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HEALTH SAVINGS ACCOUNTS

Participation Grew, and Many HSA-Eligible Plan Enrollees Did Not Open HSAs while Individuals Who Did Had Higher Incomes

Statement of John E. Dicken
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May 14, 2008

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Participation Grew, and Many HSA-Eligible Plan Enrollees Did Not Open HSAs while Individuals Who Did Had Higher Incomes

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Highlights

Highlights of GAO-08-802T, a testimony before the Subcommittee on Health, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

With health care spending increasing, Congress enacted legislation effective in 2004 establishing Health Savings Accounts (HSA) to be coupled with eligible high-deductible health plans. The novel structure of eligible health plans coupled with HSAs has raised questions about who selects them and how they are used. Proponents contend that the lower premiums of the health plans and the tax-free savings potential of HSAs appeal to consumers, while the health plans' high deductibles encourage enrollees to be more astute health care consumers. However, critics are concerned that HSA-eligible plans may attract enrollees who seek lower premiums but lack the resources to contribute to an HSA, and wealthy enrollees who may use the HSA primarily to accumulate tax-advantaged savings.

This statement focuses on (1) participation in HSA-eligible high-deductible health plans and HSAs, (2) the income characteristics of HSA account holders, and (3) the funding and use of HSAs. This statement is based primarily on findings from GAO's April 2008 report entitled *Health Savings Accounts: Participation Increased and Was More Common among Individuals with Higher Incomes* (GAO-08-474R). For that report GAO reviewed industry data on the participation in HSA-eligible plans and HSAs, and analyzed Internal Revenue Service (IRS) data on tax filers who claimed deductions for HSAs. The statement also draws on findings from related GAO reports issued in 2006.

To view the full product, including the scope and methodology, click on GAO-08-802T. For more information, contact John E. Dicken at (202) 512-7114 or dickenj@gao.gov.

What GAO Found

GAO found that the number of individuals participating in HSA-eligible high-deductible health plans and HSAs increased significantly since 2004. A series of health insurance carrier surveys reported that the number of lives covered by HSA-eligible plans increased significantly from about 438,000 in September 2004 to an estimated 6.1 million in January 2008. GAO's analysis of IRS data showed that the number of tax filers ages 19 to 64 reporting HSA activity nearly tripled from about 120,000 in 2004 to about 355,000 in 2005. Industry estimates indicated continued growth in HSA participation in 2006 and 2007. However, many HSA-eligible plan enrollees did not open an HSA. From 2005 through 2007, 42 percent to 49 percent of HSA-eligible plan enrollees reported that they had not opened an HSA, and 20 percent to 24 percent did not plan to open an HSA, citing their inability to afford an HSA or a belief they did not need an account.

Tax filers who reported HSA activity and enrollees in certain HSA-eligible plans had higher incomes on average than other tax filers. For example, among tax filers between the ages of 19 and 64, the average adjusted gross income (AGI) for those reporting HSA activity in 2005 was about $139,000, compared with about $57,000 for other filers. About 59 percent of HSA filers had AGIs of $60,000 or more, compared with 26 percent of other tax filers. Moreover, income differences between HSA and other filers existed across all age groups and within different tax filing statuses, such as single or joint tax filers.

Among all filers reporting HSA activity in 2005, average contributions—reflecting both individual and employer contributions—were about $2,100, compared to average withdrawals of about $1,000. Among filers who reported HSA contributions in 2005, about 41 percent did not withdraw any HSA funds that year, while about 22 percent withdrew as much or more than their reported contributions. About 93 percent of reported withdrawals were claimed for qualified medical expenses. Some HSA-eligible plan enrollees GAO interviewed for a 2006 report were unsure what medical expenses qualified for payment using their HSAs, and few researched the cost of services before obtaining care.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today as you examine issues related to tax advantaged health savings accounts (HSA) and HSA-eligible high-deductible health plans. With health care spending increasing in the United States, Congress enacted legislation effective in 2004 establishing HSAs to be coupled with HSA-eligible high-deductible health plans.[1] The novel structure of HSA-eligible plans coupled with HSAs—a type of consumer directed health plan[2]—has raised questions about who selects them and how they use the accounts. Proponents of consumer-directed health plans contend that the lower premiums of HSA-eligible plans and the tax-free savings potential of HSAs appeal to many consumers, while the high deductibles encourage them to be more astute health care consumers.[3] However, some critics are concerned that HSA-eligible plans may attract enrollees who seek lower premiums but lack the resources to contribute to an HSA, and wealthy enrollees who may seek to use the HSA primarily to accumulate tax-advantaged savings rather than pay for medical expenses.

