

SHOULD YOU CONSIDER A MEDICAL SAVINGS ACCOUNT?

As medical insurance premiums continue to climb, qualified workers may want to take a second look at a federal pilot program called medical savings accounts. Congress has extended this controversial program, also called the Archer MSA, through 2003.

The program is limited to the self-employed and owners and workers for businesses that employ 50 or fewer and that offer no medical plan other than a high-deductible insurance policy. That's not a small number of workers. According to late 2002 numbers from the Employee Benefits Research Institute, roughly four in ten workers are not covered by an employer-sponsored health care plan, and it's generally smaller employers that can't afford medical plans.

Say you're self-employed. The first step is to buy an MSA-approved high-deductible medical policy, sometimes called catastrophic coverage. The policy must meet certain deductible limits. For a family, the minimum annual deductible for 2003 is \$3,350 and the maximum deductible is \$5,050. For singles, the limits are \$1,700 to \$2,500. These deductibles are adjusted for inflation each year.

Depending on the policy, that means you and your family must pay out of pocket the first \$3,350 to \$5,050 for qualified expenses allowed by the plan. Once you exceed the deductible, the policy starts paying 80 to 100 percent of costs.

The next step is to open an MSA through a financial institution or perhaps the insurance carrier offering the medical policy, though because of low participation to date, choices for opening MSAs are somewhat limited. You then put money into the medical savings account—on a pretax basis much like an individual retirement account—which you later draw on—also tax free—to pay for qualified out-of-pocket expenses, which can even include long-term care insurance premiums. (Withdrawals not used for medical purposes are taxed as regular income, and a 15-percent penalty is imposed unless you are disabled, dead, or 65 or older.)

The law limits how much you can put into the MSA each year on a pretax basis. Individuals can contribute no more than 65 percent of the medical plan's deductible, and families can contribute no more than 75 percent. For example, if the policy deductible is \$3,350, then the family can contribute up to \$2,512.50 each year.

If medical expenses are low, contributions and earnings accumulate from year to year. It's not the "use it or lose it" feature people face when using flexible spending accounts through their employer for medical expenses.

Investment options vary from plan to plan. Some pay only a fixed return, others let you choose investments. If you have a choice, many financial planners recommend sticking to low-risk options such as a money market until you accumulate one to three years' worth of deductibles. After that, consider more aggressive options. If accumulations grow enough, the MSA could pay for medical care not covered by Medicare, thus reducing the need to buy Medigap insurance, or it could even serve as another retirement account once you reach age 65.

But why, you might ask, use a plan that requires you to pay at least \$3,350 out of pocket before insurance kicks in? Why not buy a lower-deductible policy that starts paying the bulk of the costs much sooner?

First, monthly premiums for a catastrophic policy are significantly lower than for a standard policy – as much as 50 percent. The premium savings alone may fund much of the MSA.

Second, the money you put into the account (up to the prescribed limits) is pretax, making for additional savings.

Furthermore, employers that sponsor an MSA plan may be willing to use some of their premium savings to fund each employee's MSA account, which it can do on a tax-free basis. And you may be able to negotiate discounts with your doctors because you're paying in cash.

This is where the controversy sets in, however. Critics argue that while an MSA may be a good deal for healthy people, it is a poor deal for unhealthy people because they end up spending the high deductible on care and are never able to build up any funds in their account.

But for now, the MSA experiment continues. And as long as you open an MSA by the end of 2003, you can continue it even if Congress doesn't renew the program.

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