



**BRIEF ANALYSIS**

No. 275

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## **Real Patient Protection: Expanding Medical Savings Accounts**

In 1996 Congress created a demonstration project permitting small employers and the self-employed to establish up to 750,000 tax-free Medical Savings Accounts (MSAs). However, as a result of opposition in Congress, lawmakers imposed a number of restrictions that limit who can purchase MSAs and thwart the ability of MSAs to work properly.

Although more than 100,000 qualified MSA policies have been sold, the restrictions have hampered the popularity of MSAs among employers, consumers and insurers and have led to a number of problems that have discouraged MSA sales. As a result, Congress is now considering proposals intended to correct problems in the original legislation and to make Medical Savings Accounts available to every working American, including federal employees.

**Current MSA Law.** Tax-advantaged MSAs are personal savings accounts that must be combined with high-deductible health insurance. Account holders typically use their MSA funds to pay small and routine health care bills, while relying on health insurance to pay more costly ones. Under the demonstration project passed by Congress, certain individuals or their employers may make annual tax-deductible contributions to an MSA of up to 65 percent of the policy's deductible in the case of individual coverage and 75 percent of the deductible for family coverage. Qualified deductibles range from a minimum of \$1,500 to a maximum of \$2,250 for an individual and from \$3,000 to \$4,500 for a family.

### **Needed MSA Reforms**

- Allow everyone to have an MSA
- Make the program permanent
- Permit any size company to adopt MSA plans
- Lower the minimum deductible
- Reduce out-of-pocket exposure
- Eliminate penalties for surplus withdrawals
- Let federal employees have MSAs

Money not spent during the year may be left in the account to grow tax free. In addition to medical expenses, MSA funds may be used to pay health insurance premiums when people are between jobs.

**How MSAs Can Help Meet the Challenge of Managed Care.** Most Americans are currently in some form of managed care. While managed care appears to have succeeded in reducing the growth of health care spending, it also has interfered with the doctor-patient relationship, often making doctors feel they are agents of a

managed care bureaucracy rather than agents of their patients. Critics also believe that managed care has lowered the overall quality of health care. MSAs can solve many of the problems created by managed care by restoring money — and control — to patients.

However, before MSAs can resolve these and other problems facing the health care system, Congress needs to make several legislative reforms.

**Needed Reform: Allow Everyone to Have an MSA.** The

current pilot program permits up to 750,000 families over a four-year period to have an MSA. However, major insurers are reluctant to enter so small a market since its size does not warrant the marketing of a new product — for example, the way Roth IRAs have been marketed. To remedy this problem, we should lift the 750,000 cap and allow an unlimited number of people to have an MSA.

**Needed Reform: Make the Program Permanent.** Another restriction that discourages major insurers from offering and aggressively promoting MSA products is that because Congress established it as a demonstration project, the MSA program ends after four years. This sunset provision should be eliminated so that buyers

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and sellers of MSAs know they will be able to use their accounts for years to come.

**Needed Reform: Permit Any Size Company to Adopt MSAs.** Medical Savings Accounts are currently available only to the self-employed and to small businesses with 50 or fewer employees. In addition, small businesses that switch to an MSA plan may under the law grow to 200 employees within the four-year demonstration period without affecting its MSA plan, but additional employees would force the company to drop its MSA program or to enroll new employees in a different plan. These arbitrary restrictions are unreasonable and unwise. All employers should be able to offer high-deductible health insurance coupled with MSAs.

**Needed Reform: Lower the Minimum Deductible.** Under current law, MSA plan deductibles cannot be lower than \$1,500 for individual policies and \$3,000 for families. While these deductibles are not unusual among standard high-deductible plans, they are intimidating to many middle-income Americans, especially those used to low deductibles. In addition, the deductible makes it difficult for insurers to create a plan that meets consumer needs. To remedy these problems, Congress should lower the minimum deductibles at least to \$1,000 and \$2,000, respectively.

**Needed Reform: Reduce Out-of-Pocket Exposure.** Another problem is that MSA tax-free deposits are limited to 65 percent of the individual deductible and 75 percent of the family deductible. The remaining gap could leave individuals and families exposed to significant out-of-pocket expenditures. A better approach is to allow people to deposit the entire amount of the deductible in their MSA accounts.

**Needed Reform: Eliminate Penalties on the Withdrawal of Surplus MSA Funds.** Currently any money withdrawn for nonmedical reasons is subject to personal income taxes and an additional 15 percent penalty — unless such withdrawals are made after age 65 or the

onset of a disability. Congress should lift the 15 percent penalty for nonmedical withdrawals if the full amount of the deductible remains in the account. Thus a person with a \$2,000 deductible and a \$2,200 MSA balance would be able to withdraw \$200 and pay income taxes only — avoiding a \$30 penalty.

**Needed Reform: Make MSAs Available to Federal Employees.** Currently some 9 million federal employees and their dependents are enrolled in the Federal Employees Health Benefits Program. Since MSAs combine the security of first-dollar coverage with the lower utilization rates of a high-deductible policy, Congress should expand MSAs to federal employees, lowering federally funded health care costs while giving federal employees more choices.

Many FEHBP plans provide unintentional incentives to overutilize health care. MSAs would eliminate those incentives, cut overutilization and save taxpayer dollars.

**Conclusion.** While the MSA demonstration project was a step in the right direction, it needs some adjustments. Lifting the restrictions on MSAs would encourage the health insurance industry to promote the concept more aggressively. Increasing the potential market for MSAs so that every American is eligible would slow the growth in health care costs. Enabling Americans to become more prudent shoppers of health care would lead many uninsured to sign up for an affordable MSA. In addition, experience in the demonstration project shows that many of those who purchase MSA plans are people who otherwise would elect to remain uninsured.

Making MSAs more available and efficient will raise the number of insured and lower the cost of health care. Wasn't that the goal of health insurance reform all along?

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