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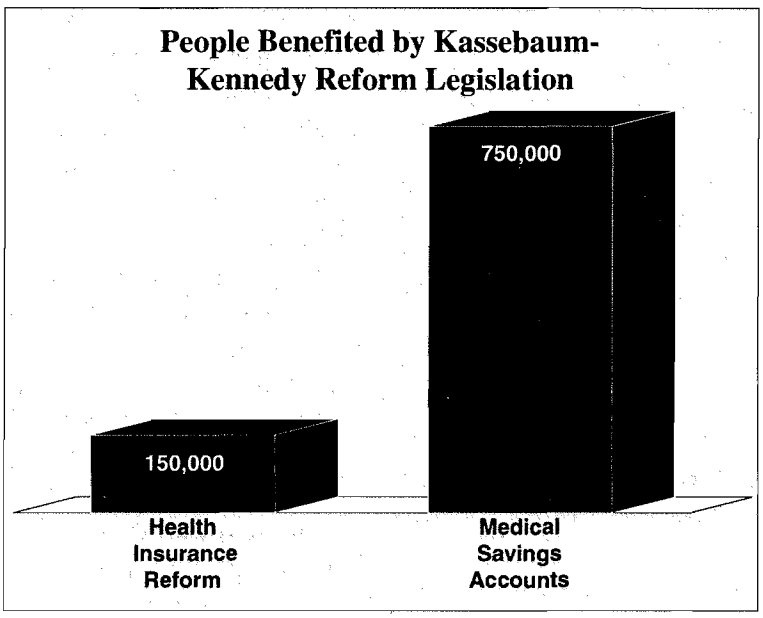
Medical Savings Account Legislation:

The Good, the Bad and the Ugly

After years of bipartisan legislative proposals to create tax-free Medical Savings Accounts (MSAs), months of partisan congressional wrangling over whether to include MSAs in health insurance reform proposals and weeks of discussion on various MSA demonstration projects, Congress passed a law that includes a limited version of Medical Savings Accounts. The legislation has some good and some bad points, but the future fight over who can have an MSA likely will get ugly.



The Good. The good news is that Medical Savings Accounts have a foot in the door. The agreed-upon demonstration project is short of what most MSA proponents wanted, but it is a start. The agreement permits:

- An annual tax-deductible contribution to the MSA — up to 65 percent of the policy's deductible in the case of individual coverage and 75 percent of the deductible for family coverage — when combined with a health insurance policy with an annual deductible of $1,500 to $2,250 for an individual and $3,000 to $4,500 for a family.
- Tax-free buildup of money in the MSA and tax-free distributions of MSA funds for medical expenses.
- Maximum out-of-pocket expenses of no more than $3,000 under an individual policy and $5,500 under a family policy.
- Funds withdrawn and used for nonmedical expenses to be considered as income and subject to income taxes, plus a 15 percent penalty — unless such withdrawals are made after age 65 or the onset of a disability.
- At death, any remaining MSA balance would be includible in the decedent's gross estate, under rules similar to those applicable to Individual Retirement Account (IRA) funds.
- No "sunset" provision for MSAs; those who have them will get to keep them.

While limiting allowable out-of-pocket expenses represents a troubling attempt to micromanage MSAs, most companies that might sell tax-free MSAs will be able to.

The Bad. The bad news is that the restrictions Congress imposed on MSAs not only limit the number of people who can buy them, but also will make their purchase and maintenance very complex.

- Only employers with 50 or fewer employees, along with the self-employed and the uninsured, will be permitted to obtain a tax-free MSA.
- The demonstration project is limited to four years and 750,000 policies. Fortunately, there is no limit on the numbers of dependents covered or the numbers of uninsured who may apply. However, once the 750,000 cap has been reached for employees and the self-employed, no more uninsured may get an MSA.
- Small businesses that switch to an MSA plan may grow to 200 employees within the four-year demonstration project; additional employees could force the company to switch policies.

Dallas Headquarters: 12655 N. Central Expy., Suite 720 • Dallas, TX 75243-1739 • 214-386-6272 • Fax: 214-386-0924 • E-Mail: ncpa@onramp.net
Washington Office: 727 15th St. N.W., 5th Floor • Washington DC 20005 • 202-628-6671 • Fax 202-628-6474
For more information: Curt Erickson in Dallas at 214/386-6272 or Joan Kirby in Washington at 202/628-6671

These restrictions were imposed because MSA opponents raised a number of ridiculous objections to Medical Savings Accounts. For example, Consumers Union objected that: "Today, an amazing 98 percent of employers offer health plans that limit the burden of costs their employees must carry to 20 percent. The MSA proposal under debate in Congress allows insurers to charge coinsurance of 30 percent, even after the $5,000 to $7,000 deductible is met."

What this concern ignores is that, except in the state of Hawaii, employers are not required to offer their employees *any* health insurance. Further, they may set the deductible at any amount, with any combination of reimbursement and copayment they choose. The only force driving these "amazing" employers to provide their employees with health insurance is their desire to attract good workers.

In fact, the evidence shows that almost all employers who have already switched to an MSA plan (which currently does not enjoy the tax advantage made available in the legislation) have *lowered* their employees' out-of-pocket exposure.

In addition to the above-mentioned restrictions, the legislation:

- Requires the Treasury Department to evaluate and report to the Congress on the adequacy of high-deductible policies purchased in conjunction with MSAs.
- Mandates appointment of an independent health policy organization to study and report on the impact of MSAs in the small group market, examining such issues as the impact of MSAs on health care spending, adverse selection and preventive care.

Ironically, the unusual restrictions on the MSAs ensure that the demonstration project will be unable to answer the questions MSA opponents have posed. For example, will MSAs result in "adverse selection" — in which the healthy move into one plan while the sick remain in another?

By limiting the demonstration to employers with 50 or fewer employees, Congress has virtually guaranteed that the answer will be no. In order for adverse selection to occur, employees would need to have a choice between two or more employer-provided health insurance policies. Almost all small employers who offer health insurance offer only one plan. Without the ability to switch at will, the adverse selection problem is barely existent.

The Ugly. Unfortunately, only 750,000 policyholders — roughly determined on a first-come-first-served basis — will get to have an MSA during the four-year pilot program. Everyone else will continue in the current system.

As a result, those who get an MSA will be those lucky enough to work for an employer who already has an MSA plan or swift enough to get a plan before the cap is reached. The ensuing rush to get an MSA could get ugly and result in legal challenges, since some people will believe they have been financially and perhaps medically harmed because they were unable to get an MSA.

Many insurance companies that might have offered an MSA product will be discouraged from doing so, fearing there will not be enough time to create the product or to gain sufficient market share to make the effort worthwhile. Ironically, as a result of this short-sighted attempt to limit MSAs, the few companies that already sell MSA plans may get most of the new market.

Conclusion. Despite its problems, the MSA legislation is a good beginning. Indeed, it is one of only a few beneficial provisions in the otherwise problematic Kassebaum-Kennedy health insurance reform legislation. The Congressional Budget Office estimated that the health insurance provisions in Kassebaum-Kennedy could help some 150,000 people gain insurance. Medical Savings Accounts could help millions, but the Congress limited their benefit to 750,000.

However, once some people have them, others likely will demand access. Thus will begin a new era in which patients and their doctors — not faceless bureaucrats — determine the kind of medical care Americans receive.

This Brief Analysis was prepared by NCPA Vice President of Domestic Policy Merrill Matthews Jr.