tool that can create such a restoration within an individual employer group health plan.

Pre-paid medical vs. insurance: Health insurance under the current model is not, really insurance at all. It has become pre-paid medical (or better, someone-else-pays medical). To illustrate this, if we insured our cars the way we insure our bodies, we could not afford the cost of automobile insurance. Wipers, tires and oil changes would be covered benefits and we would plunk down a co-pay and let someone else pick up the balance.

Consumerism: As a consequence of health insurance as pre-paid medical, we are shielded from the true cost of the health care we receive. The consumer dynamic that we employ in every other financial area of our lives is largely irrelevant in the health care arena. In fact, most of us pay more to get our hair cut than to visit a physician. Even more telling is the fact we have no idea of what the physician bills the insurance company beyond our $10-30 co-pay. All elements of consumerism are lost.

The graph below illustrates how this loss of consumerism has developed since 1960. When today's employees are paying for only 17% of their total health care, it is easy to see why there can be virtually zero consumerism under most current models.



Source: Hewitt & Associates

Does this make a difference? Here is an example that drives home the power of consumerism. Laser corrective eye surgery (Lasik and it predecessors) hit the marketplace in a major way about 5 or so years ago. At that time, the procedure cost over $2000 per eye and was offered by relatively few specialty clinics. Today this procedure can cost under $1000 per eye (and is dropping) and is readily available. If this was an insured procedure, it would very likely cost over $3000 per eye. When providers are not accountable to consumers, there is little incentive to control prices. The key point is this, before we are patients, we are consumers. A health care delivery system that restores this consumer dynamic will also restore provider accountability and the ability of consumer to impact prices.

The HRA Solution

The following plan design works to correct the aberrations of non-insurance and non-consumerism under most current plan design models. This is now the most commonly adopted HRA plan design. Employers are excited by its power. Employees enjoy its simplicity and freedom.

1. Employers purchase a high deductible health plan to provide catastrophic coverage. Any dental or vision insurance is dropped. This can be a guaranteed issue or an underwritten plan - which ever provides the best value and a sweet spot in rates.
2. If an Rx card and office visit is required, buy the highest possible co-pay. Consider deleting the Rx card altogether.

3. Second, employers install an HRA that reimburses first dollar for all qualified health care expenses (based on IRC Section 213). This would cover medical, dental and vision expenses. The dollar amount of this HRA can vary. Most common are $500 to $2000 for a single and $1000 to $4000 for a family.
4. Employers establish a "carry forward" or "roll-over" of unused dollars. This can be the full amount of the unused balance or some percentage of the used balance to a cap or unlimited. Additional design options can also be applied to enhance employee incentives and choice.
5. A Section 125 FSA plan is established that must be exhausted before using HRA dollars. With a carry-forward, this effectively removes the "use-it-or-lose-it" aspect of a FSA plan.
6. Employees are responsible to fund the deductible in the insured health plan out of their pocket or by reserving HRA dollars by not spending them elsewhere.

Using this plan design, the health insurance and the HRA are not linked. Employees are free to use their HRA according to their needs and choice. Carry-forward dollars can be used to self-fund the deductible in future years. Employees who determine they have more expenses than can be paid for with HRA dollars will elect to have additional dollars pre-taxed in a Section 125 Medical Reimbursement plan. Employees who seek to self-fund their deductible will also elect FSA dollars to protect their ability to carry forward unused dollar.

This plan design accomplished several meaningful objectives.

1. It restores consumerism and health insurance as insurance.
2. It removes the employer from the health care delivery business.
3. It rewards the low to moderate health care utilizer.
4. It offers real hope for benefit cost stabilization.
5. It allows employers to stabilize or reduces employee contributions to the premium.
6. No more annual benefit tinkering to shave 8% off a 32% rate increase.

<u>Alternate HRA Models</u>

The model described above is aggressive in plan design. Less aggressive plan designs can also be implemented to capture scaled back objectives and to position the employer for future enhancements.

1. The Wrap HRA – in this design the employer targets reimbursement to fill a gap to make a higher out-of-pocket cost health plan so that it looks like a lower out-of-pocket cost plan. Here deductibles, Rx and office visit co-pays can be reimbursed back to lower levels.
2. The Rx, Dental or Vision HRA – insured coverage for these expenses are eliminated and self-funded under and HRA that reimburses only targeted expenses.
3. Second Dollar HRA's – HRA dollars are spent only after the employee pays a front end deductible or co-pay.

