

# Self-Funding

**Cost relief to employers,  
regardless of size.**

*A White Paper by Meritain Health*



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## Cost relief to employers, regardless of size

The price of healthcare benefits continues to increase, through the worst recession in the U.S. in twenty five years and despite the most extensive changes to our healthcare system in half a decade. According to recent projections by the **Centers for Medicare & Medicaid Services**, healthcare spending is expected to grow at an average annual rate of 5.7 percent from now until 2023.<sup>1</sup>

Self-funded plans continue to allow employers to keep short- and long-term costs under control. This, as well as the other advantages of self-funding—cash flow improvement, plan design flexibility and now, increased benefits under healthcare reform—are available to companies of all sizes and financial circumstances. In fact, businesses having as few as 25 employees can overcome the obstacles that formerly made it difficult for them to self-fund.

### For example:

- Stop loss carriers are becoming adept at working with smaller companies to mitigate financial risk.
- Third Party Administrators (TPAs) provide a broad range of services to supplement the human resources capabilities of small and mid-sized companies.
- Experienced health plan consultants help companies design plans to meet the needs of diverse workforces.

These resources put the benefits of self-funding within the reach of small, mid-sized and large companies alike.

## Increased enrollment by small companies

More and more companies have begun to enroll in self-funded plans. In 2013, more than half (61 percent) of all covered employees were enrolled in a self-funded plan. This percentage has remained stable over the past few years, but since 2000 is up from 49 percent.<sup>2</sup>

It's true that covered workers in large companies were more likely to be enrolled in a self-funded plan than workers in small companies (83 percent vs. 16 percent). However, enrollment in self-funded plans by smaller companies is increasing. Since 2006, enrollment of small companies (3-199 workers) in a self-funded health plan has increased from 13 percent to 16 percent.<sup>3</sup>

As more companies realize the benefits, both financial and otherwise, of self-funding, these percentages could increase. With current reform regulations, it's important for employers to understand the advantages of different funding methods. Self-funded and partially self-funded health plans put employers in greater control and aren't as likely to be influenced by state mandates.

## What is a self-funded health plan?

A health plan under which an employer assumes the responsibility and related financial risk for paying plan participants' healthcare expenses is known as a self-funded health plan.

Stop loss coverage is often purchased to protect self-funded companies from high claims by putting a ceiling on financial risk.

In contrast, under a fully insured plan, an employer pays fixed monthly premiums to an insurance carrier, and the carrier assumes the responsibility and related financial risk for paying plan participants' claims.



### Percentage covered in self-funded plans, small group

	2006	2009	2013
<b>Firm size</b>			
3-199 workers	13%	15%	16%
<b>All firms</b>	55%	57%	61%

### Percentage covered in self-funded plans by firm size, 2013

<b>Firm size</b>	
200-999 workers	58%
1,000-4,999 workers	79%
5,000 or more workers	94%
<b>All Small Firms (3-199)</b>	16%
<b>All Large Firms (200 or More)</b>	83%

SOURCE: Kaiser/HRET Survey of Employer Health Benefits, 1999-2013



<sup>1</sup> "National Health Expenditure Projections 2013-2023;" Centers for Medicare & Medicaid Services; 2013.

<sup>2</sup> "Employer Health Benefits 2013 Annual Survey," The Kaiser Family Foundation and Health Research & Educational Trust, 2013.

<sup>3</sup> *Ibid*

## Limited effects under ACA

Many provisions of the **Affordable Care Act (ACA)** affect both self-funded and fully insured plans. However, some mandates that could result in higher health plan costs apply only to plans that are fully insured. These regulations include:

- **Medical Loss Ratio (MLR).** Insurers are generally required to spend a minimum of 80 percent of every premium dollar on claims and quality improvement for the health plan. This percentage increases to 85 if the group has more than 50 employees. If this percentage is not met, the insurer must rebate the difference to the members.
- **Rate Increase Review.** Insurers charging rate increases of 10 percent or more must submit these to the U.S. Department of Health and Human Services for review.
- **Essential Health Benefits (EHB).** This regulation requires that fully insured plans cover EHB and may not impose lifetime or annual dollar limits on these benefits. Self-funded plans are not required to cover EHB; however, if they do there are certain requirements that must be met.
- **Modified community rating.** Per this rule, insurers may not consider health, industry or gender when setting premiums.

