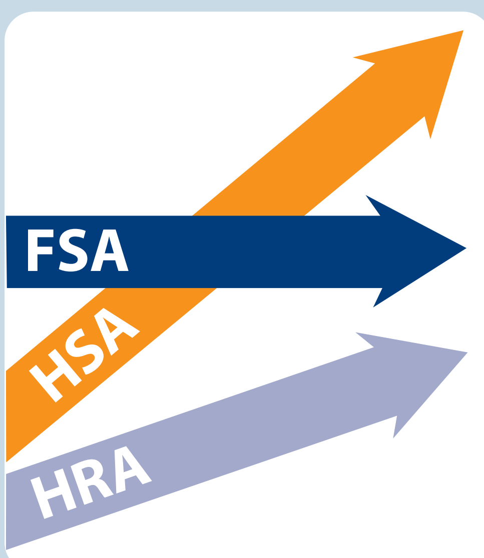
FSA, HSA & HRA Report:
Trends & Predictions

June 2015

A look into the use of FSAs, HRAs and HSAs as market conditions change, and projections for the future of these Consumer-Driven Accounts.

What are employers offering today?



What will they offer in the future?

Introduction

With the Affordable Care Act (ACA) weighing on employers' every healthcare decision, it is no surprise that they are doing whatever they can to stabilize costs for themselves, while better engaging their employees into the cost-sharing process. Plus, with new Employer Mandate requirements and a looming Cadillac Tax not too far off, employers are looking to utilize benefits that provide greater value for themselves and their employees.

The integration of Consumer-Driven Accounts has rapidly emerged at the workplace as a key strategy to combat rising health care costs. These plans enforce why cost shifting is so prevalent and why getting consumers engaged and aware of the cost is important.

Consumer-Driven Accounts are known by several different names, including tax-advantaged accounts, account-based health plans, personal care accounts, pre-tax accounts and more. To keep things simple, we will utilize Consumer-Driven Accounts for the purpose of this report.

Consumer Directed Plan FSA
Health Savings Account
Consumer-Driven Account Tax-Advantaged Account
ABHP Pre-Tax Account HSA
Health Care Accounts Flexible Spending Account Health Reimbursement Arrangement
HRA Account-Based Health Plan
Personal Care Account CDHP

Health Care Flexible Spending Accounts (FSAs), Health Savings Accounts (HSAs) and Health Reimbursement Arrangements (HRAs), are the best examples of Consumer-Driven Accounts because they provide the ability to pre-tax contributions to pay for eligible health care expenses. These benefit programs can provide significant tax savings to both employers and participating employees, which assist in controlling costs and paying for out-of-pocket expenses.

A Health Care FSA is an employee benefit program that allows participants to set aside money, on a pre-tax basis, to pay for unreimbursed health care expenses. Because FSA contributions are deducted from the participant's paycheck before payroll taxes are applied, participants can save around 30% of the amount elected, which can translate into lower healthcare costs.

One significant perk of the Health Care FSA is that participants can access their entire elected amount at the start of the plan year—meaning that they do not need to wait until funds have been payroll deducted before using their account.

A potential disadvantage, however, is that funds not used by the end of the plan year could potentially be lost to the participant, although employers can design their FSA to allow for some limited rollover amounts. Some FSAs can also be used to pay for Dependent Care expenses on a pre-tax basis, but our study did not address this type of FSA and we will not be focusing on them in this report.

HSAs are savings accounts designed to be used in conjunction with High Deductible Health Plans (HDHPs). These accounts allow users to contribute tax-free money to help pay for eligible out-of-pocket health care expenses. HSAs offer what is often referred to as a triple tax advantage; tax-free contributions to the account, tax-free investment earnings and tax-free withdrawals for qualified medical expenses. Unlike FSAs, HSA funds roll over without restriction and accumulate year to year if not spent. HSAs are owned by the individual, which differentiates them from employer-owned benefits like the FSA and HRA.

