Account-*ability*

HCSAs are becoming a popular choice for both employers and employees.

BY ART BABCOCK

If you were designing the ideal benefit, you'd probably want it to appeal to employees, offer plan sponsor funding and be tax-effective, flexible and easy to administer. However, you might be surprised to learn that such a benefit already exists: spending accounts (SAs) offer all of this—and more.

SAs have been around for a number of years, but until recently they were not what many in the industry considered mainstream benefits. This view is changing rapidly as plan sponsors look to find more efficient and effective ways to provide a high-value benefits program to employees who expect them as part of their total compensation package.

The SA family includes the healthcare spending account (HCSA)—a.k.a. health spending account or healthcare expense account—and the personal spending account (PSA)—sometimes called the flexible spending account. Like fraternal twins, they have similar and distinct characteristics.

While both options are gaining momentum, HCSAs presently have the edge. A 2010 Aon Hewitt survey indicated that 57% of plan sponsors surveyed currently offered an HCSA, and almost 28% planned to do so in the next 24 months. Fifteen percent of respondents offered a PSA.

The SA "brothers" enjoy significant popularity among employees; 91% of HR leaders responding to the survey indicated they believe employees perceive the HCSA/PSA as a valuable part of their benefits program. Additionally, results from the 2010 *sanofi-aventis Healthcare Survey* showed that

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A *Hybrid* Approach

Applying the DB-DC plan model to group benefits. **By Michael Trowell**

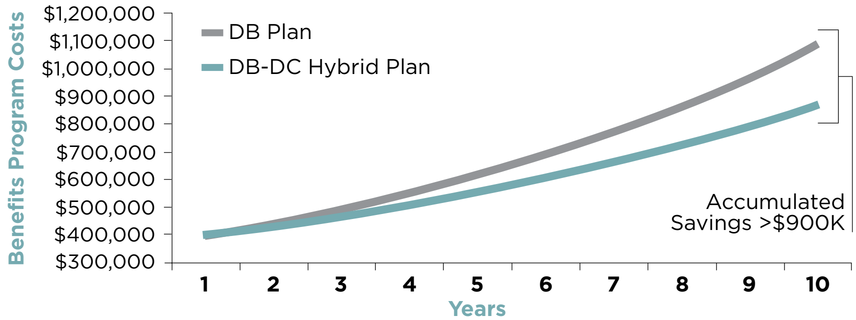
Traditional group benefits programs are facing unsustainable cost pressures; healthcare costs alone are expected to double in the next five years, based on information included in the 2010 *Canadian Health Care Trend Survey Results* by Buck Consultants. There are many contributors to the cost pressures, including cost inflation, changes in prescription drug costs and usage, the introduction of new, expensive drug therapies, the increased utilization of paramedical services, the off-loading of expenses by governments to private plans and an aging workforce.

Although it may seem that many of these pressures are beyond plan sponsors' control, there are actions employers can take to reduce some of the related costs.

Look no further than the retirement services industry, where a major shift from DB to DC plans is occurring. Why not take that same philosophy and apply it to group benefits programs?

Define the contributions made by the plan sponsor as opposed to the benefits covered. Shift the more predictable, non-catastrophic benefits (such as vision, paramedical and dental) from a DB to a DC model. Maintain the unexpected catastrophic benefits—drug coverage, out-of-country medical, certain medical services and supplies—within your DB arrangement. CONT'D ON PAGE 27

The potential savings of implementing an HCSA



Note: This is based on current health and dental costs of $400,000 and the transfer of dental, vision and paramedical benefits from a DB to a DC arrangement (assumes average industry claiming patterns). Average industry inflationary factors have been applied to the DB plan (13.8% for health and 8.0% for dental), compounded annually. An increase to employer contributions of 3% per annum has been applied to the DC plan. This example assumes no plan design changes during the period. Results will vary by organization.

Source: Comprehensive Benefit Solutions Ltd.

HCSAs had the second highest rate of usage among a number of health-related benefits. Funding through plan sponsor contributions no doubt adds to the popularity of these accounts from the employee perspective.

Red Deer, Alta.-based Pat Quesnel, senior vice-president of Servus Credit Union, says members of the company's plan give high marks to the SAs it offers. "We offer our staff both a healthcare spending account and a personal spending account, and our HR advisory committee has given us very positive feedback on both," he says. "It puts decision-making in employees' hands and moves our benefits program from a good plan to an exceptional plan." Quesnel also reports that the most claimed HCSA expenses are for vision care (41% of claims), dental care (20%) and health plan premiums (17%).

Administration Duties

A third party, typically the insurance company that administers the health portion of the benefits program, most often handles administration of HCSAs and PSAs. The Aon Hewitt survey revealed that 88% of HCSAs and PSAs were administered by third parties. This arrangement simplifies the operation of the plan for both the employer and the employee, and offers the advantages of professional adjudication, assurance of privacy, external dispute resolution and recordkeeping/reporting services. For example, Great-West Life has moved its HCSA administration and claims payment forward with the introduction of a debit card-type process.

