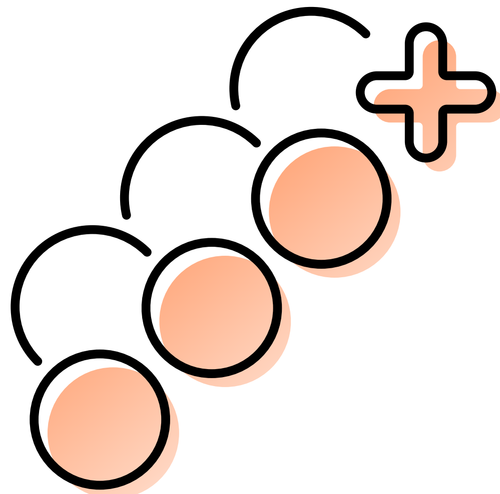
COVID-19 and spending accounts: Impacts and opportunities

October 2020



The COVID-19 pandemic has put unprecedented pressure on people, their families, businesses and the economy at large. Data shows that on top of these unexpected burdens, employees are not adequately saving for future health and other expenses, a worrisome trend as healthcare costs are only expected to climb.

With these situations to consider, employers are looking for ways to help their employees through this crisis and have a unique opportunity to provide them with options to lessen the severity of the financial burdens ahead. Tax-advantaged spending and savings accounts, like **health savings accounts (HSAs)**, **flexible spending accounts (FSAs)** and **commuter benefits**, can offer employees the financial flexibility and assistance they need in a time when they may need additional support.

In this article, we'll explore the current impacts from the pandemic on spending accounts, how legislative changes have played a major role in their value and what we can expect to see in the months ahead. We'll also outline clear actions employers can take to help employees during open enrollment and beyond.

What impacts have we seen?

Let's look at tangible impacts Alight Solutions has been monitoring specific to spending accounts through the first half of 2020. As behaviors and spending habits have changed, so have the daily interactions with our health accounts.

Decreasing savings rates

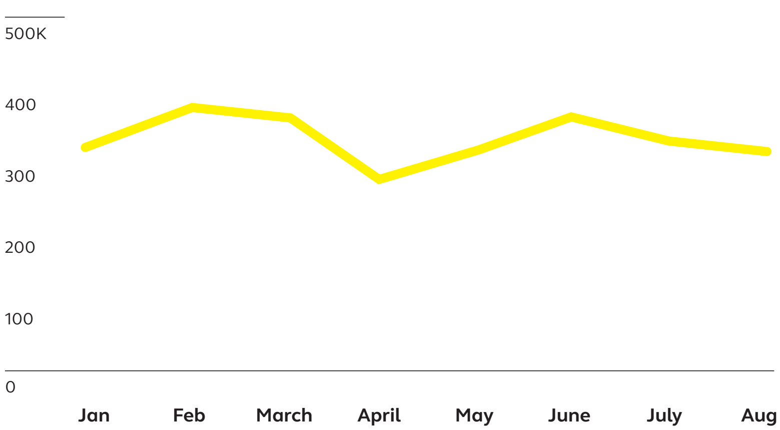
As employees experience financial hardship, they naturally look to immediate changes that can increase take-home pay. This unfortunately leads to reductions in contributions to benefit plans that can be changed throughout the year — primarily 401(k)s and HSAs.

As HSAs are often funded specifically to cover deductible expenses through the plan year, reducing (or eliminating) contributions can have significant consequences. Failing to save enough can leave a financial exposure that employees may be unprepared to handle, which is critical as **healthcare expenses are predicted to rise**.

The trend in reduced savings is not limited to 2020 coverage; this mindset is already impacting employee decisions for 2021 open enrollment.

Figure 1

Monthly card swipe activity in 2020



In the second quarter of 2020, data showed the single biggest source of the GDP decline came from healthcare alone. As virus cases continued to surge, many chose to avoid care strictly out of fear, leading to major decreases in healthcare spend and, ultimately, decreases in spending account card swipes.

In fact, a major national employer that recently completed open enrollment noted the impact to spending account elections were significant. Total healthcare FSA contributions have dropped by over 25% with only 70% of participants continuing coverage into next year. Total dependent care FSA contributions dropped by over 55% with only 43% of participants continuing their coverage into next year.

This trend mirrors what we're seeing on mid-year changes, and the worry is that it will continue as more 2021 benefit elections are made.

Decreasing card activity and increasing declined payment card transactions

Historical data shows that HSA and FSA spending habits tend to stay constant from year to year, but 2020 has put an end to the expected trend.

Data shows a clear reduction in card swipe activity during COVID-19 shutdowns in April 2020 and a significant increase heading into June (Figure 1). This is certainly unique to 2020 as prior years have had no such change in Q2. Altered spend habits can even be seen within certain geographic locations, likely dependent on the restrictions in place and the re-opening stage.

While card swipe activity is increasing again, we are seeing higher rates of payment card declines at the point of sale. Alight data reflects a 2% increase in card declines from Q2 2019 to Q2 2020. In addition to this increase, there is also a clear shift in the primary cause of card declines.

In 2019, insufficient funds caused 7% of all card declines — an amount that has more than doubled to 18% year-to-date 2020.