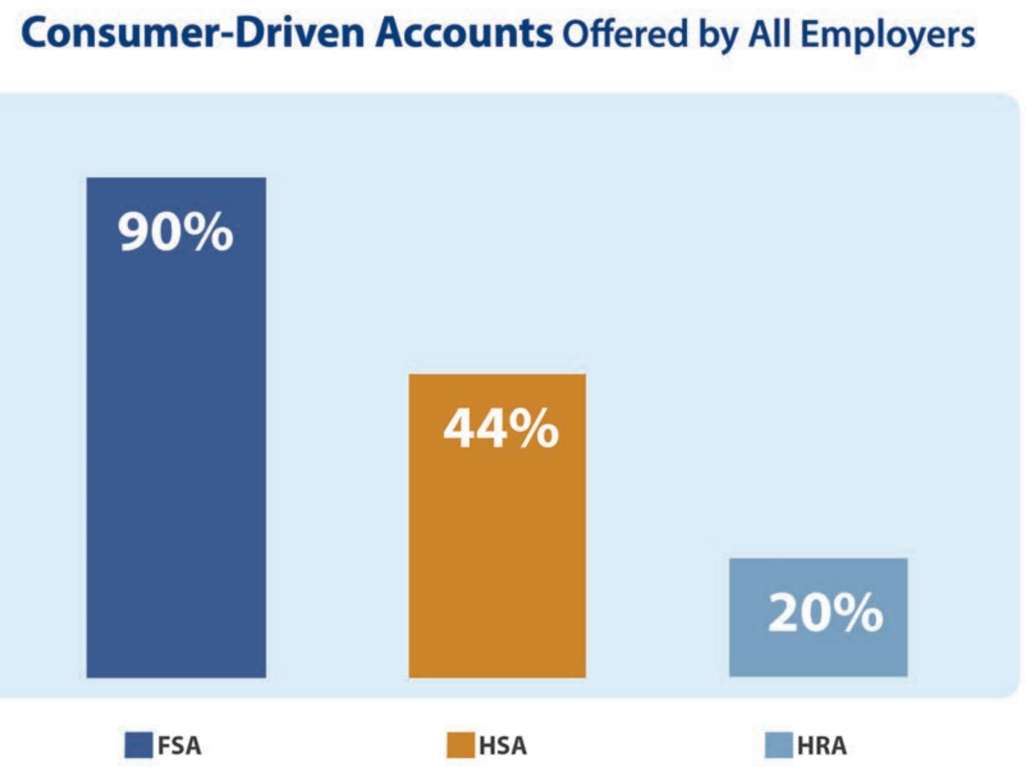
HRAs are employer-funded, tax-advantaged benefit plans that reimburse employees for out-of-pocket medical expenses. HRAs are not limited to HDHPs, as with the HSA, and can be used in conjunction with any type of health plan. The employer decides which expenses are eligible under the HRA, how much the plan will reimburse and if unused funds will roll over at the end of the plan year. The HRA is employer-owned and must be funded solely by the employer.

While FSAs have been around for more than 40 years, HSAs and HRAs have only been available since the early-2000s. With the emergence of the ACA, Consumer-Driven Accounts have received significant interest throughout the benefits industry.

As an advocate in the Consumer-Driven Account marketplace, Flexible Benefit Service Corporation (Flex) pondered how many employers are offering these plans, how offer rates differ by employer size and, in light of the ACA, what the future holds for their growth or demise. Flex received survey responses from more than 500 employers of all sizes throughout the U.S. to find out more about their Consumer-Driven Account offerings and we were able to identify several key trends.

What are Employers Offering Now?

For this survey question, we asked employers to select any and all Consumer-Driven Accounts that they are currently offering.