Employers can benefit from exploring alternate funding arrangements. Continuing with the status quo could cause employers to incur short- and long-term costs that could be prevented.

## Advantages of a self-funded health plan

Companies gain significant advantages when they implement self-funded healthcare plans, regardless of company size:

- ▶ **Financial and administrative control**
- ▶ **Improved cash flow**
- ▶ **Plan flexibility**

### Financial and administrative control

Administration of a health plan is an invisible process to a company whose health plan is fully insured. Each month, the company pays a premium, which includes charges for administration of the plan, as well as reasonably expected claims, and the insurer performs all administrative tasks—outside the company's vision or control.

When a company makes the change to self-funding, it assumes responsibility for administration of the health plan. With this responsibility comes the ability to:

- Operate efficiently and effectively.
- Detect areas where modification of systems and processes may be desirable or necessary.
- Make continual improvement in plan operations, with a goal of optimizing plan performance, improving employee satisfaction and, ultimately, saving money.

## Improved cash flow

Companies that self-fund their health plans receive significant cash flow advantages.

### ••• First advantage—pay as you go

Under a fully insured health plan, a company pays premiums to pre-fund claims and other costs. The insurer uses these pre-paid funds to pay plan participants' claims. In addition, the insurer retains a portion of the premiums to cover overhead costs and to compensate itself for the services it performs and the financial risk it assumes.

A company with a self-funded plan does not pre-fund its claims costs. Rather, the company pays claims as they are incurred. This allows the company, not the insurer, to invest and receive returns on unused claims funds. Of course, many small companies use TPAs for claims administration and plan management; however, TPA charges typically are lower than those of traditional insurers.

### ••• Second advantage—claims liability

At the end of a plan year in which claims have been lower than anticipated, a traditional insurer keeps the premiums and no savings are returned to the fully insured company. When claims paid by a company's self-funded plan are lower than anticipated, the savings belong to the company alone.

### ••• Third advantage—premium taxes

Self-funded health insurance plans are liable for state taxes only on stop loss premiums. Conversely, fully insured plans are liable for state premium taxes on total plan cost. According to industry experts, this disparity results in direct, automatic savings to a company that self-funds. These savings are estimated to be two to three percent of the premiums' dollar value.

All the cost-saving advantages of a self-funded health plan help employers beat ever-increasing healthcare trends and leave more money to be invested back into the success of the company.

## Plan flexibility

Traditional insurers offer *one-size-fits-all* health plans. As a result, a company with a fully insured health plan may be forced to pay for benefits its employees will not use. Also, the company may be unable to offer other benefits its employees particularly need.

The flexibility of self-funding allows a company to custom design a cost-effective health plan tailored to employees' specific needs. For instance, high-cost benefits that employees do not value can be eliminated, and replaced by benefits that employees want—often for a lower cost.

With the help of experienced plan design specialists, a company can identify additional cost-saving opportunities while custom building a plan that supports corporate objectives and offers a range of options matching the needs of a diverse workforce. For example, a company may:

- Develop a more cost-effective plan by excluding or limiting non-applicable benefits, while still meeting employees' needs.
- Implement a care management program to direct participants toward the most efficacious and cost-effective medical care.
- Offer alternative health plan options, such as Consumer-Directed Health Plans (CDHPs).
- Provide coverage for alternative treatment procedures, such as chiropractic services and acupuncture.
- Design prescription drug plans that provide cost-saving opportunities.

The flexibility of self-funded health plans offers another important advantage to companies with multiple locations. Because self-funded plans are not bound by state law requirements, a multi-location company is not burdened with managing multi-state plans. Instead, the company can design and manage a single self-funded plan that fits the needs of employees in diverse locations.

## Considerations of self-funding to small and mid-sized employers

When small and mid-sized companies explore the potential benefits of self-funding, they may encounter challenges not faced by larger corporations. For instance, small and mid-sized companies may:

- Be wary of taking on the financial risk inherent in self-funding.
- Experience large cost fluctuations due to the unpredictability of the timing of claims.
- Lack internal resources (e.g., personnel and specialized expertise) to manage and administer self-funded plans.

Fortunately, these challenges can be met through appropriate risk management strategies, accurate claims administration and effective plan design.

