Chapter 10 SUPPLEMENTARY FINANCING OPTION (3) - MEDICAL SAVINGS ACCOUNTS

Medical Savings Accounts as Supplementary Financing

10.1 Medical savings accounts are mandatory employment-based and income-linked individual savings accounts which accrue contributions from an individual's income with investment return to pay for the fees charged for healthcare services he/she consumes. Each individual in employment with remuneration above a certain level is required to save up a certain percentage of his regular income in his individual medical savings account. In short, medical savings accounts serve the purpose of enabling individuals to build up a healthcare reserve fund of their own over time to pay for their future healthcare needs, and the fund can go to their estates if unused.

10.2 Medical savings accounts underwrite part of the financial risks of individuals for their own healthcare needs over time, when they would be able to have a reserve fund to meet such needs, especially after retirement when the individual is likely to have to spend more on healthcare but may not have a regular income. For society as a whole, medical savings accounts provide a mechanism where the working population saves for its own future healthcare needs, thereby reducing the pressure on the public healthcare system in the future and in turn the economic and financial burden on future generations.

10.3 Medical savings accounts, however, do not provide for risk sharing or risk pooling among individuals. Medical savings accounts by themselves also do not help generate additional funding that will go into the healthcare system. The funds remain in the individual's account and will only go into the healthcare system when healthcare services are used, and only if the fee for using such services is more than nominal.

Financing Implications

10.4 As healthcare needs differ among individuals, the financial impact of medical savings accounts on individuals can vary significantly. Those who need to use healthcare services substantially (such as patients who need long-term medication) or those who need to use costly healthcare services (such as patients who are struck by catastrophic illnesses or requiring complicated surgery or treatments) may not have sufficient savings in the account to cover their healthcare expenses and may have to fall back on the safety net. Patients with savings may also choose to use highly-subsidized public healthcare services and allow the

savings to remain unused in their accounts. On the other hand, those who stay healthy throughout their lives without requiring long period of care would leave behind sizeable savings unused for healthcare purposes.

10.5 To study the implications of a medical savings account scheme, we have commissioned an actuarial simulation of individuals' savings and medical expenses, and estimated the average amount of savings accrued when an individual reaches age 65, and the probability that he/she would have enough savings in the medical savings account to meet his/her own medical expenses after 65 until death.

10.6 **Table 10.1** shows the estimated figures for individuals within the age group of 20-29 who start saving a rate of 3% of their income (capped at $20,000) until 65 for meeting their future healthcare needs, and that 15% of the savings will be used before 65. The actuarial simulation takes into account salary progression and labour participation rates, and assumes a real investment return of 3%, real annual medical inflation of 3%, and medical expenses at around 20% of public healthcare cost for both in-patient and out-patient services (i.e. healthcare services subsidized at 80% level).

Table 10.1 Estimated amount of medical savings for individuals who start saving at age 20-29 at **3%** saving rate

Monthly income groups (range of initial income)	Average accrued savings at age 65	Average post-65 medical expenses	Average account balance at death	% of account holders with sufficient savings to meet post-65 medical expenses
Lowest 30% of income earners (below $7,650)	$151,000	$520,000	-$362,000	28%
30th to 80th percentile of income earners ($7,650 - $14,499)	$236,000	$575,000	-$295,000	40%
Highest 20% of income earners ($14,500 or above)	$350,000	$582,000	-$124,000	58%

10.7 On the other hand, **Table 10.2** shows the estimated figures for individuals within the age group of 20-29 who start saving a rate of 5% of their income under the same set of assumptions as above. As clearly shown by the figures, the sufficiency of the estimated savings would improve significantly across-the-board at a higher saving rate.

Table 10.2 Estimated amount of medical savings for individuals who start saving at age 20-29 at **5%** saving rate

Monthly income groups (range of initial income)	Average accrued savings at age 65	Average post-65 medical expenses	Average account balance at death	% of account holders with sufficient savings to meet post-65 medical expenses
Lowest 30% of income earners (below $7,650)	$252,000	$520,000	-$211,000	47%
30th to 80th percentile of income earners ($7,650 - $14,499)	$393,000	$575,000	-$55,000	62%
Highest 20% of income earners ($14,500 or above)	$583,000	$582,000	$234,000	80%

10.8 The actuarial simulation indicates that a medical savings account scheme involving savings alone may not be an adequate source of supplementary financing due to the very different healthcare utilization patterns among different individuals. This, coupled with the variations in income profile, could lead to very different levels of savings, resulting in a significant proportion of individuals still relying on the public healthcare safety net while some would have accrued sizeable savings in their account without the need to spend it.

Overseas Experience

10.9 The medical savings accounts arrangement is adopted by Singapore, where the subsidy rate of public service is not as high as that in Hong Kong. The subsidy rates are 80% for "C" class wards, 65% for "B2" class wards, and 20% for "B1" class wards. There is no subsidy for the private "A" class wards. The unsubsidized portion of the hospital charges is paid out-of-pocket by the patient or by insurance if the patient has such coverage.