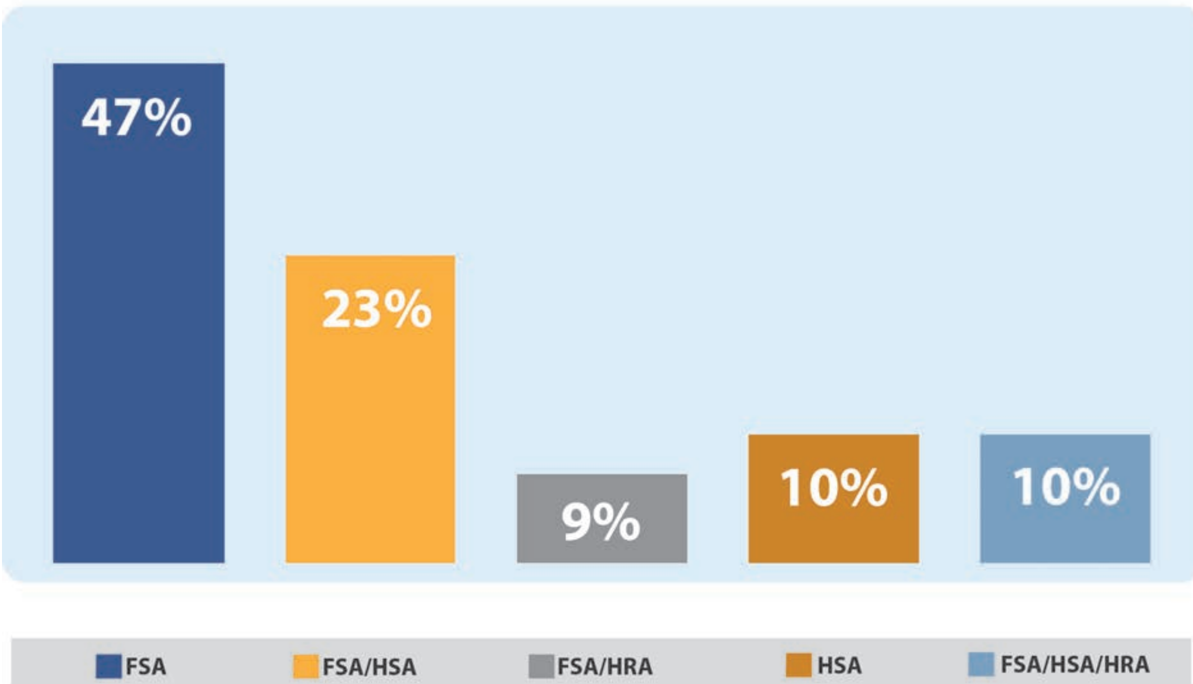
Key Findings

- 90% of employers offered Flexible Spending Accounts (FSAs)
- 44% offered Health Savings Accounts (HSAs)
- 20% offered a Health Reimbursement Arrangement (HRA)

An overwhelming majority of our survey respondents offered an FSA, which indicates that these plans are the most widely used of the three Consumer-Driven Accounts we studied. HSAs were a distant second at 44%, but their popularity was more than double that of HRAs, which are only being utilized by 20% of employers.

As these results do not account for employers who offer more than one Consumer-Driven Account, we decided to take it a step further to see which types of plans are being offered together.

