GROOM LAW GROUP

October 31, 2006

MEMORANDUM TO CLIENTS

RE: DOL Guidance Provides Further Clarification on HSAs and ERISA

On October 27, 2006, the Department of Labor ("DOL") issued Field Assistance Bulletin 2006-02, addressing frequently asked questions that DOL has received concerning the application of ERISA to Health Savings Accounts ("HSAs") since the release of FAB 2004-01 in April, 2004.[1] The guidance is helpful to employers because it identifies several ways in which an employer can assist employees with setting up an HSA without causing the HSA to become subject to ERISA. Particularly significant is that DOL has clarified that the prohibition on employer "endorsement" that applies under other DOL safe harbor guidance relating to group or group-type insurance *does not* apply to an HSA as long as the employer satisfies the specific requirements of FAB 2004-01. However, the guidance also serves as a reminder that the prohibited transaction rules apply to HSAs, and provides some examples of when the prohibited transaction rules may be implicated when an employer makes available HSAs to employees.

I. Background

In FAB 2004-01, DOL provided guidance concerning when an HSA could be considered outside the definition of ERISA. Specifically, FAB 2004-01 provides that an employer can contribute to an HSA and can select a single HSA provider to which it will forward employer and employee contributions without causing the HSA to become subject to ERISA as long as the employer does not:

1. require employees to establish an HSA (i.e., establishment must be completely voluntary);

2. limit the ability of participants to roll funds over to another HSA, if allowed by the Code;

3. impose conditions on the use of HSA funds (e.g., stating that HSA distributions may only be used for medical expenses);

4. make or influence the investment decisions with respect to funds contributed to an HSA;

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[1] A Field Assistance Bulletin is guidance that the Department of Labor issues to its enforcement staff to follow in conducting an audit.

5. represent that the HSAs are an employee welfare benefit plan established and maintained by the employer; and

6. receive any payment or compensation in connection with an HSA.

In this guidance, it was not clear what other steps employers should avoid to ensure that their involvement in the HSA was appropriately limited.

II. FAB 2006-02

A. ERISA

FAB 2006-02 ("FAB") clarifies that an employer can take the following actions and still satisfy the above requirements of FAB 2004-01, allowing employee HSAs to be outside the scope of ERISA:

- *Open an account for employees and make contributions on behalf of employees*. DOL states that this would not violate the "voluntary" requirement of FAB 2004-01, as long as employees could decide whether or not to make salary reduction contributions, and could move funds to a different HSA provider.

- *Select an HSA provider that also offers some or all of the investment options made available to employees in the employer-sponsored Section 401(k) plan.* DOL states that this would not violate the prohibition against making investment decisions, as long as there are reasonable investment options available, and as long as employees are not limited in moving their funds to another HSA. However, DOL states that the selection of a single HSA provider that offers a single investment option would not afford employees a reasonable choice of investment options. Given this guidance, it is not clear whether an HSA provider could require an account owner to accumulate a threshold HSA account balance before offering additional investment options and still satisfy the "reasonable choice of investment options" requirement.

- *Pay HSA fees that the employees would otherwise have to pay*. DOL states that because employers are allowed to contribute to an HSA without causing it to be subject to ERISA, employers should be able to pay fees as well.

- *Limit the HSA providers that an employer allows to market their HSA products in the workplace or select a single HSA provider to which it will forward contributions*. DOL also provided this information in FAB 2004-01. This guidance makes clear that such actions will not be considered prohibited "endorsement" by the employer.

- *Allow employees to contribute to HSAs through the employer's cafeteria plan.* DOL states that the FICA and FUTA tax savings that an employer achieves by allowing employees to make HSA contributions through the employer's cafeteria plan should not be viewed as violating the prohibition in FAB 2004-01 that an employer not pay or receive compensation in connection with an HSA.

- *An HSA provider may offer an HSA product that it offers to the public to its own employees without the HSAs being considered ERISA plans.* DOL states that offering HSA products that the employer offers to the public in the regular course of business would not mean that an HSA provider has established or is maintaining the HSA as an employer.

