Legislative Fiscal Bureau
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January 25, 2006

TO: Members,
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Senate Bill 131 and Assembly Bill 341: Offering Health Savings Accounts under the State Employee Health Care Coverage Program

Senate Bill 131 (SB 131) and Assembly Bill 341 (AB 341) are virtually identical companion bills would direct the Group Insurance Board to offer health savings accounts (HSAs) under the state employee health care coverage program. The bills differ in only one minor regard. SB 131 uses the Public Law 108-173 reference to HSAs, while AB 341 uses the United States Code reference to HSAs.

SB 131 was introduced and was referred to the Joint Committee on Finance on March 23, 2005. AB 341 was introduced on April 15, 2005, and was referred to the Assembly Committee on Health. A public hearing on the bill was held on June 9, 2005. On January 17, 2006, the Assembly Committee on Health adopted Assembly Amendments 1 and 2 on separate votes of 8 to 5. The bill, as amended, was recommended for passage by a vote of 8 to 5. The bill was referred to the Joint Committee on Finance on January 17, 2006.

CURRENT LAW

The Group Insurance Board of the Department of Employee Trust Funds (ETF) offers group health care coverage plans for state employees, local government employees, and Wisconsin Retirement System annuitants. For state employees, the Board must offer at least two insured or self-insured health care coverage plans providing substantially equivalent hospital and medical benefits, including a health maintenance organization or a preferred provider plan, if those health care plans are determined by the Board to be available in the area of the employee's place of employment and are approved by the Board. The Board is required to place each of the plans into one of three premium payment tiers established in accordance with standards adopted by the Board. The tiers must be separated according to the employee's share of premium costs.

Under federal law, an employee or another worker covered by a high-deductible health insurance plan may make pre-tax contributions to an HSA to cover heath care costs. HSAs became effective for federal purposes as of January 1, 2004. High-deductible health plans must satisfy certain requirements related to minimum annual deductible amounts and maximum out-of pocket expense amounts. The associated amounts are indexed annually for inflation. For tax year 2006, a high-deductible health plan must have at least a $1,050 annual deductible for self-only coverage and a $2,100 deductible for family coverage. A qualified plan must also limit annual out-of-pocket expenses paid under the plan to $5,250 for individuals and $10,050 for families. Such expenses include deductibles, co-payments, and any other amounts paid for plan benefits.

Contributions to HSAs may be deducted from gross income in the determination of adjusted gross income, and are limited to the lesser of: (1) 100% of the annual deductible for the high-deductible health plan; or (2) for 2006, $2,700 for individuals and $5,450 for families. Eligible individuals over the age of 55 are permitted an additional contribution of $700. The contribution limits are adjusted annually for inflation.

An individual's employer may also make contributions to an HSA on behalf of an eligible individual. If an employer makes such contributions, the employer must make available comparable contributions on behalf of all employees with comparable health insurance coverage during the same period. If an employer makes contributions to an HSA for an employee, the contribution limits described above apply to the sum of the contributions made by the employer and the employee. If both an employer and an employee make contributions to an HSA for the employee, then the amount contributed by the employer is excluded from the employee's gross income (and associated unemployment and withholding taxes), and the amount contributed by the employee may be deducted from income on the employee's individual income tax return.

The state does not currently offer a qualified high-deductible health care plan to state employees that could be utilized for the purposes of an HSA, nor does the state contribute to HSAs.

SUMMARY OF BILLS

As introduced, SB 131 and AB 341 were identical except that AB 341 contained updated cross references to federal law relating to health savings accounts and high-deductible health plans. The two bills would require the Group Insurance Board, beginning on January 1, 2006, to offer a health care coverage option to state employees that consists of a high-deductible health plan and the establishment of an HSA authorized under federal law. Both bills would also require that the state make annual contributions into each employee's HSA that are equal to the difference between the state's share of the annual premium cost of the high-deductible health plan and the state's share of the annual premium cost of the lowest tier plan that is available in the county in which the employee resides.

Subject to the approval of the Group Insurance Board, ETF would be required to promulgate all rules required for the administration of HSAs for state employees. Following enactment, the provisions of the bill would apply to nonrepresented state employees as soon as the state compensation plan provided for the new benefit. The new benefit would apply to represented state employees as provided in the collective bargaining agreements between the represented state employees and the state.