10.10 In Singapore, where the medical savings account scheme is called Medisave, the government has in place a mechanism to provide a limited extent of risk pooling through the setting up of a catastrophic health insurance scheme (the Medishield scheme). The objective of the scheme is for all Medisave account holders and their dependents up to 85 years old to share out the risk of catastrophic illnesses. Premiums for the insurance are paid through the Medisave. Unless Medisave account holders choose to opt out of the scheme, they will automatically be covered by the insurance.

Advantages as Supplementary Financing

10.11 Introducing medical savings accounts as a supplementary financing arrangement has the following advantages –

(a) **Saving for own use**: medical savings accounts are more desirable from an individual's point of view in that the savings remain the individual's own assets, which, if not used by himself/herself (and his/her family members subject to scheme design), are left to his/her estates. Saving for one's future is a concept well accepted in Hong Kong.

(b) **Saving for individuals to meet future medical needs**: medical savings accounts enable an individual to spread out his financial risks due to poor health over time, by saving up to meet future medical needs. This is particularly useful after retirement, when the individual is likely to have to spend more on healthcare but is no longer getting any regular income.

(c) **Reduce the financial burden on future generations**: given our demographic changes in the coming decades, we are likely to have a smaller working population to support a growing elderly population. Medical savings accounts could reduce the financial burden on our future generations. However, to enable savings in medical savings accounts to be channelled into the healthcare system to reduce the reliance on the public purse, there has to be a larger range of private sector services from which patients with savings can choose, and there would also be a need for public fees to be increased.

(d) **Instil sense of self-responsibility for health**: by requiring an individual to save for his own healthcare, medical savings account will help instil a sense of self-responsibility for health, and encourage individuals to adopt a healthier lifestyle and take better care of their own health.

(e) **Promote judicious use of healthcare services**: as individual patients have to use their own savings for healthcare (on top of any government subsidies or insurance payout), medical savings accounts may also have an effect in encouraging individuals to be more judicious and responsible in using subsidized healthcare services, especially if they are required to pay a higher level of payment for services which are more prone to inappropriate use or abuse.

Disadvantages as Supplementary Financing

10.12 Introducing medical savings accounts as a supplementary financing arrangement has the following disadvantages –

(a) **No risk-pooling**: pure medical savings do not pool the health risks among the population, and could still be inadequate to cover the medical expenses of those heavy users requiring more healthcare. As in the case of Singapore, it would be necessary to supplement the scheme with some form of insurance so that every patient who has savings is protected while the unfortunate minority who have to pay out huge medical expenses are covered to some extent by the insurance.

(b) **Not a guaranteed source of supplementary financing**: while medical savings accounts will accumulate over time a sizeable pool of savings that could potentially be tapped to finance healthcare, the use of such savings is up to the individual. There is little predictability on when and how the savings would be used, and thus the amount of additional finance that can be secured for healthcare is uncertain. As our actuarial simulation shows, the usage pattern of savings can be very diverse among individuals. This is especially the case if public healthcare services remain highly-subsidized at the current level (95% subsidized), where the account holders would have strong incentives to continue using public services, in which case the savings would not relieve the pressure on the public healthcare system. This contrasts with the situation in Singapore, where the highest subsidization for public healthcare services is only 80% and the savings would at least provide funding to cover 20% of the cost.

(c) **Does not in itself support market reform especially in redressing public-private imbalance**: medical savings accounts on its own, coupled with the current highly-subsidized public healthcare system, provides little incentive to make more use of private services. This not only casts doubt on the ability of medical savings accounts to provide supplementary financing for healthcare, but also renders it unable to support the necessary market reforms to the healthcare system, especially those aimed at redressing the public-private imbalance.

(d) **Use of savings before retirement defeat the purpose of saving for future medical expenses**: medical savings accounts are intended to provide savings to meet future healthcare needs. Allowing the use of savings before retirement could easily deplete savings and would defeat the purpose of medical savings accounts. To cater for frequent withdrawals

from medical savings accounts to meet unpredictable healthcare expenses from time to time, savings would have to be invested in assets with high liquidity and low volatility, thereby foregoing the upsides of long-term investment, making medical savings accounts a less attractive proposition.

(e) **Incur administration cost**: the accrual of savings and the subsequent disbursement of the savings for healthcare expenses will entail administration costs. The administration costs for collection of savings can be minimized by making use of the established MPF framework, where there is synergy and economy of scale. However, the administration costs for disbursement of medical expenses are unavoidable and is similar to the administration costs for processing claims payouts under health insurance (be it social insurance, voluntary insurance or mandatory insurance).

(f) **Locking up huge pool of funding**: if the contribution is set at a relatively higher level to ensure a greater degree of sufficiency and alternative usage such as investment is not allowed, medical savings accounts will lock up a huge pool of idle funding.