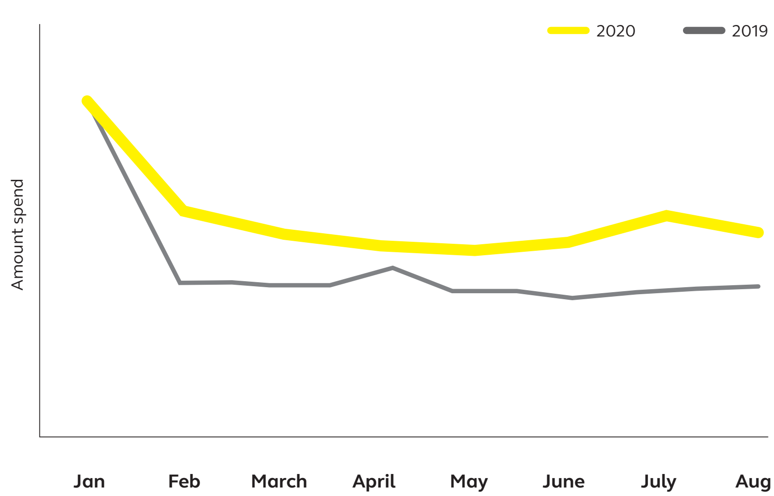
As we take a closer look at these declines, it is clear that HSA participants are heavily impacted. This is expected due to the nature of HSAs requiring payroll contributions to increase available balances, while FSAs provide full annual election in the beginning of the plan year. That dynamic will reverse as we head into Q4, and we expect the impacts to follow.

We see that concern coming soon for FSA participants, where monthly spend is far from the expected trend line (Figure 2). We typically see a clear peak in January followed by an approximate 85% drop in monthly spend, which holds relatively stable through year-end. In 2020, this behavior has changed significantly. That normal reduction in February looked more like 50% instead of 85%, and it's holding steady at that rate.

This identifies one significant concern — available balances are shrinking faster than normal and will be depleted earlier in the plan year.

Figure 2

FSA monthly spend



What impacts do we expect to see next?

We can reasonably expect the trends noted above to continue into next year, which will exacerbate the problem. When it's time to access care, employees will find that they lack the funds to cover their out-of-pocket expenses since they didn't enroll in an HSA or chose to underfund it. Further compounding the problem is the expected surge in healthcare spend as detailed in Alight's recent whitepaper, **The ongoing impact of COVID-19 on employer healthcare budgeting**.

If no action is taken, we can expect this to adversely impact employee health, financial wellbeing and overall workplace engagement.

We expect employers to look to plan design changes that address increased healthcare spending in 2021. Plan design changes may include additional shifts to high deductible plans, increased deductibles and decreased co-insurance resulting in a greater out-of-pocket expense burden on employees. Health spending and savings accounts will play a critical role in making pre-tax funds available to cover those expenses.

There may be additional legislative changes to enhance the advantages of spending accounts. As seen in the **CARES Act**, spending accounts are in the spotlight as a means to help Americans fund healthcare expenses. Legislative activity is aimed at providing individuals more flexibility on using available spending account funds and expanding the period in which claims can be submitted against remaining balances.

What can employers do to help?

While data fluctuates and habits can change without reason, it's clear that the pandemic will have a significant impact on spending accounts and, consequently, employee savings. The need for a robust spending account strategy has never been more critical to help address employee needs for 2021.

The data reflects a reduction in saving, an increase in spending and a resulting lack of readiness for a pending surge in healthcare spending.

We encourage employers to reevaluate your savings and reimbursement account strategy as you search for ways to improve the financial and physical wellbeing of your employees. While these accounts may be providing more flexibility than ever before, are you fully capitalizing on the benefits provided by your HSAs, FSAs and HRAs?

As we approach open enrollment, it's imperative to ask yourself these questions to identify key areas of opportunity for your business.

- Are your employees aware of the advantages these accounts have to offer?
- How are you helping your employees prepare for the surge in healthcare costs?
- How are you creating a compelling rewards package to attract and retain top talent for your organization?

Once you've answered these questions, consider these ways to optimize the benefits experience for your people:

Expand your benefit offerings

- One downside to a health savings account is that participants can only access funds that have accumulated through pay cycles to date. Seeding HSAs or providing employees the option to access future contributions they'll make throughout the year eliminates this obstacle, **gives them more control over their finances and enables them to receive care when they need it, not when their HSAs have accumulated enough to pay for it**.

This is an effective way to show your people you truly care about their health and wellbeing as well as the health of their family members. It also **encourages increased enrollment in high deductible health plans** by removing the risk of first dollar exposure. Adding this solution to your benefits offerings **adds significant value at little-to-no cost and helps attract top talent to your organization**.

- Providing products that address specific financial challenges (like those affiliated with COVID-19), **enables employers to provide targeted support to address employees' most basic needs with maximum flexibility and control**. Employee Care Cards are an excellent way to offer tax-free dollars for employees to spend on expenses you select, such as groceries, office supplies, childcare, healthcare, utilities and more.

