

OTCs No Longer FSA-Eligible Expenditures

December 17, 2010

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There are some regulatory changes expected starting January 1, 2011 as a result of the landmark healthcare reform legislation, Patient Protection and Affordable Care Act, that was passed in 2010. Nonprescription drugs, also referred to as OTCs, will no longer be allowed medical expenses using consumers' flexible spending accounts (FSAs). FSAs are also sometimes referred to as Health Savings Accounts (HSAs). Since 2003, the Internal Revenue Service has considered nonprescription drugs to be "qualified medical expenses" where consumers can use pre-tax dollars set aside in their FSAs to pay for OTCs. The list of OTCs that were FSA-eligible was wide-reaching and included cough, cold and allergy medicines, digestive products, internal analgesics, topical products, feminine products, vitamins and minerals, and sleeping aids. These products will no longer be eligible FSA expenses starting January 1, 2011 according to the new regulation.

The OTC industry, along with pharmacists, and retailers however, have formed a coalition in opposition to this new rule. The coalition has sent a letter to Washington last month asking that the U.S. Congress repeal the requirement that would prevent consumers from using their FSAs to pay for OTC medicines. The coalition is made of up of OTC manufacturers that are members of the Consumer Healthcare Products Association, the National Association of Chain Drug Stores, the American Pharmacists Association, and the National Community Pharmacists Association. The coalition is seeking to repeal or delay the adoption of the new provision. CHPA President and CEO Scott Melville was quoted recently as saying "This new restriction will eliminate a tool that 35 million Americans have come to depend on to cost-effectively purchase medicines they need, when they need them. As Congress considers extensions of current tax cut policy, they should also be mindful of the middle-class working families who will see their FSA benefits slashed if this provision is not repealed. "

FSAs are offered by many employers as part of the overall benefits package. The way FSAs work is that consumers decide, usually during open enrollment period in the prior year, how much money they would like to have deducted from their pay check to be set aside into the FSA using pre-tax dollars. The consumer then has access to that money from January 1st through the end of the year to pay for things like dental work, orthodontia, eye glasses, and copayments for prescription drugs and doctor visits. The FSAs operate on a "use it or lose it" system so that consumers must use all the money in the account by the end of the year or they will forfeit any money left. This can sometimes lead to small surges in OTC purchases and other eligible expenses at the end of the year.

There have been studies conducted by Hewitt Associates, a human resources consultancy, that have found that OTCs make up a relatively small portion of

healthcare expenditures using FSAs. The study concluded that only 7% of all FSA claims in 2009 were for nonprescription drugs and just 3% of FSA expenditures went into buying OTCs. So why then, you might ask, does the legislation preclude OTCs from being an FSA-eligible expense? The chief reason for OTCs now being excluded from FSAs is to help pay for other goals of the health care legislation, including giving more Americans access to affordable health insurance.

The new legislation does not prohibit the use of FSAs to pay for OTCs however, if a physician prescribes an OTC for the patient. Therefore, there are some concerns that the new legislation may actually increase healthcare utilization, because some patients may visit their physician for the purposes of gaining prescriptions for nonprescription medicines, where they were previously not required. Congress has not yet replied to the coalition about a repeal or a delay to the provision so we must wait and see what is decided. However, either way it is not expected to have a material impact on overall sales of OTCs in 2011 as consumers will continue to buy the OTCs they rely on. Some cash-strapped consumers however, may increasingly opt for private-label OTCs if they cannot use their FSA dollars to pay for more expensive branded OTCs. Time will tell.

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