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Is a Credit Card the Answer to HSA Reimbursement Questions?

JOHN J. ROBBINS SR.

As explained in this article, many regulatory issues recently have been resolved so that employers, carriers and providers now may offer electronic payment cards as a way to facilitate payment of health expenses.

Today, more than ever, the employee benefits market is experiencing many changes due to new governmental guidelines, evolving technology, changing health insurance arrangements, the slumping economy and industry consolidation. Employers and administrators alike are seeking more benefits for the dollar spent and more cost-effective ways to deliver them.

CONSUMER DRIVEN HEALTH CARE

The rising cost of providing employees with a competitive benefit plan has led to the development and growth of a new health care paradigm called Consumer Driven Health Care (CDHC), in which individuals are encouraged to become more savvy health care consumers. The traditional components of a CDHC plan have included Flexible Spending Accounts (FSA) and Health Reimbursement Arrangements (HRA). Under these plans, employers can establish an FSA and/or an HRA to provide tax-free medical expense reimbursement to employees. An employee who incurs medical expenses that are not otherwise covered or reimbursed (i.e. co-payments) may be reimbursed for such expenses by participating in the FSA or HRA. If the FSA or HRA is established and maintained in accordance with IRS rules, the amounts reimbursed are excluded from the employee's gross income and are deductible by the employer.

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THE DRAWBACKS

There are drawbacks, however. With FSAs, for example, employees can end up having to pay upfront twice for the same medical bill. First, they have money deducted from their paychecks each period, which are subsequently deposited into their FSA. When the employees receive medical service, they must pay the co-payment or any other required charges at the time the services are rendered. In many instances, reimbursement for these out-of-pocket expenses involves time-consuming paperwork for both the employee and the employer and creates additional administrative costs for the employer or benefits administrator. The employees receive their reimbursement checks by mail at a later time - sometimes as much as a month later. For years, employers, carriers and providers strived to develop electronic payment cards as a way to facilitate payment of health expenses but were hindered by a plethora of technology and regulatory issues. All that changed in 2003.

With the release of Revenue Ruling 2003-43 on May 28, 2003, the IRS lifted a cloud of uncertainty regarding the use of debit and credit cards in FSA and HRA accounts. Unknowingly perhaps, it also opened a window of opportunity for the soon-to-be-developed Health Savings Accounts (HSA). The ruling solidified the IRS's position on substantiation requirements, including:

- ♦ The employee must certify that the expense is eligible.
- ♦ The expense is not reimbursed from any other source.
- ♦ The employee will not seek reimbursement from another plan.
- ♦ The expense must be substantiated by the medical provider.
- ♦ The claim must be adjudicated.

The ruling states that adjudication is required on all FSA and HRA claims without exception, but electronic adjudication is acceptable if it meets certain standards, which begins with the cards being limited to medical providers via Merchant Category Codes. Also, substantiation must happen by way of one or more of the following:

- ♦ Correlation of the amount of the expense to a specified co-payment under the plan
- ♦ Correlation of the amount of the expense to a recurring amount for a previously approved charge (e.g., a prescription refill) at the same provider
- ♦ "Real time substantiation" via tie-in with an independent third-party adjudicator (e.g., a pharmacy benefits manager).

IRS RULING

On Sept. 3, 2003, the IRS also issued a ruling that over-the-counter (OTC) medicines can be reimbursed from FSAs and HRAs. This was a significant event for employer plan sponsors, employees, third-party administrators (TPAs) and card vendors. Most plan participants want to have OTC drugs reimbursable under their benefit plans, and they want to be able to buy them anywhere, not just at certain designated drug stores.

Employers want the convenience promised by the card vendor, as well as the increased payroll tax savings generated when more of their employees participate (enrollment increase) with even larger contribution amounts elected (contribution increase). The more dollars directed into these accounts (exchanging taxable salaries for nontaxable benefits), the more payroll tax savings generated for both the employee and the employer.

DEBIT OR CREDIT?

Debit cards were the first to appear — well in advance of the Revenue Rulings mentioned above. In fact, the market for electronic payment cards for reimbursement accounts began in roughly 1995-96, when several companies began to aggressively pursue the employer plan sponsor directly while also aggressively pursuing the Section 125 Cafeteria Plan system vendors to enter into marketing co-ops. The co-op effort brought value to the TPA (the responsible party to the employer plan sponsor customer) by building an interface between the card system and the vendor's Section 125 administration system.

A unique form of debit card emerged called the stored value card. Although a typical debit card is tied to a general bank account, a stored value card is tied to specific employer-sponsored reimbursement accounts. These are nominal accounts supported by the underlying programs. The stored value card, therefore, is able to access multiple reimbursement "purses" based on the priority payment criteria established within the system.

Indeed, stored value cards work well for FSAs and HRAs and have experienced rapid growth in the benefits industry because they eliminate the cash flow burden created by out-of-pocket expenditures arising under the historical payment methods. In addition, stored value cards reduce paper administration for the participant, administrator and employer plan sponsor. On the other hand, stored value cards can also include faxing and other paperwork — termed "pay and chase" — for funded and unfunded payments.