Plan sponsors enjoy the fact that HCSAs and PSAs can be budgeted relatively easily. The maximum liability on an annual basis is simply the employee allocation times the number of eligible employees (adjusted for carry-over and forfeitures) plus the administration fees. Administration fees most commonly range from 7% to 10% of paid claims.

The *Income Tax Act*

HCSAs are tax favoured under the *Income Tax Act* (ITA), while PSAs confer taxable benefits to the user. Considered as private health services plans by the Canada Revenue Agency (CRA), HCSAs allow employees to be reimbursed for health, dental and vision care expenses that are eligible as tax credits under Section 118.2 of the ITA, on a tax-free basis. Items such as health or dental plan deductibles and co-pays, certain paramedical services, "over maximum" amounts and employee-paid group health and dental premiums are but a few examples of expenses for which employees can claim reimbursement from their HCSA. One large insurer reports that dental and vision care combined make up the majority (more than 60%) of claims reimbursed under its clients' HCSAs.

Although not constrained by the ITA, reimbursements from a PSA will be taxable to employees. The good news is that employers can choose to reimburse staff for almost anything they choose to include in the program. Most often, plan sponsors align eligible items with company wellness or professional development initiatives, although some plans include things more unique to their employee needs or work environment. Some examples of plan sponsor reimbursed expenses include conference attendance, personal development lessons, fitness memberships, subscriptions, nutrition/weight loss programs, green fees, sports equipment and accounting services.

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A DB-DC hybrid plan—the combination of these two benefit strategies—may be a possible solution. A benefits program would continue to provide coverage for those losses that may be considered "true insurance" (drugs, out-of-country medical) while using tax-effective DC vehicles such as healthcare spending accounts (HCSAs) to fund the remainder of the programs. The amounts allocated to the HCSA are determined by the plan sponsor, thus providing full control in the allocation of available resources. Any unused allocations are forfeited, according to Canada Revenue Agency rules, back to the organization. These accounts are easier to administer than a traditional flexible benefits arrangement, making them a realistic alternative for all employers.

Benefits for Employees

For employees, a DB-DC plan offers considerable flexibility. The DC component provides plan members with a predetermined annual contribution; members may choose how to spend their benefit dollars. This not only encourages a degree of consumerism but also provides employees with choice. HCSAs also expand the list of eligible expenses, increasing the depth of the benefit offering. If today's intergenerational workforce has taught us anything, it's that people's needs are different and that choice is key. Through the introduction of more options and flexibility, you can enhance the perceived value of your benefits program and increase attraction and retention.

Generally, firms with average to above-average vision, dental and paramedical claims (in excess of 30% to 35% of total group benefits costs) are good candidates for a DB-DC hybrid plan.

Implementing the Hybrid Approach

A financial analysis of the current program is the first step in determining whether or not this approach is a viable alternative for an organization. Total current benefit costs, claiming patterns, industry inflationary factors and proposed increases to employer contribution levels form the basis for this assessment. Generally, firms with average to above-average vision, dental and paramedical claims (in excess of 30% to 35% of total group benefits costs) are good candidates for a DB-DC hybrid plan. An analysis of this type will demonstrate the potential financial impact of implementing these changes, which, in many cases, is significant (see chart on page 23).

Once the analysis is completed, employers are able to determine if this concept is right for their plans. There is no doubt that traditional group insurance programs will need to respond to cost pressures currently facing benefits programs. The DB-DC hybrid plan may be the answer. **BC**

Michael Trowell is assistant vice-president of Comprehensive Benefit Solutions Ltd. mtrowell@compben.com

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"Our plan started with both an HCSA and a wellness account, but we changed the taxable component to a more narrowly defined professional development account (for one employee class) or cash payout basis," says Leasa Schmelzle, benefits co-ordinator at Athabasca University in Alberta. Schmelzle offers a tip to plan sponsors considering a "wellness account" approach: "Be sure to have clear reimbursement guidelines from the beginning."

Account Contributions

Plan sponsor allocations to HCSAs and PSAs vary widely. Typical HCSA annual contributions range from $150 to more than $5,000 for some executive programs. The Aon Hewitt survey indicates averages of $767 for HCSAs and $460 for PSAs. Servus Credit Union offers employees $750 annually, while Athabasca University provides $875 or $1,000 annually, depending on classification.

The CRA allows HCSA allocations (often referred to as "credits") to be carried forward for 12 months after the year in which they were granted. Any credits not used within that time are forfeited. Alternatively, plan sponsors may elect to establish an expense carry-forward provision, subject to the same forfeiture rules. Credits may never be "cashed out" under the CRA guidelines.

PSA allocations, on the other hand, are not subject to such restrictions unless implemented by the plan sponsor. PSA credits may be converted to cash, used to fund RRSP/tax-free savings account contributions or carried forward indefinitely according to the employer's design.

Although they do have somewhat different personalities, HCSAs and PSAs do get along and "play well with others." Their popularity, flexibility and utility make them an appealing benefit for many employers and employees alike. **BC**

Art Babcock is vice-president with Aon Hewitt in Edmonton.
art.babcock@aonhewitt.com