My comments today are based primarily on findings from our April 2008 report entitled *Health Savings Accounts: Participation Increased and Was More Common among Individuals with Higher Incomes*.[4] My remarks focus on (1) participation in HSA-eligible high-deductible health plans and HSAs, (2) the income characteristics of HSA account holders, and (3) the funding and use of HSAs.

[1]HSA-related tax advantages were authorized by the Medicare Prescription Drug, Improvement and Modernization Act of 2003 for individuals covered by HSA-eligible health plans—plans that meet minimum deductibles and maximum out-of-pocket spending limits. Pub. L. No. 108-173, §1201, 117 Stat. 2066, 2469. Both employers and individuals may—but are not required to—contribute to HSAs, up to an annual limit.

[2]Consumer-directed health plans generally include three basic components—a health plan with a high deductible; an associated tax-advantaged account to pay for medical expenses under the deductible; and decision-support tools to help enrollees evaluate health care treatment options and costs.

[3]HSA contributions up to annual limits are exempt from income tax, and withdrawals for qualified medical expenses are not federally taxed. Contributions exceeding the limit are subject to federal tax. Withdrawals for nonqualified expenses are also subject to federal tax, and—if withdrawn before age 65—an additional tax penalty.

[4]GAO-08-474R (Washington, D.C.: Apr. 1, 2008).

In conducting our work for the April 2008 report, we analyzed industry data, Internal Revenue Service (IRS) data, and nationally representative survey data. To examine participation in HSA-eligible health plans we obtained estimates of the number of lives covered by HSA-eligible health plans from 2004 to 2007 from America's Health Insurance Plans (AHIP).[5] For this statement we updated this information to 2008 based on AHIP's more recent estimates. To examine participation in HSAs, we analyzed 2004 and 2005 tax filer data from the IRS Statistics of Income (SOI) sample to estimate the number of tax filers reporting HSA activity in those years,[6] reviewed various estimates of the number of HSAs in 2006 and 2007 that were reported in health care and financial industry publications,[7] and examined data from nationally representative surveys of HSA-eligible plan enrollees conducted from 2005 to 2007.[8] To examine income characteristics of HSA account holders, we analyzed IRS tax data from the 2005 SOI sample. To examine funding and use of HSAs, we analyzed IRS tax data from the 2005 SOI sample and data from nationally representative employer surveys conducted from 2005 through 2007.[9] We performed this work from September 2007 through February 2008, and a detailed explanation of our scope and methodology is included in the report. I will also draw on findings from our related reports issued in 2006.[10] We conducted all our work in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[5]AHIP is a trade association representing health insurers.

[6]We defined HSA activity for a given year as any reported contributions to or withdrawals from an HSA in that year.

[7]We also interviewed officials from the organizations that prepared the estimates—Atlantic Information Services, Financial Research Corporation, and Information Strategies Incorporated—however, we did not verify the reliability of the estimates.

[8]Blue Cross Blue Shield Association, CDHP Member Experience Surveys, 2005, 2006, and 2007.

[9]Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits: Annual Survey* (Menlo Park, Calif., and Chicago, Ill.: 2005, 2006, and 2007) and Mercer, *National Survey of Employer-Sponsored Health Plans* (New York, N.Y: 2005, 2006, and 2007).

[10]A list of these related GAO products is included at the end of this statement.

In summary, we found that the number of individuals participating in HSA-eligible health plans and HSAs increased significantly since 2004; however, HSA-eligible health plans still represented a small share (about 2 percent in 2006) of individuals with private health coverage. While participation in both the eligible health plans and the HSAs grew, survey estimates indicate that more than 40 percent of the health plan enrollees did not open an HSA, citing among other reasons their inability to afford an HSA or a belief that the accounts were not needed. Tax filers who reported HSA activity in 2005 had higher incomes on average than other tax filers—about $139,000 compared with about $57,000. Among all filers reporting HSA activity in 2005, average contributions—reflecting both individual and employer contributions—were about $2,100, compared to average withdrawals of about $1,000. Among filers who reported HSA contributions in 2005, about 41 percent did not withdraw any HSA funds that year, while about 22 percent withdrew as much or more than their reported contributions. About 93 percent of reported withdrawals were claimed for qualified medical expenses. We reported in 2006 that some HSA-eligible plan enrollees we interviewed were unsure what medical expenses qualified for payment using their HSAs, and that few researched the cost of services before obtaining care.

