SOCIETY OF ACTUARIES

Article from:

The Actuary

February 1996 – Volume 30, No. 2

The Newsletter of the Society of Actuaries

Vol. 30, No. 2

February 1996

Actuary

Predictions of employee MSA selection will be challenge for actuaries

by Edwin Hustead

At the time this article was written, the House and Senate had agreed on the design of Medical Savings Accounts (MSAs), and the specifications were incorporated in the proposed budget reconciliation act. The reconciliation act containing that design was being negotiated between Clinton and Congress, but employee MSAs were not controversial. Therefore, if the reconciliation act was passed, MSAs can be established this year. This article discusses implications of the MSAs for employees in medium to large firms.

The design

The legislative change is simple and straightforward. The challenge is in designing a sound MSA/high-deductible plan. Individuals who are covered by a high-deductible health insurance plan can place money in a tax-preferred MSA. The funds placed in the account are not taxed. Funds can be used, without tax, to pay unreimbursed health care expenses and long-term care premiums.

While there are few restrictions on the account, the following are critical to the design of an employee health benefits option:

- Monies can be put into an account by either an employer or an employee, but not both.
- The employee's health plan has to provide that an individual has to meet a deductible of at least $1,500, and a family has to meet a deductible of at least $3,000.
- The annual limit on contributions to the MSA is the lower of the deductible or $2,000 for an individual ($4,000 for a family).

The actuarial problem

An employer who introduces a high-deductible plan so employees can qualify for an MSA needs to be particularly concerned about the interaction of the new option with the existing health plan options. The actuary will be called on to predict the number, demographics, and spending patterns of employees who will select the new option. That prediction will be the basis for determining the amount that the employer can give to the employee in return for selection of the high-deductible plans.

The first step in the analysis will be to obtain information on the current plan. One essential set of data is a distribution of claims by size and type. Another is a distribution of employees by current election and demographics.

The actuary will then have to predict the number and characteristics of those who will select the new option. Prediction of selection should be based on the potential change in out-of-pocket expenses, including premium payments, that would occur with the election. Employees who see a potential gain will be more likely to join the high-deductible plan and those who see a potential loss will be less likely to move. However, the

(continued on page 4)

Inside this issue

Predictions (continued from page 1)

prediction of selection is complicated by the tendency of employees to remain in the current plan and avoid risks. The result will be that the high-deductible participation, at least initially, will be much lower than predicted by individual economic considerations alone.

The second step will be to determine the amount of reduction in insurance benefits for each employee expected to transfer to the high-deductible plan. The reduction results both from plan design and from the change in expenditures resulting from the increased out-of-pocket expenses. The latter is called the induction effect. Total administrative expenses will probably decline, but the percentage of premium paid for administrative expenses could show little change. Since the premium for the high-deductible plan will be lower than for the current plan, the absolute amount of premium needed for administrative expenses will decline.

A key outcome of the analysis will be to determine the amount that can be credited to the employee without increasing the cost to the employer. In a typical case, this amount will be around one-fourth to one-third of the increase in the deductible. Because the credit will almost always be much lower than the maximum permissible MSA contribution, the employer will probably want to credit the savings to the individual through some other method than a direct contribution to the MSA. Then the employee can make the maximum possible MSA contribution.

The covered expense trap

Patients will be able to use the MSA funds to pay any unreimbursed expenses that are permitted by IRS rules. Many of these expenses (e.g., contact lenses and outpatient psychiatric care) might not be covered by the health plan or only partially covered. In many cases, the result will be that an employee will think the deductible has been met, but the plan will find that some of the MSA payments were for non-covered expenses. The employee will then have to pay additional amounts before the deductible is satisfied.

The table on this page shows an extreme example. The employee might well believe that the coinsurance on all additional expenses would be paid by the plan. In fact, the employee will have to pay an additional $1,050 toward covered expenses before the plan pays the coinsurance. This covered expense trap will require careful design and communication of the new health plan. Even with a well-designed communication program, many employees will be surprised when some of their MSA expenditures are not counted toward the deductible. One approach would be to keep a running record of the applicability of MSA expenditures toward the deductible. However, this approach would decrea the administrative savings achieved by using the MSA for the smaller expenses.

Expenditures	Paid from MSA	Covered by Plan
10 psychiatric outpatient visits @ $100 each (plan covers $25 per visit)	$ 1,000	$ 250
Contact lenses (plan doesn't cover)	$ 200	–0–
Outpatient surgery (UCR is $200)	$ 300	$ 200
Total	$ 1,500	$ 450

Academy reports

The American Academy of Actuaries has issued two reports on MSAs that provide details on the design and pricing of MSA/high-deductible options. The first report, May 1995, is a general discussion of the concept. The second, October 1995, is an analysis of the proposal that was before Congress at the time. The proposal analyzed in October is similar to the final bill. Actuaries can contact Mike Anzick at the Academy, 202\223-8196, for a copy of both reports.

Edwin Hustead is senior vice president, The Hay Group, Washington, D.C., and chairperson of the American Academy of Actuaries Medical Savings Work Group. His e-mail address is axtuary@aol.com.

Spring 1996 Exam Seminars

Organization	Course	Instructor/Phone	Location	Dates
The Austin 150 Seminar	150	Dr. James Daniel, ASA 512/343-8788	Austin, Texas	March 30-April 6
Spring Exam Preparation Seminars	120, 130, 135, 140, 150, 151, 160, and EA1-A	Prof. Sam Broverman, ASA 416/978-4453 416/966-9111	Chicago New York	April 9-29 April 16-May 9