Make your flexible spending accounts as flexible as possible

Revisit those CARES Act optional changes that you may have initially declined and reevaluate your needs. Many employers declined optional relief primarily because of the administrative burdens and capacity to support; HR teams needed to prioritize the direct employee impacts from the pandemic.

- Allowing mid-year election changes without a Qualified Status Change **provides significant relief to employees as they try to maximize their benefits in a fluid economic environment**.
- If you provide a Grace Period for your healthcare flexible spending account, there's never been a better time to adopt the alternative $550 maximum rollover option. With the CARES Act shifting this maximum to be indexed annually, **it provides greater flexibility to employees to not lose their funds**.

Reconsider some of the underutilized options that were already available before recent legislative changes.

- Many employers began permitting changes to **dependent care FSAs** under the existing qualified status change rules. While this requires a legal opinion, most agree that a childcare closure certainly meets the mark for triggering a coverage change, allowing employees to reduce their elections to $0. This enables **impactful flexibility for employees to halt savings for a benefit they may not be able to utilize as expected and helps put much needed cash back into net income**.
- While it's well known that a limited-use FSA can be paired with an HSA to increase tax savings, some employers avoid the option for various reasons. Alternatively, some employers offer the limited-use FSA, but do not permit the account to convert to a full healthcare FSA once the medical deductible has been met (as regulations allow). In either case, this **represents unused flexibility that could be offered to employees**.

Reimagine your communications

The pandemic highlights the gaps that have always existed when it comes to **HSAs** and **FSAs** — the widespread lack of awareness on the advantages and a general misunderstanding of how they work.

Additionally, Alight data reflects that 40% of participants who have taken a financial health assessment have $0 saved for healthcare costs, showing that people either don't realize that they need to save more for healthcare costs or they can't afford to.

It's time to take a fresh look at how you're educating employees to address the trends we have noted above and ensure employees are best positioned for physical and financial wellbeing in 2021.

- Keep it simple and reevaluate the value proposition for enrolling in spending accounts. While the pre-tax benefit is appealing, it isn't enough. Many employees simply don't care about the tax benefits. Remember that your workforce is comprised of employees in all stages of life, and what one employee may prioritize when it comes to their health and wealth may not be the same as another. It's not a one-size-fits-all solution, and your message needs to change based on the target audience.
- When it comes to efficiency, there's never been a better time to integrate your benefits administration and health accounts into a **single, optimized portal**. Having one system to integrate your benefit offerings, enrollment and related communications enables your employees to easily find, access and navigate their offerings and resources — like conveniently enabling participants to increase their contributions or make other changes at any point of the year, all from one easily-accessible page. Creating this efficient, enhanced experience drives **smarter decisions and ultimately optimizes outcomes**.

Additionally, by using one common platform, employers can **use the power of data, analytics and AI to surface the right messages at the right time**, providing actionable information for employees to stay educated and informed on how to best optimize their benefits offerings. A common, personalized platform means employees no longer need to reconcile benefits information from disparate sources. Instead, they receive omni-channel messages built on their unique data set that continuously adapt based on their actions or inaction, **helping them to better stay on top of offerings relevant to them, like HSA accounts, commuter benefits or dependent changes**. Imagine being able to automatically communicate to employees upon login to add a newborn to their medical plan or adjust their tax withholdings after a pay raise. These are moments where the right tailored message can impact thoughtful decisions.

Align benefit choices to your return to work strategy

Spending accounts are a critical component to your total rewards package and are equally as important to supporting your employees through a holistic return-to-work strategy. It's not news to say that the pandemic has disrupted the work-life balance, but recent market data really underscores the depth of the issue for **working parents** and their employers before the school year even began.

Most families with children under 14 do not have an available caregiver in the family, and parents are balancing this need with work priorities.

Alight research shows 43% of all working parents say it's gotten more difficult to manage commitments, which is expected to increase as schools re-open virtually. This has a direct impact on business results as well — 54% of employers believe remote learning will have a moderate to high impact on executing return-to-work plans.

- It's important for employers to better understand how your people have been impacted and what support they need. This understanding can inform your overall strategy and enable new communication strategies, like creating a microsite specifically for families to bring together all your information, programs and resources.
- Recall the 55% reduction in dependent care FSA contributions we saw in a recent open enrollment. The employees who left the plan almost certainly did so because they cannot take their children to daycare, still need to work from home, etc. That will change, and employers should address the need for employees to re-enroll in certain benefits as their work lives adjust.
- Consider how spending accounts can help your employees through new challenges. As many US schools remain virtual, working parents can leverage the dependent care FSA for completely new uses, such as community-based programs that provide in-person oversight of remote learning. Employers can also leverage spending accounts, like the Employee Care Card, to help pay for these costs as well.
- Don't forget about **commuter benefits**. As offices re-open, employers should ensure they are enabling their people to re-enter these benefit plans to the maximum extent possible. Implementing (or better communicating) a monthly ordering cycle can easily provide this flexibility.

Though the pandemic has changed many aspects of both our work and personal lives, there are still plenty of ways to look out for your people and provide them with resources and benefits to help them during these uncertain times. For more information on spending accounts, visit **alight.com**.