Mix of **Consumer-Driven Accounts** Offered by All Employers



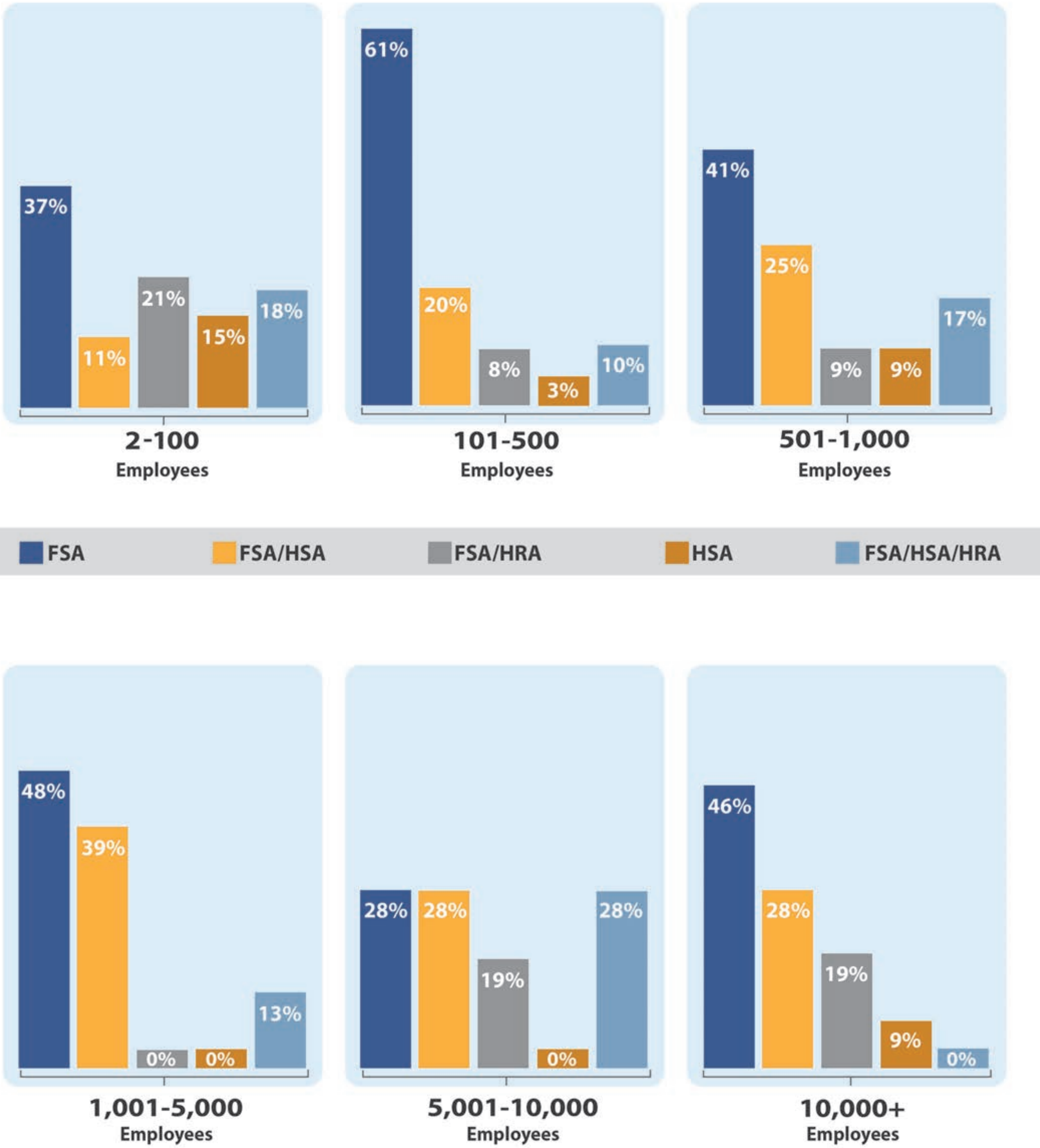
Key Findings

- 47% of employers offered only an FSA
- 23% offered both FSA and HSA

FSAs were the overwhelming favorite, with nearly half of the employers offering the FSA as a stand-alone option. Half as many offered the choice between an FSA or an HSA. The remaining employers were evenly split between the HSA only, all three plans together or the FSA and HRA combination.

So far, our survey results have shown that FSAs have been almost universally adopted by employers with 90% of the total respondents having adopted this benefit, and 47% of those having the FSA as their only Consumer-Driven Account option. However, it should also be noted that HSAs are holding their own, with 44% of employers offering an HSA and 10% of those offering it as a stand-alone option. HRAs are a distant third with only 20% of total employers offering it and none of these employers offering it as a stand-alone option.

We decided to break down the data even further to see what trends we could identify with respect to employer size.



Key Findings

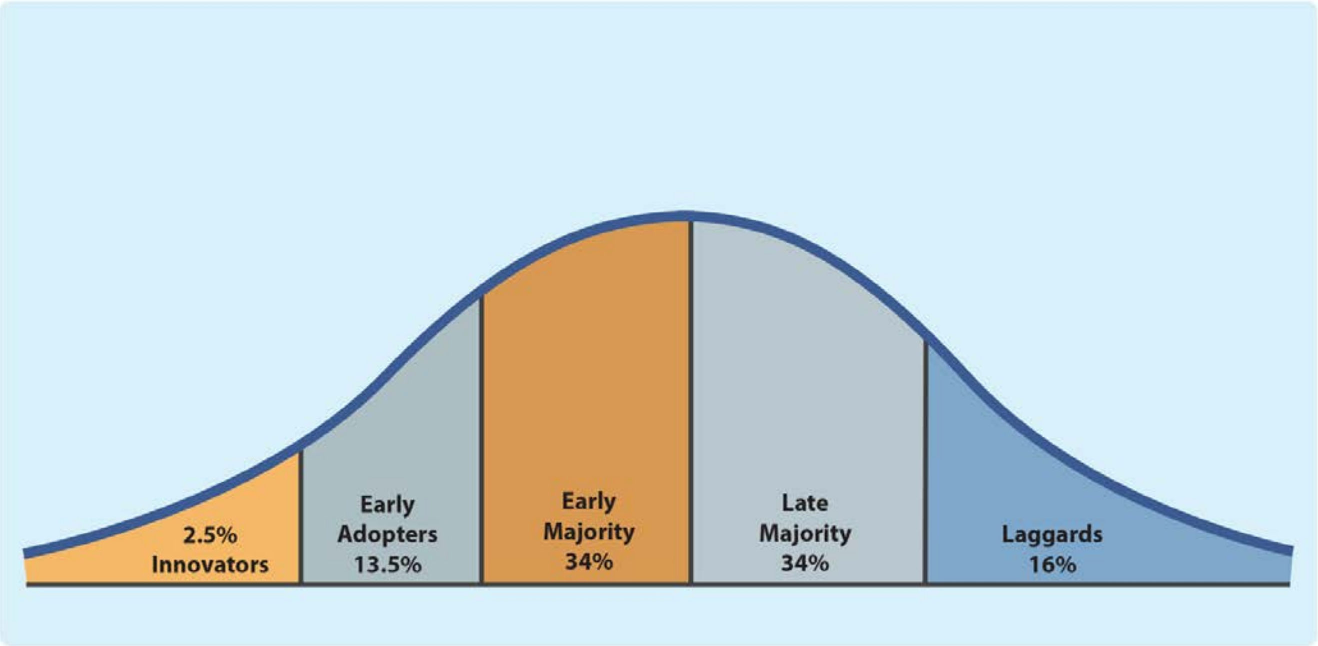
- Stand-alone FSAs were the most popular option across all group sizes, with a noticeable spike in the 101-500 market
- Of all the market segments, stand-alone HSAs were offered most in the 2-100 segment
- When combined with other plans, HRAs were most prevalent in the 2-100 and 5,000+ markets