Background

Most Americans—about 202 million in 2006—receive health coverage through private health plans. Over the past several years, insurers have expanded their portfolio to include insurance plans with high deductibles, lower premiums, and, generally, an associated savings account to pay for services up to the deductible. These consumer-directed health plans are designed to reduce health care spending and encourage more consumer control. To help achieve these goals, insurers typically offer online tools to enrollees designed to help them evaluate the cost and quality of health care services. Experts suggest that reliable information about the cost of particular health care services and the quality of specific health care providers would help enrollees become more actively engaged in making health care purchasing decisions.

Beginning in 2004, insurers began to market HSA-eligible consumer-directed health plans. HSA-eligible health plans are required to meet certain statutory criteria, including minimum deductible amounts, which are higher than health plan deductibles on average, and maximum limits

on enrollee out-of-pocket spending.[11,12] HSA-eligible plans are sold either to an individual or through group plans, such as those offered by employers.

HSAs are tax-advantaged savings accounts established to pay for qualified medical expenses.[13] Individuals are eligible to open an HSA and contribute funds if they are enrolled in an HSA-eligible plan and have no other health coverage, with limited exceptions.[14] Both employers and individuals may—but are not required to—contribute to HSAs, up to an annual limit.[15] Individuals may claim a deduction on their federal income taxes for their HSA contributions not exceeding the limit. HSA withdrawals for qualified medical expenses are not federally taxed; withdrawals for nonqualified expenses are subject to tax and, when withdrawn before age 65, an additional tax penalty. HSA account holders may access their account funds by check, by debit card, or by allowing providers to directly debit their account funds. Account administrators, such as financial institutions, report to IRS the contributions and withdrawals made to and from the accounts they manage, and individual account holders report to IRS the amount of withdrawals they used for qualified medical expenses or other expenses. Unused HSA balances may accumulate from year to year without limit and earn interest. HSAs are owned by the account holder and individuals may keep their accounts if they switch jobs or are no longer enrolled in an HSA-eligible health plan.

[11]An out-of-pocket spending limit is the most an enrollee is required to pay toward the cost of covered services. The out-of-pocket spending limit includes deductibles and other payments, but not premiums.

[12]These amounts are annually adjusted for cost-of-living increases. In 2008, the minimum deductible amount is $1,100 for single coverage and $2,200 for family coverage, and the maximum limit on enrollee out-of-pocket spending is $5,600 for single coverage and $11,200 for family coverage.

[13]Qualified medical expenses are generally identified under the Internal Revenue Code (26 U.S.C. § 213(d)).

[14]Limited coverage (including specific injury or accident, disability, dental care, or vision care) in addition to the HSA-eligible plan is permissible.

[15]The annual contribution limit is adjusted annually for inflation. In 2008, contributions are allowed up to $2,900 for single coverage or $5,800 dollars for family coverage, regardless of the amount of the deductible. In 2007, contributions were allowed up to $2,850 for single coverage or $5,650 for family coverage. Prior to 2007, contributions were limited to the lesser of the deductible amount for the HSA-eligible plan or the limits specified for each year.

Participation in HSA-Eligible Plans and HSAs Increased Significantly, and Many HSA-Eligible Enrollees Did Not Open an HSA

Industry estimates indicate significant increases in the number of individuals covered by HSA-eligible health plans. For example, a series of insurance carrier surveys conducted by AHIP found that the number of lives covered by HSA-eligible plans increased significantly from about 438,000 in September 2004 to an estimated 6.1 million in January 2008.[16] Despite the growth, HSA-eligible plan coverage represented only about 2 percent of individuals with private health coverage in 2006.[17]

Participation in HSAs also increased significantly. IRS data show that the number of tax filers between the ages of 19 and 64 reporting HSA activity nearly tripled from about 120,000 in 2004 to about 355,000 in 2005. In addition, although industry estimates varied, all indicated continued growth in HSA participation in 2006 and 2007. For example, one industry publication estimated that the number of HSAs managed by major financial institutions more than doubled between 2006 and 2007.[18]

Despite the growth in HSA participation, many HSA-eligible plan enrollees did not open an HSA. Nationally representative surveys of HSA-eligible plan enrollees conducted in 2005 through 2007 found that 42 percent to 49 percent reported that they had not opened an HSA, and 20 percent to 24 percent did not plan to open one.[19] Reasons survey respondents cited for not planning to open an HSA included that they could not afford them or they did not believe they needed them. On the basis of an analysis of publicly available survey data and data obtained from IRS, we also reported that roughly 45 percent of HSA-eligible plan enrollees in 2004 did not report contributions to an HSA.[20] Similarly, industry representatives we spoke with told us that many HSA-eligible plan enrollees did not have an HSA. The representatives also said that they expect that there would

[16]America's Health Insurance Plans, *January 2008 Census Shows 6.1 Million People Covered by HSA/High-Deductible Health Plans* (Washington, D.C.: April 2008). The estimates included plans from the individual and group markets.

