The Effects of Health Care Reform on Flexible Spending Accounts

A recent Hewitt analysis shows that most Americans will not see a major change or cost impact to their own flexible spending accounts (FSAs) as a result of the recently passed U.S. health care reform bill. This analysis was conducted among Hewitt’s benefits administration database of more than 220 employers covering more than six million employees. Employers that offer this benefit, on the other hand, will quickly have to take a number of steps to comply before 2011 annual enrollment begins.

Few Employees Currently Take Advantage of FSA Account Benefits
Despite the tax savings, only one in five (20%) employees contributed to an FSA in 2010. However, employees who do participate find the benefit very valuable. Individuals typically save between $250 and $400 each year in federal taxes. In addition, 75% of FSA expenses are for prescription drugs and medical treatments, showing that FSAs serve as an important source of funds for wellness, maintenance care, and medication.

OTC Drugs Affected by Reform Comprise a Small Portion of Overall FSA Spending
Most immediately, starting in 2011, over-the-counter (OTC) medicines other than insulin will no longer be reimbursable through FSAs without a prescription. Items such as Tylenol and antihistamines will now need a doctor’s order to be reimbursed by an FSA. Health care reform does not change the reimbursement status of OTC items that are not medicines (e.g. bandages). An analysis of companies using Hewitt’s Spending Account Administration services found that approximately seven percent of all FSA claims in 2009 were for OTC drugs, the majority of which are still eligible.

Most Employees Contribute Significantly Less Than the New $2,500 Maximum Limit
Starting January 1, 2013, FSA accounts will be limited to $2,500 annually. This cap will be adjusted annually, indexed to inflation. Of those employees who contribute to an FSA, the average annual contribution is $1,441. Just 18% contributed more than the new limit of $2,500 and those who did tended to be individuals earning more than $150,000 per year.

To Comply, Employers Have Their Work Cut Out For Them
Approximately 94% of all companies offer their employees an FSA benefit. They now need to take a number of steps in order to comply with the new regulations. Specifically, those steps include:

■ Work with their spending account administrator to exclude OTC medicines that do not have a prescription and verify these administrators do not allow these items to be purchased with an FSA-specific debit card.

■ Update plan documents, summary plan descriptions, and other plan materials to reflect the changes.

■ Begin communicating now to employees about how these changes may impact them and use these changes as an opportunity to promote the value of spending accounts generally.

■ Begin thinking about how to modify plans and administrative systems – including modeling tools – to limit FSA contributions to $2,500 by 2013. According to Hewitt data, most companies that currently offer FSAs (62%) currently have a $5,000 contribution maximum. Only 4% had a $2,500 or less maximum.

With the passage of health care reform, FSAs will continue to benefit employees and employers though reduced expenditures and meaningful tax savings.