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Solutions for Today's Health Policy Challenges

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Archer MSAs: A Good Beginning — A Better Future

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) gave small employers and the self-employed a new option in health care coverage. This alternative, called a Medical Savings Account (MSA), can reduce health insurance premiums and enable the insured to build up tax-favored funds to pay out of pocket for smaller and routine medical expenses. While tax-favored MSA-type programs have been operating in the states for a decade, the passage of HIPAA created the first federal demonstration program allowing federal tax breaks on these savings accounts when used for medical purposes. These HIPAA MSAs are often referred to as Archer MSAs, named after Rep. Bill Archer (R-Texas), the former chairman of the House Ways and Means Committee and a tireless champion of MSA legislation.

How an Archer MSA Works. An Archer MSA is a savings account controlled by the insured person to pay health care expenses. HIPAA requires that account holders also have a high-deductible health insurance policy to cover catastrophic medical costs. For example, an employer might deposit \$2,500 in a worker's MSA at the beginning of the year and provide a \$3,000 deductible health insurance policy. Workers would be responsible for the first \$3,000 in medical costs, but they would use the \$2,500 in the MSA to fund most of those claims. If workers or their families exhaust the \$2,500 MSA allotment, they would pay the next \$500 out of pocket. The high-deductible policy would be activated at \$3,000 (i.e., \$2,500 MSA + \$500 out of pocket = \$3,000 deductible).

Because high-deductible policies cost less than low-deductible policies, the employer (and/or the employee if the policies are jointly funded) saves money by switching to a high deductible. For example, according to a CAHI member survey, the premium for a \$3,000 deductible policy can be almost half that of a \$500 deductible. Part or all of that premium savings can be used to fund the MSA. Thus, an employer (and/or employee) who had been spending \$5,000 on a low-deductible family policy might spend only \$3,000 on a high-deductible policy — leaving \$2,000. The employer could put that amount or any portion (e.g., \$1,500) into the MSA, thereby lowering the employer's health care costs.

Who Can Have an Archer MSA? Not everyone is allowed to have a HIPAA-qualified MSA. By law the accounts are restricted to the self-employed and those working for small businesses (50 or fewer employees). Large and medium-sized employers and workers whose employers do not provide health insurance are not eligible for an Archer MSA. They may still be able to participate in one of several nonqualified MSA plans, but they get no federal tax break for doing so.

By contrast, nonqualified plans are not subject to the restrictions imposed on Archer MSAs. For example, an Archer MSA requires the worker to roll over remaining funds at year's end. Workers who withdraw funds for nonmedical reasons must pay the taxes they escaped and a 15 percent penalty. Workers with nonqualified plans do not pay a penalty because their deposits are taxed up front, much like a Roth IRA.

The Benefits of an Archer MSA. Employers have been faced recently with health insurance premium increases of 16 percent, on average. And some small employers and those in the individual market have experienced increases of 40 to 50 percent. As a result, employers, workers and the self-employed are looking for a way to lower health care costs. MSAs may be the solution.

What MSAs do is change consumer behavior. They give consumers a reason to be value-conscious shoppers in the health care marketplace. They give patients a reason to discuss with their doctors both their medical options and the costs of those options. Ibuprofen for \$5 or Celebrex for \$80? If someone else is paying the bill, it makes little difference. If the money is coming out of the patient's MSA, he or she has a strong incentive to weigh the costs and benefits of each health care choice and to pay close attention to the doctor's recommendations.

Future of Archer MSAs. The Archer MSA demonstration project will end on December 31, 2003, unless it is extended or made permanent by law. The administration and many in Congress want to broaden the program's scope and availability, reduce its restrictions and make it permanent. Although MSAs may not be for everyone, they can be an important part of the health insurance market. MSA reform would give them the chance to reach their real potential.

An MSA Comparison: What We Have & What We Need

Issue	Current Program	Improvements Needed
Permanence	<p>The Archer MSA is a demonstration project due to expire on December 31, 2003. Without an extension, only those qualified individuals and employers who have been contributing to MSAs prior to the sunset date will be allowed to have them.</p> <p>The temporary status has discouraged insurers from offering MSA plans, so only limited numbers are available.</p>	<p>Extend the sunset deadline for the demonstration project or make it permanent.</p> <p>Unless the program is expanded and made permanent, MSA options may remain limited.</p>
Scope	<p>HIPAA established a participation limit of 750,000 MSAs, with no limit on qualified uninsured individuals until the cap is met. To date, the demonstration project cap has not been reached.</p>	<p>Lift the 750,000 enrollment cap and allow an unlimited number of people to have an MSA. The demand exists, but certain individuals cannot join the program due to eligibility requirements.</p>
Eligibility	<p>MSAs are available to employer groups of 50 or fewer and to the self-employed. This restriction creates an inequality on the tax code, preventing some individuals from taking advantage of tax-favored MSAs.</p>	<p>Remove the barriers on who can establish an MSA so that all employers and individuals can participate. (A recent poll by Zogby America found that 89% of those surveyed wanted the option to purchase an MSA.)</p>
Qualifications	<p>Must have a qualified high-deductible health plan. Individual policies must have deductibles no less than \$1,650 or no greater than \$2,500 (with a total out-of-pocket expense maximum of \$3,300). Family policy deductibles can be no less than \$3,300 and no greater than \$4,950 (with a total out-of-pocket expense maximum of \$6,050).</p>	<p>Allow consumer demand and the marketplace to determine available deductibles.</p>
Contributions	<p>Can be made by the employer or the employee, but not both in the same year. Individuals can contribute up to 65% of the deductible and families can contribute up to 75%.</p>	<p>Allow contributions to the MSA from both the employer and the employee in the same year. Allow account holders to fund their MSA up to 100% of the deductible, which would permit them to save for future medical expenses.</p>
Withdrawals	<p>Qualified medical withdrawals: Medical expenses as specified in the Internal Revenue Code §213(d); insurance premiums may not be paid from the MSA, except for COBRA continuation coverage, long-term care insurance (or services), and premiums for health insurance coverage while receiving unemployment compensation.</p> <p>Nonqualified withdrawals are subject to a 15% penalty and included in gross income for taxation purposes.</p>	<p>The 15% withdrawal penalty was intended to discourage account holders from removing funds for nonmedical purposes. However, nonqualified withdrawals have not been a major problem, so reducing the penalty to 10%, as with Individual Retirement Accounts (IRAs), may be appropriate.</p>
Benefit Design	<p>MSAs are not allowed in six states due to state-mandated benefit laws. Also, MSAs are not allowed under employer cafeteria plans.</p>	<p>Either federally preempt first-dollar state-mandated benefits or provide the flexibility for MSA plans to adjust to comply with those conflicting insurance mandates.</p> <p>Allow MSAs to be offered as part of a cafeteria plan.</p>

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Council for Affordable Health Insurance

112 S. West Street, Suite 400

Alexandria, VA 22314

Phone: 703/836-6200 Fax: 703/836-6550

Email: mail@cahi.org

www.cahi.org

Prepared by Victoria Craig Bunce, Director of Research & Policy, Council for Affordable Health Insurance.

For additional information please contact Tom Gardner, Director of Communications, at 703/836-6200 or by email at tgardner@cahi.org