[17]GAO analysis of America's Health Insurance Plans' 2006 and 2007 estimates of lives covered by HSA-eligible health plans, and the U.S. Census Bureau's 2006 Current Population Survey estimate of lives covered by private health insurance.

[18]Atlantic Information Services, Inc., "Number of HSAs Doubles Over Past Year; Firms Now Hold Nearly $2 Billion, ICDC Finds," *Inside Consumer-Directed Health Care* (Mar. 9, 2007).

[19]Blue Cross Blue Shield Association, CDHP Member Experience Surveys, 2005 through 2007.

[20]See GAO-06-798.

always be some share of eligible consumers who would choose not to open an HSA.

HSA Account Holders Reported Higher Incomes than Other Tax Filers

Tax filers who reported HSA activity and enrollees in certain HSA-eligible plans had higher incomes on average than other tax filers. Among tax filers between the ages of 19 and 64, the average adjusted gross income (AGI) for those reporting HSA activity in 2005 was about $139,000, compared with about $57,000 for other filers.[21] About 59 percent of HSA filers had AGIs of $60,000 or more, compared with 26 percent of other tax filers.[22] Moreover, income differences between HSA and other filers existed across all age groups. (See fig. 1.) Income differences between HSA and other filers also existed within different tax filing statuses, such as single or joint tax filers. In 2006 we reported similar findings based on different data sources covering different time periods. For example, we reported that about 51 percent of HSA filers in 2004 had AGIs of $75,000 or more, compared with 18 percent of all tax filers under age 65.[23] In addition, we reported that among active federal employees enrolled in the Federal Employees Health Benefits Program in 2005, 43 percent of HSA-eligible plan enrollees earned federal incomes of $75,000 or more, compared with 23 percent for all enrollees.[24]

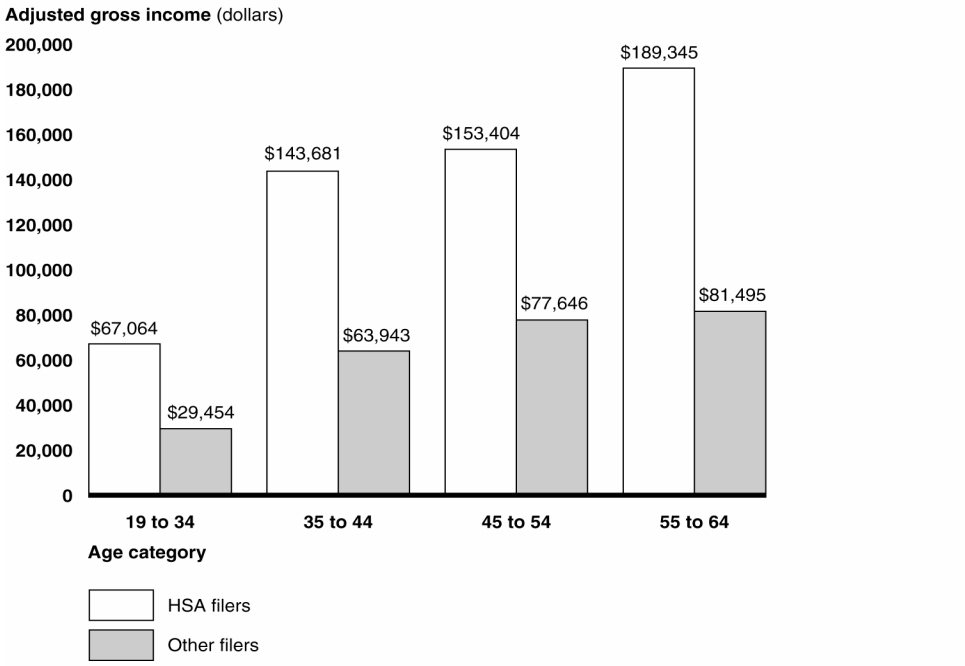
[21]The median income of HSA filers in 2005 was about $72,000 compared with about $32,000 for other filers.

[22]Other tax filers include both insured and uninsured individuals. The uninsured tend to have lower incomes than those with health insurance coverage. For returns of married couples filing jointly, the AGI included the combined AGIs of both filers.

[23]See GAO-06-798.

[24]See GAO-06-271.

Figure 1: Comparison of HSA and Other Tax Filers' Average Adjusted Gross Income by Age, 2005



Source: GAO analysis of IRS data.

