Thinking about Self Funding?

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When health insurance premiums continue to increase at a rate in excess of general inflation or wage increases, many employers ask us whether self-insuring their health plan makes sense for them. Self-insuring is certainly a popular option. Surveys show that more than 50% of employees covered by employer-sponsored health plans are covered by self-insured plans. There is also no question that self-insuring, also referred to as self- funding, can save money in many cases; but the decision to self-fund should not be made arbitrarily as there is additional complexity and risk that should be considered before making the jump. The purpose of this article is to provide a basic education so that you can begin to assess whether self-funding makes sense for your plan.

There are several distinct advantages to self-funding medical, dental, vision, and short term disability insurance. Many employers are already self-funding paid sick time off in the form of sick or PTO days and have a good idea of what the costs are in relation to the liability. Calculating and understanding this cost to liability equation is fundamental to the decisions regarding self-funding other pieces of the benefits package.

At its simplest, self-funding breaks down an insurance premium into its component pieces. With a fully insured plan, the employer pays in advance a full premium to cover anticipated claim costs and reserves, plus fixed costs to cover administration costs, risk charges and margin. With self-insured plans the employer pays the fixed costs as they would an insured premium, but they don't have to pre-fund their claim costs. Rather, the company pays for their actual claims once they have been incurred and paid by the administrator, up to pre-determined caps set by stop-loss protection. If during the plan year the paid claims are lower than anticipated, the self-insured plan gets to retain the savings. If the claims are higher than expected, the stop-loss protection is there to protect the employer's liability. Particularly at a time when more employers are looking for ways to improve their employees' health and reduce their claim costs, more employers are also interested in participating directly in those savings.

Other advantages of self-funding include:

Lower Taxes: Paying the claims directly from your general assets removes the 2-3% state premium tax charged to fully insured premiums.

Governing Law: Self-insured plans are governed by the Federal laws set forth in ERISA, not individual state laws. This allows you to create one plan for your entire company, even if out of state employees have previously been subject to state specific benefit requirements.

Choice: You can deconstruct your plan and choose on an individual basis the best-in-class administrator, stop loss carrier, provider network, pharmacy vendor, disease management vendor, and a host of other vendors. If one vendor in your health plan doesn't perform to expectations, you can change that single vendor and keep the ones that are working well rather than replacing the entire program.

Flexibility: Self-insured plans can truly create a custom insurance program. Unlike fully insured plans where there is limited latitude to design the benefit options, self-insured plans give you the opportunity to choose what benefits to offer and at what levels.

Transparency: Being that the claims are paid by the employer, management receives full reporting as to what claims are being paid. This data can be invaluable when determining budgets, renewal estimates, cost drivers and the impact of plan changes to costs and to employees.

Cash Flow: Claims take anywhere from 15-60 days from the date of receipt to be processed, which leaves a lag of up to two months before the expense is realized. This means the cash remains in the company's control during this time compared to a fully insured plan where premiums are paid before the claim is even incurred.

There can be disadvantages to self-funding, as well. With greater flexibility comes greater responsibility. To that end, the benefits team, including HR, finance, and senior management, need to understand the details that pass the risk from the traditional insurance company to the employers. Specifically:

Cash Flow: Although the cash flow advantages can be a strong inducement to self-fund, it should be recognized that the plan's total cost will vary from month-to-month and cash flow may be affected. Although the risk is quantifiable and can be budgeted, this variability in cost can be disconcerting to some employers.

Program Details: It is critical to understand the contracts of the various vendors, especially the stop-loss carrier. The stop-loss contracts determine how the carrier will respond in the event of a major individual claim or high aggregate claims. The stakes are high and the employer, as a fiduciary, is responsible for the benefits spelled out in the benefits booklet. Clearly it is important for the benefits booklet to match the stop-loss contract. Additionally, the devil can be in the details when assessing how the stop-loss will protect the employer's liability. Too often we hear of situations when the employer does not have the protection they think they purchased. Any gap in the stop-loss protection or even a delay in stop-loss reimbursement can place significant strain on an employer's cash flow.

We also want employers with interest in self-funding to understand what happens at renewal. A decision to self-fund should not be based upon first-year liability without consideration of the reserve liability. Because of the claim lag mentioned above, it is easy to illustrate significant savings if reserve funding is not included. This can lead to absolutely brutal surprises at that first renewal.

Commitment: Finally, it is important to have an exit strategy. A good consultant will help you arrive at proper reserve funding as well as discuss with you how your liability can be protected through stop-loss at plan termination. Once you've made the decision to self-fund your benefit plan, you cannot easily jump from insured to being self-insured each year based on premium costs. Planning for the future is a critical facet to entering a self-funded arrangement.

So now you are familiar with the basics of self-funding and some common benefits and disadvantages. What is the best way to evaluate the option of self-funding? The answer requires some due diligence but is relatively straight forward. With some basic plan information we can create rates from the ground up using analytical tools and underwriting methods. At the end of the process, benefits teams should expect to know exactly how much money can be saved and the potential liability.

Self-funding is a sound method for insuring an employee benefits plans. For employers that are comfortable with additional risk and understand the short and long term implications, self-funding is a tool that can be used to save money and better manage the expense of providing their employees with health care.