Time to Rethink Your Health Insurance?

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If you get your healthcare coverage through your workplace, open season will be on you sooner than you realize. Open season allows employees to change health care plans and change contributions to healthcare or flexible spending accounts. Take the time now to determine if you are better off with a high deductible/health savings account combination, or if a more traditional plan makes sense for you and your family.

The Basics. Over the past couple of decades, we've gotten used to the PPO/POS/HMO[1] insurance model: There is a network of participating providers. Most doctor's visits and prescriptions require co-pays. There are out-of-pocket costs for emergency room visits, hospital stays, and outpatient procedures. You may need a referral to see a specialist. So long as you stay within your network, costs are known.

Typically, your employer subsidizes insurance premiums, a nontaxable benefit. There are no formal regulations around the availability and size of employer subsidies; on average, larger employers subsidize 80 percent of an individual employee's premiums and 70 percent of family members. However, those subsidies vary wildly, both in percentages and in whether they cover family members. Employees are responsible for any premium not paid by the employer; those premiums are paid with after-tax dollars.

Along with these plans, your employer may offer a Flexible Spending Account (FSA). An FSA allows the employee to contribute pre-tax dollars to pay expenses not covered by the employer's insurance plan. Here, tax free really means tax free: FSA contributions (unlike 401k contributions) are not subject to Social Security or Medicare taxes.

You can use your FSA to pay expenses including co-pays, out-of-pocket costs, both over-the-counter and prescription drug costs, and the like. The 2021 FSA contribution limit—for any employee—is $2,750. You select the contribution amount during open season and usually cannot change it during the year. Your employer may permit you to carry forward as much as $550 of an unused FSA to the following year—anything else is gone. As a result, December tends to be a big sales month for prescription eyewear and over-the-counter medication. Further, if you leave your job with an unused FSA balance, it may disappear.

High Deductible Healthcare Plans. Your employer may also allow you to enroll in a High Deductible Healthcare Plan (HDHP). These plans are required to have specific, higher limits on your potential deductible and out-of-pocket costs. For 2021, the deductibles must be at least $1,400 for an individual and $2,800 for a family and no more than $3,600 and $7,200, respectively. The maximum out-of-pocket costs (including the deductible) may not exceed $7,000 and $14,000, respectively. The tradeoff for these potentially higher expenses is lower premiums and the ability to participate in a Health Savings Account—often with an employer contribution.

[1] In order: Paid Provider Organization, Point of Service plan, Health Maintenance Organization.

Along with lower premiums, some—but not all—HDHPs allow you to open a Health Savings Account (HSA). This is the big selling point and is critical in helping an HDHP make economic sense. Think of the HSA as a souped-up FSA. You can use it to pay for the same qualified medical expenses. Your contributions are pre-tax and escape Social Security and Medicare taxes.

However, an HSA can do far more than an FSA. You can contribute more--$3,600 for an individual plan and $7,200 for a family plan (plus an additional $1,000 if you are at least age 55). Your employer may contribute as well—up to $750 for an individual plan and $1,500 for a family plan. Unlike an FSA, HSA balances don't expire at year end and are portable between employers. If you retire with a balance, you can use your HSA to pay retirement health care costs.

If you use your HSA for healthcare in retirement, withdrawals remain tax free. Withdrawals after age 64 for non-healthcare costs are taxable. Before age 65, those withdrawals also incur a ten percent penalty. Essentially, your HSA can enhance your retirement savings. Moreover, you can invest HSA funds before spending them. Your employer has a default custodian for your HSAs, and in order to receive the employer contribution you must use that custodian until you leave your job. Once you do move on, you can use the custodian of your choice.

Making the Decision. Received wisdom says young, healthy employees are better off with the HDHP/HSA combination. It's more nuanced than that. Calculators exist; many ask for inputs such as the full cost of doctor's appointments or prescription drugs. You likely have no clue about those numbers and would probably stop the analysis there.

An alternative method is to compare your costs under the two alternatives, assuming you use your full deductible. A couple of real-world examples may help.

Young and single: Eleanor needs only cover herself. Her employer offers a PPO with an annual deductible of $500 and a maximum out-of-pocket (including the deductible) of $2,000. Her bi-weekly cost is $116. Alternatively, Eleanor can enroll in an HDHP for $69 every two weeks. The annual deductible is $1,500 (out of pocket maximum of $2,500), and her employer will contribute $750 to Eleanor's HSA. Here's how the math stacks up:

	PPO	HDHP
Deductible	$500	$1,500
Additional Out of Pocket	$1,500	$1,000
Annualized Premium	$3,016	$1,794
Employer HSA Contribution		($750)
Eleanor's Total Maximum Cost	$5,016	$3,544

Even if Eleanor is a heavy healthcare user, she saves using the HDHP/HSA combination. If she were to use her entire deductible but not incur additional out-of-pocket costs, she'd still save with the HDHP/HAS: that is $2,544 for the HDHP/HSA versus $3,516 for the PPO.

Older with Family: Faith covers her spouse and children on her health insurance. Further, her employer's premium subsidies are less generous. Because Faith is comparing family plans, her employer will contribute $1,500 to an HSA. Here are Faith's choices:

	PPO	HDHP
Deductible	$1,000	$5,000
Additional Out of Pocket	$7,000	$7,000
Annualized Premium	$11,443.80	$10,804.04
Employer HAS Contribution		($1,500)
Faith's Total Maximum Cost	$19,443.80	$21,304.04

For Faith, the large difference in the deductibles along with the small difference in the premiums militate for the PPO.

<u>HSA Considerations</u>. If the HDHP/HSA combination appeals, there are a few other variables to consider. First, once you turn 65 and register for Medicare, you are no longer able to contribute to an HSA. If you continue in the workforce after age 65, be certain you understand your Medicare registration requirements and how those affect your employer-provided health insurance.

As noted above, to receive an employer contribution to your HSA, you must use your employer's custodian. Take a good look at that—many custodians are owned by insurance companies. They may come with high fees, limited investment choices, and unattractive returns. This is more of an issue if you intend to build up your HSA for retirement, and it can make the HDHP/HSA combination less economical.

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IMPORTANT: This information should not be construed as tax or legal advice. Please consult your attorney or tax professional before pursuing any of the strategies described above.

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