Notes: Analysis was limited to tax filers between the ages of 19 and 64. HSA filers included those reporting any contributions to or withdrawals from an HSA. Contributions include those made by individual tax filers or by employers or other individuals on their behalf, but do not include any funds that were transferred to an HSA from a medical savings account. Withdrawals did not include those made to avoid a tax penalty by removing contributions that were in excess of the allowable limits, or those made to transfer funds from one HSA to another. For returns of married couples filing jointly, returns were categorized based on the age of the primary tax filer, and the AGI included the combined AGIs of both filers.

HSA Contributions Exceeded Withdrawals and Most Withdrawals Were Claimed for Qualified Medical Expenses

The total value of account holder and employer HSA contributions in 2005 was about twice that of account holder withdrawals—about $754 million compared to $366 million. Among all filers reporting HSA activity, the average HSA contribution was about $2,100, the average HSA withdrawal was about $1,000, and average contributions and withdrawals generally increased with both income and age. Employer survey data provided varying estimates of the extent to which employers contributed to their employees' HSAs. For example, a series of surveys reported that more than a third of large employers offering HSA-eligible plans did not contribute to their employees' HSAs in 2005, 2006, or 2007.[25] Another survey reported that 47 percent of small and large employers offering HSA-eligible plan coverage for families did not contribute to their employees' HSAs in 2007.[26]

The extent to which account holders withdrew HSA funds varied, but of the funds withdrawn, most were claimed for qualified medical expenses. Among filers who reported HSA contributions in 2005, about 41 percent did not withdraw any HSA funds that year, while about 22 percent withdrew as much or more than their reported contributions.[27] This is consistent with statements from industry experts that characterized HSA account holders as either savers or spenders, where savers primarily used HSAs as a tax-advantaged savings vehicle.[28] Of the HSA funds that were withdrawn in 2005, about 93 percent were claimed for qualified medical expenses. The remaining 7 percent of withdrawals were for nonqualified expenses, which are subject to tax and, if withdrawn before age 65, an additional tax penalty.

We reported in August 2006 that some HSA-eligible plan enrollees we interviewed were unsure what medical expenses qualified for payment using their HSAs, and few researched the cost of services before obtaining

[25]Mercer, *National Survey of Employer-Sponsored Health Plans*, 2005, 2006, and 2007.

[26]Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits: 2007 Annual Survey*.

[27]HSA withdrawals may exceed contributions in a given year if balances are carried over from prior years.

[28]GAO-06-514.

care, although many researched the cost of prescription drugs.[29] In addition, we reported in April 2006 that consumer-directed health plan experts and employers told us the tools provided by insurance carriers to assist consumers in assessing the price and quality of health care providers and services did not provide sufficient information to allow enrollees to fully assess the cost and quality trade-offs of health care purchasing decisions.[30] They cited several reasons for this, including potential legal barriers to greater price transparency and a lack of consensus on what would make ideal quality measures.

Mr. Chairman, this concludes my prepared remarks. I would be happy to answer any questions that you or other Members of the Subcommittee may have.

For future contacts regarding this statement, please contact John E. Dicken at (202) 512-7114 or at dickenj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Randy DiRosa, Assistant Director; Gerardine Brennan; Stephen Ulrich; and Timothy Walker made key contributions to this statement.

[29]See GAO-06-798. Information on HSA-eligible plan enrollee experiences was gathered from focus groups we conducted of employees from three large employers that offered HSA-eligible health plans. These focus groups also revealed that participants generally reported positive experiences, but most would not recommend the plans to consumers who use maintenance medications, have a chronic condition, have children, or may not have the funds to meet the high deductible.

[30]See GAO-06-514.

Related GAO Products

Health Savings Accounts: Participation Increased and Was More Common among Individuals with Higher Incomes. GAO-08-474R. Washington, D.C.: April 1, 2008.

Health Savings Accounts: Early Enrollee Experiences with Accounts and Eligible Health Plans. GAO-06-1133T. Washington, D.C.: September 26, 2006.

Consumer-Directed Health Plans: Early Enrollee Experiences with Health Savings Accounts and Eligible Health Plans. GAO-06-798. Washington, D.C.: August 9, 2006.

Consumer-Directed Health Plans: Small but Growing Enrollment Fueled by Rising Cost of Health Care Coverage. GAO-06-514. Washington, D.C.: April 28, 2006.

Federal Employees Health Benefits Program: First-Year Experience with High-Deductible Health Plans and Health Savings Accounts. GAO-06-271. Washington, D.C.: January 31, 2006.

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