The stand-alone FSA was strong across all group sizes—leading the pack in every market segment. HSAs are also a popular choice, especially when paired with an FSA, but they seem to have more of a foothold with employers between 500 and 5,000 employees. HRAs have found greater popularity with small or very large employers.

Identifying Trends with Consumer-Driven Accounts

Our research indicates that Consumer-Driven Accounts on the whole are popular with employers of all sizes, but there is a marked difference among the three different plans that we studied. We decided to use the adoption curve to analyze the market penetration for each of these plans.

When a new type of employee benefit plan is introduced, it usually takes a number of years to fully penetrate the market. The adoption curve provides a useful way to break employers down into five segments: innovators, early adopters, early majority, late majority and laggards. The five segments break down as shown in the diagram below.



Flexible Spending Accounts – Only the Laggards Remain

If there's one thing that's clear from our survey results, it's that employers have truly embraced FSAs. In fact, only 10% of our survey respondents didn't have an FSA in some combination or another, which indicates that they have almost reached full market penetration.

The Society for Human Resource Management (SHRM) 2013 Employee Benefits Survey reported that 72% of employers they surveyed offer Health Care FSAs. In fact, their data indicated that the offer rate has remained fairly steady in the past five years, with the 2013 offer rate only one percent higher than in 2009.

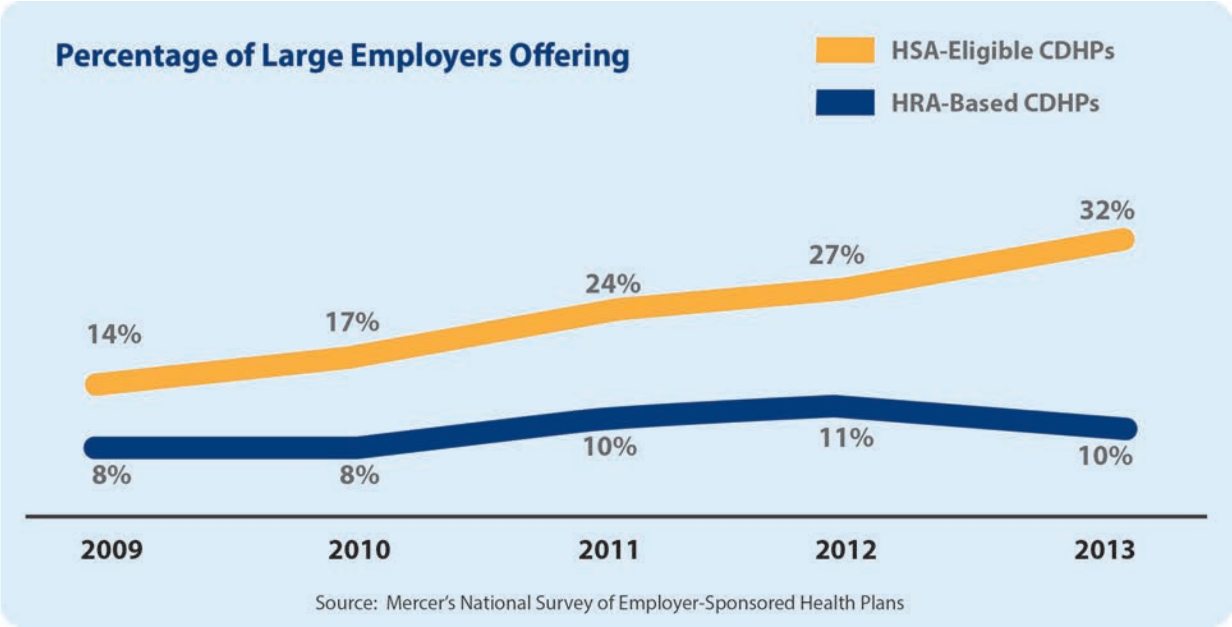
We think the increase can be attributed to recent legislative changes. Since their introduction in the 1970s, FSAs had remained virtually unchanged until the passing of the Affordable Care Act (ACA) in 2010. The ACA brought with it a statutory maximum election ($2,550 for 2015) for Health Care FSAs and limited access to over-the-counter items without a prescription. Despite the limiting effects of these new regulations, we did not see a significant decrease in the popularity of FSAs.