Assembly Amendment 1 (AA1) to AB 341. Under AB 341, the state would be required to make annual contributions to each employee's HSA that are equal to the difference between the state's share of the annual premium cost of the high-deductible health plan and the state's share of the annual premium cost of the lowest tier plan that is available in the county in which the employee resides. AA1 to AB 341 specifies that the state's contribution into each employee's HSA would equal the lesser of the following: (1) the difference between the state's share of the annual premium cost of the high-deductible health plan and the state's share of the annual premium cost of the lowest tier plan that is available in the county in which the employee resides; or (2) the maximum contribution to HSAs allowed under federal law.

The federal maximum amounts in 2006 would be the lesser of the annual deductible under a high deductible health plan or $2,700 for individuals and $5,450 for families, with eligible individuals over the age of 55 permitted an additional contribution of $700. As drafted, the citation of federal law contained in AA1 relating to the maximum allowable HSA contribution limits refers only to the family maximum. A technical correction to the federal citation is required to correctly reference the separate maximum contribution limits for single coverage.

Assembly Amendment 2 (AA 2) to AB 341. Under AB 341, the state contribution as described above would be required. AA 2 to AB 341 would authorize, but not require, the state to make the contribution.

FISCAL EFFECT

In 2005, the total costs for state employee health insurance coverage was approximately $615.2 million (all funds). The number of employees covered under state employee health insurance plans in 2005 totaled approximately 68,500 individuals. ETF estimates that about 5% of state employees do not enroll in the health care coverage plans offered by the state.

The ETF fiscal notes for both SB 131 and AB 341 are based on an analysis prepared by the Group Insurance Board's consulting actuary of a substantially identical bill introduced in the 2003 legislative session [2003 Assembly Bill 939]. ETF estimates that the provisions under SB 131 and AB 341 would result in additional state costs of approximately $32.0 million (all funds) annually.

This would represent an increase of 5.2% to the estimated total costs of state employee health care incurred in 2005.

The agency's estimate reflects the annual fiscal effect of the provisions when fully implemented. Although the bills would require the Group Insurance Board to offer the HSA health care coverage option to state employees beginning on January 1, 2006, group health care insurance contracts for state employees have already been entered into. Consequently, the provisions of the bills, if enacted, could not now be implemented until the next plan coverage year commencing January 1, 2007. If implemented on January 1, 2007, the initial fiscal effect on state costs would impact the last six months of the 2005-07 biennium, and its full effect would be realized in the 2007-09 biennium.

The ETF fiscal estimate makes certain assumptions about the characteristics of the high deductible health care plan that would potentially be offered to state employees, if the SB131/AB 431 proposal was enacted. The plan design assumes: (1) deductibles of $2,000 for single coverage and $4,000 for family coverage; (2) 20% coinsurance for covered services obtained in-network; and (3) maximum out-of-pocket expenses of $5,000 for single coverage and $10,000 for family coverage. Higher coinsurance and maximum out-of-pocket expenses would apply for services obtained out-of-network. Based on this plan design and average 2005 premium costs for the lowest tier plans currently offered, ETF estimates that the annual HSA contributions for state employees utilizing the high deductible plan would total about $1,900 for single contracts and $4,000 for family contracts.

The ETF fiscal effect estimate of $32.0 million is based on the operation of three separate factors. First, a certain number of state employees who currently “opt-out” of health care coverage under the state plans would likely enroll in the health care coverage provided under the bills in order to receive the state’s HSA contribution. The actuary estimates that approximately 5% of state employees currently opt-out of state employee health care coverage and that 60% of these individuals (or 3% of state employees) would enroll in the HSA program. The state contributions associated with such new enrollees would constitute an additional cost for the state.

A second component of the fiscal note relates to the fact that HSA contributions become the property of the employee and any unused portion of these contributions at the end of each year would be retained by the employee; that is, these state contributions are not returned to the state. ETF indicates that, under current law, unused premium contributions (for example, when an employee leaves state service) are used to offset the coverage costs of higher cost plan members. Stated differently, funds that are not needed for current year coverage are retained by the state and are available to help address the overall costs of state employee health care. Under the SB 131 and AB 341, state payments to HSAs that are not used for medical coverage would not be returned to the state to address overall state employee health care costs.