B. Prohibited Transaction Issues

FAB 2006-02 also clarifies the following issues with respect to the application of the prohibited transaction rules under Code section 4975 to HSAs:

- HSA providers may offer cash incentives that are put directly into accounts, without violating the prohibited transaction rules.
- An employer must promptly transmit participants' HSA contributions to the HSA provider, otherwise fiduciary and prohibited transaction issues could be raised for the employer.
- An employer who selects an HSA vendor may not receive a discount on another product from the HSA vendor.
- Certain ERISA prohibited transaction class exemptions that apply to owners of individual retirement accounts do not apply to HSA account holders. In particular, DOL has issued a number of class exemptions that permit the aggregation of IRAs and non-IRA accounts for purposes of qualifying for discounted or no cost services. By their terms, these exemptions do not apply to all "plans" subject to section 4975, and are instead specifically limited to IRAs (including SEPs and SIMPLE IRAs). As such, DOL's guidance with respect to PTEs 97-11, 93-33 and 93-1 is not surprising. What is less clear however, is the availability of other exemptions that apply to all "plans" under section 4975 for HSAs. For example, PTEs 75-1 and 84-24 cover investment advice to plans and should cover HSAs, as well as IRAs, since HSAs are "plans" under section 4975.
- An HSA accountholder may direct the payment of HSA funds to a credit line vendor to reimburse the vendor for HSA expenses paid with a credit card, but certain other transactions involving a line of credit associated with an HSA could raise prohibited transaction issues.

C. Employer Involvement

When we first analyzed FAB 2004-01, we felt that DOL's guidance was intended primarily to liberalize the "no contribution" requirements of the group-type insurance safe harbor, 29 C.F.R. § 2510.3-1(j), and that other aspects of the group insurance safe harbor would continue to apply. In particular, we were concerned that employers relying on FAB 2004-01 still should make efforts not to "endorse" the HSA. This has significantly limited employer involvement with HSAs.

DOL's guidance, however, suggests that an HSA may be exempt from ERISA either by: (1) complying with the terms of the group insurance safe harbor, which prohibits endorsement, or (2) by complying with FAB 2004-01. It further appears that FAB 2004-01 is more flexible than previously thought with respect to "endorsement" and that the safe harbor may be met if: (a) the establishment of the HSA is voluntary, and (b) the employer is "neutral" with regard to the HSA's establishment. FAB 2006-02 appears to define "neutrality" as only prohibiting employers from: (i) limiting the ability of participants to roll funds over to another HSA, if allowed by the Code; (ii) imposing conditions on the use of HSA funds (e.g., stating that HSA distributions may only be used for medical expenses); (iii) making or influencing the investment decisions with respect to funds contributed to an HSA; (iv) representing that the HSAs are an employee welfare benefit plan established and maintained by the employer; and (v) receiving any payment or compensation in connection with an HSA. As such, the FAB may permit other actions by employers that could have constituted "endorsement" under the group insurer regulation. For example, the new FAB may be more flexible with respect to providing employer logos on HSA marketing materials and permitting employers to directly distribute HSA marketing materials on behalf of the HSA provider.

III. Conclusion

If the HSAs of employees were subject to ERISA, an employer would have to satisfy reporting and disclosure rules (e.g., Form 5500 and SPD), and federal mandates (e.g., claims procedures, COBRA and HIPAA) with respect to the HSAs. In addition, an employer's responsibility and potential liability would increase greatly if the HSAs were subject to ERISA and the employer was a fiduciary with respect to the HSA and related investments. Finally, if an employer or insurer is sued in connection with an HSA that is subject to ERISA, ERISA rather than state law would generally control because of ERISA preemption.

FAB 2006-02 provides helpful clarification for employers who do not want the HSAs of employees to be subject to ERISA. If an employer follows this guidance and FAB 2004-01, DOL will not bring an enforcement action against the employer for failure to file a Form 5500, provide an SPD, adopt a claims procedure, offer COBRA coverage, or comply with HIPAA portability or nondiscrimination rules with respect to the HSA. In addition, the fiduciary rules of ERISA will not apply. However, whether or not the HSA is subject to ERISA, the prohibited transaction rules under section 4975 of the Code do apply, and this guidance provides a reminder of the types of actions an employer should avoid to comply with those rules.

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If you wish to discuss this guidance, please contact Tom Fitzgerald, Jon Breyfogle or Chris Keller at (202) 857-0620.