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Health savings accounts: Another conservative 'reform' nostrum that chiefly benefits the rich

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With Obamacare repeal-and-replace on the table, a favorite healthcare “reform” of Republicans and conservatives is about to have another day in the sun: health savings accounts. They sound good — tax-exempt personal slush funds that can be used to pay out-of-pocket medical expenses — but for the average person they’re almost useless and for the healthcare system they’re potentially disastrous.

HSAs were not originally conceived as a solution to the average person’s healthcare needs. They were pushed in the 1990s as a profit generator for an insurance company with a direct line to the eardrums of then-House Speaker Newt Gingrich, who was charmed by their potential to undermine Medicare.

HSAs are great tax shelters for the well to do, but most Americans simply don’t have the extra cash to put into such an account.— Healthcare analyst Wendell Potter

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These accounts have never been hugely popular among healthcare consumers, but they’ve been a central feature of Republican reform proposals since even before the enactment of the Affordable Care Act in 2010. Sure enough, they show up in the very first paragraph of President-elect Trump’s healthcare plank, albeit without any details.

“HSAs are great tax shelters for the well to do,” observes healthcare analyst Wendell Potter, a former Cigna insurance executive. “But most Americans simply don’t have the extra cash to put into such an account.”

Under existing law, a health savings account must be paired with a high-deductible, low-premium “catastrophic” health plan, defined as a plan with a deductible of at least $2,600 for a family. In the case of an unexpected medical event, the idea is that the HSA will cover the deductible and other expenses until the insurance kicks in. The HSA contribution comes out of pre-tax income; employers who offer such arrangements often kick in a few hundred bucks to seed the accounts, which are limited to $6,750 per family (in 2017). Unspent money in an HSA can be rolled over to future years, so the accounts can grow substantially for users without large medical expenses.

Superficially, that might sound like a good deal for many Americans. The vast majority have very little contact with the healthcare system: As the accompanying chart shows, the top 1% of spenders account for 20% of all spending, and the top 5% account for nearly half.

Only 5% of the population accounts for nearly half of all healthcare spending. But HSAs won't be much use to you if you become a member of that 5%. (National Institute for Health Care Management)

In the words of Richard Mayhew of balloon-juice.com, this arrangement is "good for people who have very strong reasons to believe that they are healthy and have sufficient access to resources to afford the high deductible after they get hit by a meteor." They're bad for the unlucky, however: those with expensive chronic conditions, such as diabetes or multiple sclerosis, and those who suffered an earlier catastrophic event that drained their HSA, and then get hit by a second meteor. Of course, most people can't know with any certainty which of these categories they'll land in during any year, since the time frame dividing the lucky from the unlucky can be a nanosecond.

HSAs also are dangerous for the healthcare system overall. That's because they bifurcate the insurance pool, potentially paring younger, healthier customers out of the pool and leaving those expensive, unlucky patients to face higher premiums.

In the years before the ACA when health savings accounts experienced their initial vogue, this prospect worried healthcare experts. George Halvorson, then the CEO of Kaiser, warned that they were "a step backward" from bringing health coverage to more Americans.

The number of HSAs and their total assets rose after 2006 but peaked in 2013... (EBRI)

But then again, HSAs were not primarily designed to improve the healthcare system. They were pioneered by Indianapolis-based Golden Rule Insurance and its owner, J. Patrick Rooney. Rooney and his employees contributed more than $1 million to the GOP and Republican candidates during the mid-1990s, a period in which Gingrich was launched into the speakership.

Gingrich favored Rooney's plea to provide HSAs — then known as medical savings accounts — as an option for Medicare enrollees. The idea fed into his goal of getting Medicare to "wither on the vine" by giving seniors an incentive to "leave it voluntarily."

As it happened, HSAs never were added to Medicare. But in 2003, Congress granted a key Rooney wish by making them tax-free — contributions became tax-deductible, and investment gains within the accounts and spending from them for qualified medical expenses became tax-exempt.

...while average balances appeared to peak around the same time, at a level inadequate to cover out-of-pocket costs of a high-deductible plan. (EBRI)

The change launched a transformation of health insurers into quasi-financial companies hoping to take advantage of an HSA gold rush. Typically these were located in Utah, which allowed non-financial companies to open state banks without subjecting their parent companies to bank regulations.

UnitedHealth Group bought Golden Rule in 2003 and soon afterward created Optum Bank, a wholly owned subsidiary aimed at the HSA market. By 2008 Optum had attracted $600 million in HSA deposits, and collected $34 million in service charges while passing $33 million in profits to its parent company. In 2015, the bank reported $4.2 billion in assets of 3.8 million account holders, and service charges of some $37 million.

Conservatives like to tout HSAs as enormously popular, but the facts don’t back that up. In 2008, the Government Accountability Office found that the number of Americans with high-deductible plans had soared — to more than 6 million in 2008 from 438,000 in 2004 — but that nearly half of the plan holders hadn’t opened an HSA to cover their out-of-pocket expenses, typically because they couldn’t afford to set aside the money. Those who did open HSAs had nearly three times the adjusted gross income as the average taxpayer.

The number of HSA accounts, according to the Employee Benefit Research Institute, peaked at about 12 million in 2013, topping out at $24.8 billion in total assets. Both figures fell back in 2014, possibly because the advent of individual insurance sales under the Affordable Care Act gave customers an alternative. Average account balances plateaued that year at just over $2,000 — not enough to cover the minimum deductible of a catastrophic plan.

It’s unsurprising that HSAs would be concentrated at the upper end of the income scale, for two reasons. One is that any working-class family that has trouble scraping together $1,000 for an emergency — a busted washing machine, a vet’s bill, or a car repair, say — funding an HSA with even that much is a stretch, and the $6,750 maximum HSA contribution a mirage.

The tax benefits of HSAs, moreover, are heavily weighted toward the rich. For a low-income family with minimal federal income tax liability or none at all, the tax deductibility and exemptions of HSAs are meaningless. For a wealthy family declaring income of $467,000 or more and facing a marginal tax rate of 39.6%, however, the tax benefit is fabulous. That family would pocket a tax break of nearly $2,700 at today’s limits.

So it’s understandable that congressional Republicans are hankering to make the tax break even greater. Sen. Jeff Flake, R-Ariz., and Rep. Dave Brat, R-Va., have proposed nearly tripling the maximum HSA contribution to $18,000 for families from $6,750 and eliminating the requirement that they be tied to a high-deductible health plan, thus cementing their role as a tax giveaway to the rich. For our top taxpaying family, that maximum deduction would yield a tax savings of some $7,100.

No wonder that Cato healthcare commentator Michael Cannon lauds the Flake-Brat bill as “a bigger tax cut than you’ve ever seen”; what he doesn’t mention is that the average family won’t see it, only the rich. Remember that, the next time someone tries to tell you that the HSA is a “healthcare reform.” It’s not; it’s a tax cut for people who don’t need another one.