We believe it was the modification to the use-it-or-lose-it rule that is responsible for the spike we're seeing in the FSA offer rate. On October 31, 2013, the IRS announced that employers could now allow Health Care FSA participants to roll over up to $500 of unspent funds into the next plan year. This unprecedented change allowed employers to amend their current plan year to include this new provision, or to adopt it for future years.

This new provision was extremely popular with employers who already offered FSAs, in fact, Flex has seen a 95% adoption rate among our FSA clients. As the use-it-or-lose it rule has always been the biggest barrier to participant buy-in, it only makes sense that the recent modification made FSAs more attractive to employers, and we feel that it is responsible for the large uptick in employer offer rates.

Health Savings Accounts – Headed to the Top of the Curve

HSAs were only introduced in 2004, but they are steadily moving towards the top of the adoption curve as more employers are adopting this benefit each year. The SHRM 2013 Employee Benefits Survey shows steady growth as adoption rates moved from 32% to 42% in the last five years. Our survey results are on par with this study, with 44% of our survey respondents offering the HSA. A recent Mercer survey shows even more growth among large employers, with the offer rate more than doubling between 2009 and 2014.



Another factor that we see as a major contributor to the increase of HSA offer rates is the recent growth of private exchanges. Private exchanges are online marketplaces that give employees access to a variety of health plans and typically use a defined contribution approach to health care. Employers provide a set dollar amount for health coverage, and the employees use that money toward the purchase of a health insurance plan that bests fits their needs.

Since the introduction of the ACA, the number of employers offering private exchanges has significantly grown. A recent Accenture report estimates that 6 million people currently receive employer health benefits through a private exchange, doubling from 3 million in 2014, and they predict that that number may grow as high as 40 million by 2018.

As employees enjoy increased freedom to choose their own health plan, more and more are opting for HSA compatible plans. Aon Hewitt reports that in 2013 their exchange enrollees selected HSA compatible plans at a rate of 39%, as opposed to a 12% election rate outside of the exchange. We believe that defined contributions in the exchange give employees an economic incentive to enroll in lower premium plans and expect to see continued HSA growth as the private exchange trend continues.

Health Reimbursement Arrangements – Stalled on the Way Up

HRAs first appeared on the employee benefits scene in the late 1990s, but they weren't officially recognized by the IRS until 2002. A distant third place in our survey, HRAs seemed to be most popular with small businesses and very large employers. These results fit with the trends that Flex sees as a benefits administrator.

Small employers will oftentimes use the HRA to self-fund a portion of the deductible on an HDHP, which allows them to lower premium costs while still giving their employees a rich benefit plan. Very large employers are more likely to use the HRA as a vehicle for a retiree benefits plan, allowing retirees to purchase their own individual insurance, including health, dental and Medicare plans, with tax-free dollars. It's likely that midsize employers have a lower offer rate for these plans because they self-fund their entire health plan and have lower occurrences of retiree health plans, which may make the HRAs unique attributes less attractive for this particular market segment.

While the HRA can be an extremely useful tool for certain employer groups, current industry data does not support much growth in this market. The SHRM 2013 Employee Benefits Survey actually shows a decline in popularity, with the total offer rate dropping from 26% in 2009 to 19% in 2013. The same Mercer study that showed HSAs growing more than 200% among large employers in the last five years also shows that HRAs have remained fairly level over the same time period with only 10% of large employers offering this benefit in 2013.

We believe the recent surge in HSA offer rates is partly responsible for the lack of growth in the HRA market, as employers may be replacing HRA plans with HSAs. As HSA popularity grows and their tax-advantages are more widely publicized, employers may be seeing HSAs as a more favorable choice for their employees. HRAs have not outlived their usefulness; we still see a definite trend among certain employer types and sizes which would indicate that HRAs are more likely becoming a niche product.

Projections for the Future of Consumer-Driven Accounts

The ACA is a Driving Force

As the ACA continues to impact health plans and premiums, and with many employers' benefits budgets stretched to the limit, we predict that Consumer-Driven Accounts will become an even more important weapon in the employee benefits arsenal. As employers look to restructure benefits to try and lower their total spend, Consumer-Driven Accounts are a key tool for giving back to employees.

The Cadillac Tax is a Major Concern

Implemented as a part of the ACA, the excise or "Cadillac" tax is a 40% tax that must be paid on the value of health benefits that exceed certain dollar thresholds. This new tax that will begin in 2018 already has employers scrambling to make changes to their benefits plans.