The third component of the state fiscal effect relates to the adverse selection effect the establishment of the health care option provided under the bills would have for the current state health care coverage pool. In public testimony offered on AB 341, ETF indicated that health insurance claims data indicates that about 62% of individuals covered by health insurance incur claim costs of less than $1,000 per year. This 62% of the health-care population accounts for less than 5% of health care costs. According to ETF officials, it is this group of low-cost individuals that would find the HSA option the most attractive because their HSA contributions from the state are very likely to exceed their actual health care needs in a given year. As noted above, these excess amounts would be retained by employees in their HSA accounts.

As these individuals leave the current state health care pool, the health characteristics of the remaining pool members would, on average, be more expensive to address. The current health care pool would, in effect, be deprived of those individuals who help keep average costs down. [This cost effect is termed anti-selection or adverse selection.]

A secondary effect of this anti-selection factor is that, as average costs increase for the primary health care pool, HSA contributions (under SB 131 and in AB 431 as introduced) would also increase over time. This is because the annual contributions into each employee's health savings account would equal the difference between the state's share of the annual premium cost of the high-deductible health plan and the state's share of the annual premium cost of the lowest tier plan that is available in the county in which the employee resides. As the cost of the lowest tier plan increases over time, due to adverse selection, the spread on which the HSA contribution is calculated would tend to increase. As a result, state costs would increase due to both higher premium costs for state employees in the regular health insurance coverage pool and increasing contribution amounts paid into state employee HSAs.

While not specifically addressed in the ETF fiscal estimate, it should be noted that under the two bills, individuals who choose the high deductible health care coverage and HSA option would not have to retain this option in the future. That is, during each annual open enrollment period for state employee health care coverage, individuals who formerly enrolled in the high deductible health care coverage and HSA option could opt back into coverage under the state’s regular health care options. That is, individuals who know that they or their family face higher health care costs in the coming year could opt-out of the high deductible plan by enrolling in one of the state’s regular plans and thus avoid using their HSA accounts for the higher health care costs. This factor would further increase premium costs for the state health insurance pool (this additional cost cannot be determined at this time).

Assembly Amendments. The amendments (AA1 and AA2) to AB 341 would change the fiscal effect estimates made by ETF. Under AA1, the state’s contribution into each employee's HSA would equal the lesser of: (1) the difference between the state's share of the annual premium cost of the high-deductible health plan and the state's share of the annual premium cost of the lowest tier plan that is available in the county in which the employee resides; or (2) the maximum contribution allowed under federal law. The amendment, by limiting contributions to the federal maximums, would ensure that the HSAs would qualify for the federal tax treatment of HSA contributions. This amendment would appear to potentially limit the state contribution so that this cost would not continue to increase (beyond the federal limit) as the annual premium cost of the lowest tier plan increased over time. However, this amendment would not reduce the fiscal effect relating to the three primary components of the ETF fiscal estimate (current state employee "opt-outs" enrolling in the high deductible plan, state employees retaining unused HSA contributions, and anti-selection effects increasing overall state costs for health care coverage).

Under AA 2 to AB 341, the contribution provision would specify that the state may (rather than shall) make the specified contribution to the state employee HSA. The intent of this amendment may have been to provide some flexibility for the state to contribute somewhat lesser amounts to employee HSA accounts than those required under the bill as introduced. However, ETF officials indicate that this amendment would not necessarily change the state fiscal effect of the bill. On the one hand, if the state made no contribution to employee HSA accounts, or made minimal contributions that would not clearly help employees in high deductible plans to cover their deductibles, few, if any, employees would choose this health care option. In this case, there would be no fiscal effect for the state. However, if the state made any HSA contribution that was meaningful in meeting the deductible requirements of the high deductible health care plan, it is likely that the full fiscal effects discussed above would occur.

Finally, the Department of Revenue (DOR) also submitted fiscal notes to SB 131 and AB 341. As noted above, contributions to HSAs may be deducted, up to certain maximums, from gross income in the determination of adjusted gross income for federal tax purposes. However, HSA contributions would be taxable under state law. DOR estimates that these contributions would generate additional tax revenues of $2.17 million annually from state employees who would choose the HSA high deductible option. This would take effect beginning in the tax year the HSA account was activated, with state income taxes payable beginning in the following year.

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