<u>What about HRA Costs</u>?

An obvious question is from where do HRA dollars come? The first factor that must be considered is that these dollars are not spent in a vacuum. If an employer does not do something to now to change the basic term of the benefit plan, what will be the situation next year? In two or three years?

Depending on the HRA plan design and the insurance carrier selected, premium reductions of 17% can provide adequate savings to breakeven in the second year. Consider the numbers shown below:

18% annual increases in both plans	2009	2010	2011	3 Year Total
Current Plan Premium Annual	**240,000**	**283,200**	**344,176**	**867,376**
High Deduct* Insurance Premium Annual	**199,200**	**235,056**	**277,366**	
HRA Dollars Annual (75% Utilization)	**45,000**	**45,000**	**45,000**	
Total HRA Plan	**244,200**	**280,056 Breakeven**	**322,366**	**846,622**

***High Deductible plan with a 17% reduction in premium from Current Plan Renewal**

The above scenario is only an estimate. More significant cost controls and reductions are possible depending on the carrier picture, the benefit level of the current plan and the incentive attached to the HRA.

For experience rated and self-funded groups, significant gains can be achieved with effective utilization incentives. The reason for this is a claim is a claim. A reduction in utilization of even 5-10% results in significant employer gain.

HRA Downsides

The greatest downside to implementing and HRA concerns the exclusion from HRA reimbursement for Sole Proprietors, 2% owners in a Sub-chapter S Corporation and LLC members. These individual are completely excluded from reimbursement under an HRA. The solution to this problem is the insured Section 105 which is applied only to the individuals excluded under HRA regulations.

Though not really a downside, a second issue to address is the need for effective employee education. Because this represents a significant philosophical change in benefit design, employers need to prepare their group with an education plan. For years, the low health care using employee has subsidized the high using employee. Under the HRA, this subsidy ends and is replaced with the common sense reality that "if you use more, you pay more."

A third downside relates to the carrier market. It has not yet completely adjusted to offer plans that fully support a consumer driven HRA. Although, many have started to model and offer the HRA model in their plan offerings. Ideally, a catastrophic plan should offer a menu of basic preventative and diagnostic services which is paired with a high dollar stop-loss style catastrophic coverage. Certainly an HRA can be effective in the current market. However, the picture will only improve as carriers adjust to offer better plan designs. For self-funded plan, this power is available now.

Elements of a Good HRA Administrator

Under an HRA plan design, employees will deal much less with the carrier and a lot more with the HRA administrator. As a result, the following factors should be considered in selecting an HRA administrator.

1. Does the administrator have broad experience in plan design and administrative excellence? Choosing an HRA administrator is like choosing a surgeon – successful experience counts.
2. Does the administrator understand how HRA's intersect with COBRA? This is very important to ensure COBRA is handled properly in premium pricing and communication.
3. Does the administrator handle Section 125 plans effectively? These should be administered together in many plan designs.
4. Does the administrator have a fast reimbursement turn-around time? This is important to ease cash flow issues with employees paying more at the point of service.
5. Are the administrator's fees in line? It makes no sense to consume potential savings in administrative costs. As a benchmark, figure on administrative fees to run between 1-6% of the combined premium and HRA dollars.
6. **Is the administrator independent and not connected to a health insurance carrier or TPA? This ensures plan satisfaction. As employers change carriers year by year to gain the best the rates, an independent administrator means the HRA remains consistent.**

Conclusion

The HRA is a developing option for employers to change the terms of their health insurance package. It is strategic in positioning the employer for the future. It rewards the low and moderate health care utilizing employee. It releases the employer from making one-or-two sizes-fit-all decisions about health plan options. It offers real cost control leverage to employers.

The group health insurance market is in a state of transition and evolution. The HRA is an exciting tool that will lead the way. It is a compelling and workable option for many employers right now! It will soon become a necessary component of most group health plans.

225 North 9th Street, Suite 530 | Boise, Idaho 83702 | t. 208.287.0310 | f. 208.287.0311 | integra-flex.com