A recent Towers Watson survey found that 73% of employers are very or somewhat concerned that they will trigger the tax, and 62% say it will have a moderate or greater impact on their health care strategy in 2015 and 2016. The study also revealed that 48% of employers are likely to trigger the tax in 2018 and 82% could trigger it by 2023.

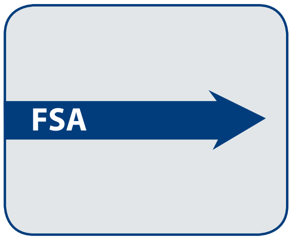
In light of these very real concerns, we predict that Consumer-Driven Accounts will only continue to grow in popularity. Mercer's National Survey of Employer-Sponsored Health Plans showed that nearly a third of employers made benefits decisions in 2014 to try to avoid triggering the Cadillac tax in 2018. The most popular of these was to introduce Consumer-Driven Accounts or take steps to increase enrollment in an existing consumer-driven health plan. The same study also reports that nearly two thirds of large employers expect to offer Consumer-Driven Accounts by 2016.

For nearly a third of employers - 31% - concerns over the 2018 excise tax influenced decisions for 2014	
Introduced a CDHP or took steps to increase enrollment in an existing CDHP	19%
Added or expanded health management programs	12%
Dropped a higher-cost health plan	11%
Unbundled dental and medical plans	4%
Other change(s)	12%

Source: Mercer's National Survey of Employer-Sponsored Health Plans

Although final regulations in regards to the Cadillac Tax are still pending, the value of coverage is expected to include a number of factors related to Consumer-Driven Accounts. Health care FSA contributions made by both the employee and employer are expected to be included, as are HSA contributions made by the employer and HSA contributions made by the employee through salary reduction. It is expected that HRAs will also be included. Future guidance is expected from the Internal Revenue Service (IRS) to help determine the HRA value, but it will most likely be an amount that is not based on the annual maximum reimbursement, but rather past utilization patterns (e.g., average historical reimbursement amounts as opposed to maximum annual reimbursement available).

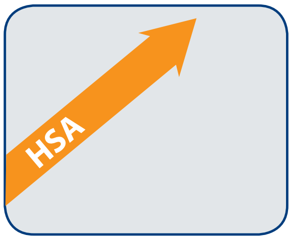
FSAs will Sustain



With 90% of our survey respondents indicating that they currently offer an FSA, we predict a majority will continue to offer these accounts within their benefits programs. While we expect employer offer rates to remain high, we predict employee enrollment rates for the FSA to decline slightly. This is due to other trending consumer-driven options, such as HSAs, and a more educated consumer looking for greater value for their short- and long-term healthcare needs.

We don't expect the Cadillac Tax to have much of an impact on FSA offer rates, as employers rarely contribute to the FSA. It is possible, however, that employers may be forced to lower their maximum employee election in order to keep the value of coverage for all plans below the Cadillac tax thresholds.

HSAs will Surge

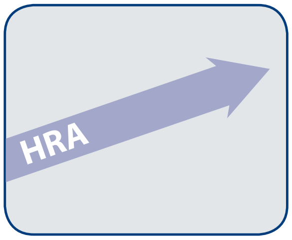


In light of the steady growth of HSAs over the past five years, we predict that the employer offer rate will increase significantly and employee adoption rates will spike. In fact, other industry reports predict that there will be nearly 45 million HSAs by 2020. *(1)*

The increasing popularity of private exchanges only stands to boost HSA enrollment even further. As employees have more choice and control when it comes to their health plans, we think they will gravitate toward HDHPs and HSAs. These plans bring with them not only the lower premium of the HDHP, but also the tax savings of the HSA, which is a win-win for the individual. Considering that some industry predictions place private exchange enrollment as high at 75 million by 2020, there are sure to be plenty of opportunities for continued HSA growth.

