

Client Alert

Promotion of HSAs May Raise Broker-Dealer and Investment Adviser Registration Concerns

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In 2003, Congress enacted the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Pub. L. No. 108-73) which permits eligible individuals to establish Health Savings Accounts (“HSAs”), tax-exempt trusts or custodial accounts under the Internal Revenue Code. Individuals covered only under high-deductible health plans are eligible to establish HSAs for the purpose of paying their qualified medical expenses. The maximum annual contribution is determined by the amount of the individual beneficiary’s health insurance deductible. Investments in HSAs may be carried over from year to year. Companies involved in promoting the new HSAs should be careful about potential implications under laws governing broker/dealers and investment advisors.

Establishing an HSA is similar to establishing an Individual Retirement Account (“IRA”) or Archer Medical Savings Account in that each individual owns the account and may deduct his/her contributions to the account. The HSA does not need to be established through the beneficiary’s individual’s employer or regular health insurance carrier. An HSA is portable and, therefore, may be “rolled-over” to another HSA custodian or transferred to another trustee if the individual so chooses.

Unlike Flexible Spending Accounts (“FSAs”) and other medical savings accounts, amounts deposited into an HSA by the beneficiary, or by the employer for the beneficiary, are not forfeited at the end of the calendar year if they are not used, but may be carried over, even to the individual’s retirement years. Deposits are invested into certain qualified investments (e.g., bank accounts, annuities, certificates of deposit, stocks, mutual funds, or bonds). Investment earnings in the HSA are accrued tax-free and distributions are tax-exempt if used for qualified medical expenses.

Although individual beneficiaries control amounts maintained in the HSAs, amounts may be invested in qualified investments selected and made available by the HSA custodian or as suggested by an insurance company or other person assisting in establishing these accounts. When mutual funds are used as qualified investments, the custodian, insurance company or person selecting or recommending funds as qualified investments may be in a position to receive transaction-based or other forms of compensation from the selected mutual fund’s distributor, underwriter or investment adviser. The receipt of such compensation, however, has potential connotations under federal and state securities laws. Generally, a recipient of compensation that is based on transactions effected in securities (e.g., shares of mutual funds) may be considered to be acting as a broker. Similarly, a person who receives compensation for advising others about investing in securities may be considered an investment adviser.

Some health insurance companies or managed care organizations may be affiliated with a registered broker-dealer and investment adviser and, accordingly, may be able to handle such payments and provide through an

affiliate the services associated with selecting mutual funds as qualified investments for HSAs to a registered entity. In other cases, insurers and managed care organization may work in tandem with broker-dealers or investment advisors in making a “seamless” offering of a HSA package for an employer and its workforce, with the insurer not receiving payments for that collaboration. However, in the wake of the mutual fund and insurance industry scandals, any receipt of compensation by a health insurer or managed care organization in conjunction with the offering of HSA investment vehicles needs to be fully evaluated to ensure both that any registration issues have been addressed and that mandatory or recommended disclosures considered.

We anticipate that the SEC staff will issue some no-action relief or interpretive guidance at least on the broker-dealer registration issue, and possibly on the investment adviser issue as well. Until such time, however, any recipient of compensation associated with making mutual fund shares or other securities available to HSA account holders should proceed very cautiously if the health insurance or managed care entity is not appropriately registered.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

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