### Alleviating risk through stop loss coverage

Although companies with fewer than 100 individuals may feel that self-funding is a gamble, there are ways to mitigate risk and ease concerns. One approach is through stop loss coverage, which protects self-funded companies from high claims by putting a ceiling on financial risk. Practically speaking, stop loss coverage changes a fully self-funded plan into a partially self-funded plan that still offers the same cost control opportunities.

#### Two types of stop loss

There are two types of stop loss coverage: specific and aggregate.

- ▶ **Specific stop loss coverage** protects a company against claims above a specified amount on a per-participant or per-family basis. An experienced consultant can work with a company to set the amount at a level that reflects the company's risk tolerance.
- ▶ **Aggregate stop loss coverage** protects a company against accumulated claims that exceed a specified ceiling. The stop loss insurer is responsible for any claims above this ceiling.

Aggregate stop loss coverage is generally provided on an annual basis; however, it also can help protect a company from interim cash flow problems that arise when monthly claims fluctuate above projections. The difference is made up as claims in other months fluctuate below projections. At year end, an annual reconciliation is performed. At that time, an adjustment can be made if overall claims for the year were higher or lower than projected.

How much stop loss coverage does a company need and how much will the coverage cost? The answers to these questions depend on a number of interrelated factors. These factors include the company's assessed level of risk, the size of its workforce and the amount of risk it is willing and able to assume. The majority of companies that self-fund typically obtain both specific and aggregate stop loss coverage.

### Alleviating risk through strategic plan design

As discussed earlier, self-funded plans have a great deal of flexibility when it comes to plan design. As a result, companies that self-fund can custom design their health plans to drastically reduce risk. Effective strategies to reduce risk include excluding or limiting certain benefits and implementing strong wellness, disease and pharmacy management programs.

## Joining a group captive

Self-funding with a group captive is an innovative way for small and mid-size employers to reap the benefits of self-funding. At the same time, they are able to minimize the potential risk associated with exposure to a large claim or series of claims. With a captive, employers with 50 to 500 employees cover their own small claims and purchase traditional stop loss insurance. Then, each employer contributes premiums to a group mechanism called a captive. The captive covers claims that fall between the small, self-funded layer and the catastrophic layer. In this way, claims are spread across a larger pool of employees, reducing risk and year-to-year volatility.

## Claims administration and plan management

Frequently, a small or mid-sized company's self-funded health plan is managed and administered by a TPA. Third party administration is not a new industry. Since the inception of self-funded health plans, TPAs have provided services such as claims administration and eligibility management.

Services offered by TPAs to administer self-funded plans include:

- Managing plan eligibility and enrollment.
- Issuing identification cards.
- Conducting enrollment meetings.
- Providing employee education.
- Responding to plan participants' questions and resolving issues.
- Negotiating, obtaining and renewing stop loss coverage.
- Managing/monitoring stop loss administration.
- Providing (or contracting with vendors to provide) wellness programs, disease management, pharmacy benefit management and provider network management.
- Negotiating provider discounts.

## Is self-funding a good fit?

This question should be explored with the help of a specialist in health plan design. Factors to be considered in evaluating whether a self-funded plan meets a specific company's objectives and fulfills the needs of its employees include the following:

- Current and projected healthcare cost trends.
- The company's healthcare claims history.
- The company's projected future claims.
- Makeup of the company's workforce.
- The projected cost of plan management and administration.
- Availability of stop loss coverage.
- Financial risk tolerance.

An experienced plan design specialist also can help a company explore the potential benefits of developing a health benefits program with multiple plan options (including CDHPs and traditional provider network plans) and assist in obtaining stop loss coverage.

## Self-funding as a long-term solution

Companies continue to experience annual increases in healthcare costs, with no end in sight. With upcoming healthcare reform regulations and the impact ACA could have on the cost of insurance, now is the time to consider a different method of funding.

Self-funding may be a lifeline, connecting small, mid-sized and large employers to valuable opportunities for increased cost control and improved cash flow. Additionally, the flexibility of self-funding allows for the development of comprehensive health benefit programs with options matching the needs of employees from diverse backgrounds and lifestyles.

### About Meritain Health

At Meritain Health, an independent subsidiary of Aetna, we are advocates for healthier living. Your Meritain Health employee benefits plan will consist of quality, affordable healthcare that is easy for your employees to access and use. This, plus our self-funded expertise and advice, will help you support your employees in healthy, productive lives.

**A healthier tomorrow starts today.**