There are also certain characteristics inherent in stored value card platforms that limit the debit card's effective transition to the newly created health savings account (HAS), including:

- Because FSAs and HRAs only allow disbursements for qualified medical expenses, debit card vendors limit purchases on the stored value cards to specific merchant category codes. On the other hand, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, under which the HSA was created, stipulates that account holders must have unlimited access to the funds in their HSAs. In addition, account holders are entitled to use the money in their HSAs for any reason (although there is a penalty and applicable tax due on any disbursement for a non-qualified expense). Therefore, stored value cards create a burdensome barrier between account holders and their HSA funds.
- Because they are tied to worksite implementation, stored value cards are not portable. Once an employee leaves a company, they cannot take their stored value card with them.
- Stored value cards do not offer flexibility if an employee's account lacks funds. Unlike the FSA and the HRA, where the entire balance is available to the employee on the very first day of the plan year, funds in an HSA are only available as they are deposited. Therefore, an employee could experience significant out-of-pocket expenses at the beginning of the plan year before an adequate account balance has been accumulated.

LINES OF CREDIT

In response to this last issue, debit card vendors have been experimenting with adding a personal line of the credit to their stored value card platforms, which basically creates a form of HSA overdraft protection. But this stop-gap measure does not address one of the most unique aspects of a HSA: the fact that it is a "savings" account wherein an individual can actually choose not to seek reimbursement right away in order to build up funds tax-free over the years. With a stored value card, funds are pulled from the account at the point of sale, basically removing one of the most attractive features of having a HSA in the first place.

Credit cards, with their natural procedural interrupt between the point of sale and the debit of funds from the account, have emerged as an attractive alternative. In their native form, these credit cards are just like any consumer credit card issued by a sponsoring bank. However, because they are built on the consumer

credit card platform, they provide inherent advantages that cannot be replicated otherwise. Stored value cards simply cannot change their underlying nature in order to "retrofit" or refashion themselves to fit within the rules and regulations.

As mentioned above, the credit card creates a natural boundary between the point of sale and the debit of funds from the account. It is important to point out that the HSA cannot serve as collateral for the credit card. It is the interconnectivity of the credit card and the HSA that empowers the account holder with connections. Because the employee's credit card account is based upon the "reimbursement approach," it involves two accounts: the employee's credit card account from which the swipe is paid and the HSA from which the reimbursement is paid. This empowers the account holder with the ability to decide whether to use the money in the HSA or to pay the credit card statement with other funds and allow the HSA balance to continue to grow. Doing this is impossible with stored value cards because they are direct pay instruments. Doing this with credit cards is not just possible — it is natural.

Each month the card balance can be paid off in two ways. One option is for a TPA to make a payment to the card account from the individual's HSA instead of issuing a check or direct-depositing money into the individual's personal account. The other option is for the account holder to pay off the balance with personal funds and then seek reimbursement at a later time (allowing for tax-free growth of his or her HSA).

FUNDAMENTAL DIFFERENCE

Another major advantage of a consumer credit card platform is based on the natural differences between a credit card and a stored value card; the credit card is owned and funded by the individual, while the stored value card is part and parcel to the underlying benefit plans funded by the employer. This fundamental difference is the reason why a credit card can be a perfect companion to an HSA, which is also owned by the individual.

Account holders and employers also appreciate the fact that no "pre-funding" of the HSA is required to provide liquidity to the credit cards because the bank is providing credit to the individual employees. This removes the worry that an individual will not have enough money in his or her account to pay for medical expenses.

The HSA credit card can also differ from a traditional credit card because it does not have to be tied to individual credit until after employment. Employers can have a credit check run on their companies in order to underwrite all employees, thereby negating the chance that some employees not be able to obtain a

card due to credit issues. The company simply agrees to a guarantee agreement with the card's issuing bank stating that if a cardholder does not pay off the balance, the employer will cover the balance and can recoup the funds via payroll deduction. Employers can also suspend the cards at any time if employees are abusing the card or aren't paying off their balances. Individuals can request individual underwriting if they would like to increase their credit line while still employed or if they would like to keep the card upon termination. This portability of the credit card is a powerful differentiator when dealing with HSAs, which were created specifically with portability as a defining characteristic.

NO "HIDDEN" COSTS

An attractive aspect of the credit card to a TPA is that there are no "hidden" costs associated with the credit card, unlike most card solutions on the market today. The cost of maintaining the credit card is naturally borne by the cardholder, as is typical with consumer credit cards. This eliminates "fee stacking" of the card vendor's fees on top of the TPA's fees. Some TPAs add the card vendors' fees (say, \$1.50 per employee per month) on top of their fees, which absorb much of any elasticity the TPA may otherwise have to subsequently raise their rates in the future. And because the bank fee can be claimed as an HSA reimbursement from plan assets, the bank fee can be paid with tax-free dollars.

Based on what we know and understand about both payment systems, employees and employers alike can not only benefit from utilizing a HSA but can also reap the benefits of selecting the right payment method. There are benefits to both methods; however, a credit card solution offers more in the way of flexibility and ease of use.