(1) HSA Consulting Services, LLC and Consumerdriven, LLC

HRAs may Emerge as a Viable Commodity



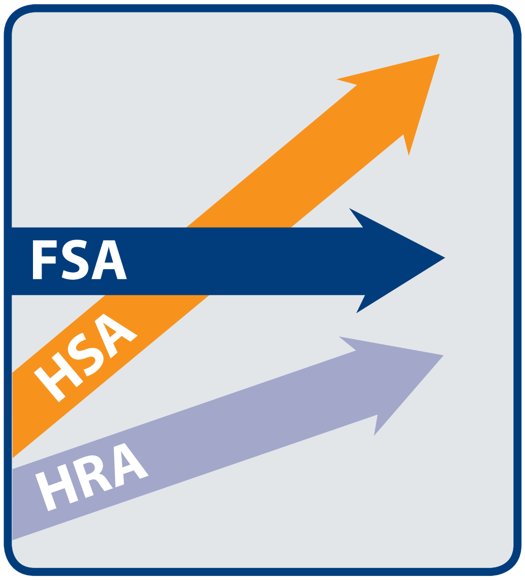
HRAs may become the unsung heroes of Consumer-Driven Accounts. We predict employers may be more inclined to offer an HRA due to its lesser impact on Cadillac Tax thresholds. Since the value of the HRA will most likely be based on past utilization and not the annual maximum reimbursement amounts, these plans stand to be a bit more economical for employers who are worried about the total value of coverage. The HRA allows them to offer employees a health plan with lower out-of-pocket exposure and without as significant an impact to the Cadillac Tax thresholds.

Conclusion

It is an exciting time in the benefits industry with the ACA roll-out providing twists and turns to Consumer-Driven Accounts. In fact, each type of account may be impacted differently by legislative changes or market needs. Nevertheless, the trend from our data and external sources maintains that Consumer-Driven Accounts are here for the long haul. The staying power of these vehicles lies in their inherent ability to be offered interchangeably in whole or in part by another type of Consumer-Driven Account (e.g., Limited-scope FSAs bundled with HSAs, HSAs instead of FSAs if a qualified HDHP is present, etc). Each account provides a viable option to save money for employees and employers on a pre-tax basis.

As the ACA continues to evolve, however, which plans will rise or fall in the employers favor is the question. Our report shows that different employer sizes use these accounts in different ways. The combinations of how these plans are bundled are notable. Employers must continue to pool various factors including political, industry and/or user experience to decide which plan to offer employees. What may have been optimal for a company just a few years ago may now be out-of-date. Whether it be FSAs that have reached significant market penetration, HRAs that seem to have found a niche with certain employer sizes, or HSAs whose growth continues to skyrocket, these plans must be taken into consideration as they each have earned their rightful place at the table of employers' benefits offerings.

Most notably, the future for HSAs looks bright. The fact that the cost of health care is going up is no surprise, but at the current rate, integrating a tax-advantaged resource like a Health Savings Account seems to be a natural move. With the rapid emergence and quick growth of exchanges, HSAs will continue to surge as a standard benefits practice by many employers. Putting the employee or individual in control of when, where and how they use their benefits, while incurring more upfront costs, will be an optimal strategy for many.



Survey Methodology

The Flex Plans Employers Survey was produced by Flexible Benefit Service Corporation (Flex). A total of 568 recipients – representing a full range of industries and company sizes nationwide – responded from December 16, 2014 through January 9, 2015.

The first annual survey, from which the results of this report were generated, was mailed electronically to a sample of employers using lists that Flex has gathered at trade shows, speaking events, educational seminars, etc. This survey was intended for business and Human Resource professionals who are not current clients of Flex and who are decision-makers for the following product offerings for their employer: Flexible Spending Accounts (FSAs), Health Savings Accounts (HSAs) and Health Reimbursement Arrangements (HRAs).

The survey was not open to the general public and invitations to participate are non-transferable. Estimated completion time was under three minutes. No purchase was necessary. The chance to win (1) one $250 gift card giveaway was offered. To be eligible for the giveaway, the respondents had to complete the survey in-full. The winner was selected randomly and notified via the email provided during the survey.

Two attempts were made to contact these recipients. An original communication on December 16, 2014 and a final reminder on January 5, 2015. There was a limit of one entry per person and they were required to complete the online survey by 11:59 p.m. CT on January 9, 2015.

Flexible Benefit Service Corporation (Flex) thanks all the survey respondents who made this survey possible.

About Flexible Benefit Service Corporation

Flexible Benefit Service Corporation (Flex) is a leader in the health insurance and benefits administration marketplace. Since 1988, Flex has continuously offered cost-effective health care solutions for producers, employers, employees and individuals. Through their consumer-driven strategies and insurance offerings, Flex serves as a full service general agency and benefits administrator. The comprehensive Flex product portfolio includes flexible spending accounts (FSAs), health reimbursement arrangements (HRAs), health savings accounts (HSAs), COBRA administration and more. Flex also partners with IXSolutions to offer the IXSuite private exchange and IXStore online marketplace.
Learn more at flexiblebenefit.com.

Media Contact

Nick Severino, Director of Marketing
Flexible Benefit Service Corporation (Flex)
888-353-9178 | nseverino@flexiblebenefit.com