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BRIEF & OVERVIEW

Health Insurance Design Meets Saving Incentives: Consumer Responses to Complex Contracts

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SUMMARY

To lower health care costs, Health Savings Accounts (HSAs) offer tax incentives in exchange for a higher insurance deductible. This new paper by Adam Leive provides a framework for optimal HSA use and shows that consumer behavior surrounding HSAs does not match policymakers' intentions.

KEY FINDINGS
Optimal Savings Model

- A dollar saved in an HSA is worth more in the future than a dollar saved in other accounts.
- Due to the HSA's more generous tax preferences, allowing the HSA to grow until the age of 65 can save money in the long run. People are often better off reducing their 401(k) contributions to pay for current health care expenses (rather than using their HSA). Whatever loss to their 401(k) is incurred is less than the value of the increased HSA balance.
- An optimal "rule of thumb" is to limit HSA withdrawals while working (for those with access to liquidity). Instead, the employee should build HSA assets while working (rather than use them for health spending) and use other funds to pay for health spending before age 65.

KEY FINDINGS
Consumer Behavior

- Most consumers do not use their HSA as a savings vehicle and withdraw most HSA balances each year.
- Very few employees max out their HSA, but many save beyond the employer match in their 401(k). By reallocating some of these 401(k) contributions past the 401(k) match limit to the HSA, employees in this study could have received over $550/year in tax benefits.
- In contrast to other studies, health spending did not decline in this setting after the employer switched to high deductible health plans. Many people offset the higher deductible by withdrawing HSA money.
- Similar to other studies, these findings cast doubt on the effectiveness of high deductible health plans, but for a different reason. Other studies have found people struggle to distinguish high-value care from low-value care and even reduce preventive care, which is covered for free. This study found people did not reduce preventive care, but they did not use their HSAs to self-insure against lifetime health care costs.

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BACKGROUND KNOWLEDGE

- HSA contributions are tax-exempt, investments made to the HSA grow tax-deferred, and deferrals for qualified medical expenses are tax-free. Employee contributions made through payroll deduction are not subject to payroll taxes (unlike 401(k) contributions). HSAs can be inherited by a spouse, who can also make tax-exempt deductions for qualified expenses.
- HSAs must be paired with a high deductible health care plan.
- HSAs have more complex features than other insurance products and offer tax subsidies meant to encourage people to trade off current health care expenses against future consumption.
- About 30% of US workers are enrolled in these plans.

FURTHER QUESTIONS

- An important unresolved question is why people behave this way.
- These findings are consistent with mental accounting models. Mental accounting is a cognitive process where people categorize income and expenditure items into different accounts, even though the money is technically interchangeable.
- Consumer use of HSAs could also be due to misperceptions about how HSAs operate or awareness about HSA rules.

ADDITIONAL DETAILS

- This study is based on data collected from a large U.S. employer that fully replaced its traditional, low-deductible health insurance with high deductible health plans and HSAs.
- This employer is a large U.S. health insurer, so it is reasonable to believe its employees have a high degree of health insurance literacy, providing a best-case scenario to assess how informed consumers make choices between complex health insurance contracts.
- The use of HSAs as self-insurance requires sufficient liquidity to meaningfully trade-off current versus future consumption.

FAQs

What are the consumer implications of this work?

Health Savings Accounts are powerful ways to save for post-retirement health expenses. Given the preferential tax treatments of HSAs, both current contributions to and later deductions from HSAs are better for the financial well-being of a consumer. In fact, saving a dollar less in a 401(k) to avoid withdrawing a dollar from the HSA to pay for current health expenses can save people money over the long-term. However, this requires that the employee have enough liquidity and available resources to be able to keep funds in the HSA and, instead, pay for immediate health expenses in other ways.

What are the employer implications of this work?

For employers interested in offering these plans, campaigns to help employees understand the many rules and features of HSAs may be beneficial to aid decision-making. In particular, the tight links between HSAs and 401(k)s may be a topic worth highlighting.

What are the policy implications of this work?

Not using the HSA as self-insurance blunts the incentives of the deductible to reduce costs. In this study, HSAs did not reduce health spending. Instead, a higher share of spending was financed tax-free. If consumers do not behave according to standard economic theory, offering complicated financial products like HSAs can fall short of realizing policy objectives.

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