Self-Funding Health Benefits

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Introduction

Since the enactment of the Employee Retirement Income Security Act (ERISA), employers of all sizes have increasingly moved away from fully insured group health insurance plans and into self funded benefit plans. This is not surprising, as employers generally seek to gain control of cost items that have the largest impact on their businesses and the cost of providing medical care has increased dramatically over time.

Self funding provides cost savings to the plan through:

- Avoidance of costs that arise from state regulation of insured health plans
- Appropriate use of insurance
- Reduced administrative costs
- Control of cash flow
- Capitalization on good claims experience
- Availability of geographically distinct managed care arrangements
- Encouragement of innovation in healthcare plans.

The Avoidance of State Regulations and Taxes Reduces Health Plan Cost

Self funded plans are primarily regulated by the United States Department of Labor under ERISA. As a result, the various states are prohibited from directly regulating or taxing self funded plans. This is known as the ERISA preemption of regulation of self funded plans.

Under Preemption, employers (Plan Sponsors) are free to design the benefits they offer to their employees in the way they think best suits the needs of their company and its workforce. This freedom creates a cost savings as employers are not required to offer over one thousand various and costly mandated coverages found within the fifty United States. Preemption further permits multi-state employers to offer a single plan of benefits for a geographically diverse workforce, reducing administrative costs.

State premium taxes range from 2% to 6% of the premium for a group health plan. The majority of these taxes are avoided under a self funded arrangement, as the only component of a self funded plan subject to a premium tax is the premium paid for stop loss coverage that the plan or employer may purchase.

Self Funded Plans Follow Sound Risk Management Principles

Self funded plans are founded on the fundamental principles of insurance and risk spreading. Insurance exists to provide for the payment of a covered loss that is unpredictable and has a significant financial impact.

A majority of claims for benefits under a group health plan are both predictable and have small financial impact on a health plan; they therefore are not insurable events. These claims do not meet the established "insurable event" criteria for either the employer or the employee and are therefore technically not within the purview of insurance. If events are predictable, then they are not risks. Only risks can be insured, everything else is either financially inconsequential or predictable.

Self funding takes risks into account appropriately. The two major risks that a plan faces are 1) large claims on individuals, or severity; and 2) overall high paid claims, or frequency. These risks can be appropriately managed through the use of Specific Stop Loss coverage, which protects the plan from the risk of large claims on individuals, and Aggregate Stop Loss coverage, which protects the plan from the risk of having high overall paid claims experience.

The stop loss industry in America is a vital one. While market consolidation continues in this industry, as in most others, there remain many top quality companies who actively complete for business through service levels, competitive pricing, and innovation.

Self-funded plans provide fundamental risk management opportunities in medical management and "wellness programs." The impact on the employer of these programs may be directly measured and evaluated.

Self Funded Plans Benefit from the Unbundling of Plan Services

Self-funded plans benefit by the unbundling of services required for plan operation. Under an insured group health plan, the employer purchases a bundled product that generally includes:

- Plan Administration
- Provider Network negotiation and management
- Utilization Review and Large Case Management
- A risk spreading vehicle

An insurance company rarely excels in every one of the component areas and each component is designed to support the carrier's primary goal; earning an underwriting profit. Under a self funded plan, individual vendors compete to provide the best value in each of the component areas. The services provided to the plan are provided by companies that specialize in each of the services plans require. Each of these areas is reflective of the competitive nature of the US economy as a whole: The selected vendors represent the best balance of price and quality.

Self funded plans generally contract with a Third Party Administrator that provides ongoing administrative functions and support to plan participants. Plans contract with Preferred Provider Organizations & Pharmacy Benefit Managers to obtain discounted pricing on services received by plan participants. Plans contract with firms that specialize in utilization review and large case management to provide for direct cost containment by influencing the services received by plan participants. Finally; plans or the employer as the case may be, obtain stop loss coverage to provide needed risk spreading.

Self Funded Plans have Flexibility in Plan Design

Self funded plan sponsors are free to design the plan of benefits they think best suits the workforce they seek to attract and retain. The resultant plan is therefore reflective of the corporate culture of which it is an important part. All plan benefits are determined by the employer, constrained only by the needs of the people the plan seeks to cover and by the regulations imposed under the various Federal Acts.

While the self funded benefit offering may actually be similar to an insured plan in many respects, it has historically been the self funded plans that lead the way in developing new ways of doing old things. The best current example of this is the new Healthcare Reimbursement Arrangement, a tool that resides exclusively in the realm of self funding.

Self Funded Plans Provide Cash Flow Benefits to Employers

Insured plans collect premiums in advance in exchange for the responsibility to provide benefits at a future date. Self funded plans pay for benefits only when the responsibility arises, giving the employer increased cash flow. Self funded plans also permit the employer to establish and hold plan reserves, leading to stability for the plan and giving the employer an additional financial planning tool.

Good Claims Experience Creates Significant Savings in Self Funded Plans

The cost of a self-funded plan is very sensitive to claims experience. While each plan has its own character of risk retention, which has a significant impact on plan fixed costs, it is fair to say that self funded plans have a low "fixed" cost of operation and the majority of plan cost is in actual paid claims. As a result, when claims experience is good, plan costs are low. Conversely, if claims experience is poor, plan cost increases. The range of costs for the plan is constrained by its fixed costs at the bottom and by its aggregate claim cap, provided by stop loss, at the top.

Self Funded Plans Benefit from Flexibility in Managed Care Arrangements

Many employers are multi-state employers; giving rise to a need for geographically distinct preferred provider organizations. Today, group health insurance companies have become managed care companies whose primary focus has been the development and maintenance of managed care networks. Unfortunately, these networks do not provide adequate access for a geographically diverse population of plan participants.

Under a self funded plan, the plan may contract with various preferred provider organizations that provide network access for each facility the employer maintains. This produces two significant positive outcomes. First, the network may be selected that produces the best blend of discounts and access on a market-specific basis, resulting in reduced cost. Second, the home office is permitted to provide a network for each of their facilities. This demonstrates sensitivity to local preferences, resulting in a healing of the split that often exists between the home office and remote facilities.

Self-funding Encourages People to Innovate in Healthcare Plans

As we struggle as a nation with redefining our healthcare system, self-funded employers are increasingly implementing programs that make significant changes to the way risks are managed in health plans. These employers are able to see the affects of their efforts immediately in their costs. Simply put, self-funding encourages people to strive for improvement and appropriate change in healthcare.

Summary

Self funded plans are an excellent tool for many employers interested in controlling their health plan costs while providing a benefit plan that truly represents their corporate culture. Self funded plans have immediate cost advantages over insured plans through the avoidance of state regulation and taxes.

Employers further benefit from the competition among vendors to provide unbundled services to the plan. Self funded plans recognize the fallacy of group health insurance and thereby gain efficiencies. Flexibility of plan design and managed care networks provide the self funded employer with a plan that may evolve over time with changing corporate needs and accommodate regional preferences in provider selection. Additionally, self-funded plans provide a vehicle for innovation and creativity in a health care marketplace dominated by few, with no real incentive for change, or dare I say reform.