Benefits Insights

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Self-insurance Guide

A growing number of U.S. employers are making the switch to self-insuring as a way to reduce costs and improve service. Self-insuring or self-funding is not right for every organization. Employers considering a switch from fully funded to self-funded health plans should analyze the advantages and disadvantages before making the switch. This article describes self-insured plans, including the pros and cons of such plans, and helps you decide if self-insurance is the right choice for your firm's health care benefits.

What is self-insurance?

According to the Self-Insurance Institute of America, Inc., "a self-insured group health plan (or a self-funded plan as it is also called) is one in which the employer assumes the financial risk for providing health care benefits to its employees. In practical terms, self-insured employers pay for each out-of-pocket as they are incurred instead of paying a fixed premium to an insurance carrier, which is known as a fully insured plan. Typically, a self-insured employer will set up a special trust fund to earmark money (corporate and employee contributions) to pay incurred claims." Employers can be partially or fully self-insured. Employers that choose to partially self-fund, may decide, for example, to continue third-party coverage of mental health or prescription benefits, but self-fund all other medical claims.

Self-insured group health plans are governed by a variety of federal laws including, but not limited to: ERISA, HIPAA, COBRA, the U.S. tax code and federal anti-discrimination laws such as the ADA.

Is self-insurance common?

According to federal statistics, self-funded plans cover 60% of the private-sector workforce—almost 90 million workers and dependents. According to a recent Kaiser Family Foundation survey, those numbers include 15% of small companies (fewer than 200 workers), and 52% of mid-sized companies (200 to 999 workers).

What benefits can I self-insure?

- Health care (indemnity, PPO, POS and HMO only if large enough group)
- Dental
- Short-term disability (STD)
- Prescription drugs
- Vision care

What benefits should not be self-insured?

- Any life insurance benefits, including AD&D and travel accident
- Long-term disability (LTD), unless coverage is for a very large group

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Advantages of self-insurance

The primary reasons employers cite for self-insuring are:

1. Reduced insurance overhead costs. Carriers assess a risk charge for insured policies (approximately 2% annually), but self-insurance removes this charge.

2. Reduced state premium taxes. Self-insured programs, unlike insured policies, are not subject to state premium taxes. The premium tax savings is about 2%-3% of the premium dollar value.

3. Avoidance of state-mandated benefits. Although both insured and self-insured plans are governed by federal law (predominantly ERISA), self-insured plans are exempt from state insurance laws. State benefit mandates can add to the cost of insured employer benefit programs. For multi-state employers, self-funding can help create national consistency by elimination of the need for state-by-state compliance.

4. Employer control. Employers who want to revise covered benefits and the levels of coverage are free from state regulations that mandate coverage and the carrier negotiation typically required with changes in insured coverage. By self-funding, employers are able to design their own customized health benefit packages.

5. Employers see improved cash flow since they do not have to pre-pay for coverage. Claims are paid as they become due. There is also a cash flow advantage in the year of adoption when "run-out" claims are being covered by the prior insurance policy. Employers pay for claims rather than premiums and earn interest income on any unclaimed reserves.

6. Choice of claim administrator. An insured policy can be administered only by the insurance carrier. A self-insured plan can be administered by the company, an insurance company or independent third-party administrator (TPA), which gives the employer greater choice and flexibility. When selecting a TPA, employers should consider whether the TPA efficiently handles claims, has contacts with stop-loss carriers, has a strong reputation, cost management skills and negotiating clout, has medical expertise on staff and provides excellent customer service and claims administration.

Disadvantages of self-insurance

The primary disadvantage of self-insurance is the assumption of greater risk. A year that brings large unexpected medical claims requires that the company has the financial resources to meet its obligations. This unpredictability puts greater demands on budgeting and cash flow. Budgeting is more difficult because health care expenses will vary from year to year, whereas with a fully insured plan, employers know how much they will pay in premiums in a given year.

Self-insured plans also require strong administrative skills. Self-insured employers can either administer claims in-house or subcontract the administrative obligations to a TPA. TPAs can help employers set up their self-insured group health plans and coordinate stop-loss coverage, provider network contracts and utilization review services. Some of the additional administrative duties associated with self-insurance may include monitoring the plan, determining premium rate equivalents for budgeting purposes, administering employee contributions, filing annual reports and day-to-day administration of the plan, establishing a trust to fund the group insurance plan and setting up cash reserves to offset claim run-out liability.

Making the Decision

When deciding if self-funding is right for your organization, make sure that you consider the following best practices to ensure that your self-funding strategy is appropriate and effective.

1) Evaluate Stop-loss Coverage. Most self-insured employers purchase stop-loss insurance on their self-insured health care benefit plans to reduce the risk of large individual claims or high claims for the entire plan. The employer self-insures claims up to the stop-loss attachment point, which is the dollar amount above which claims will be reimbursed by the stop-loss carrier. Obtain stop-loss quotes at several different levels. There are two types of stop-loss insurance: individual/specific and aggregate.

- **Individual/Specific Stop-loss Insurance**
  This type of stop-loss coverage shifts responsibility for a claim to the insurer once it exceeds a certain dollar amount. Specific stop-loss protects the employer against large, individual health care claims.

  Example: $25,000/plan participant per year attachment point. The attachment point is reapplied each year, like a benefit plan annual deductible. Specific stop-loss attachment points can run from $5,000 to $500,000, depending on the employer's size and risk tolerance.

- **Aggregate Stop-loss Insurance**
  The insurer assumes responsibility once the total amount of claims for all employees reaches a specific threshold. Aggregate stop-loss insurance protects the employer against high total claims for the health care plan.

  Example: 125% of expected total annual claims attachment point. The attachment point is recalculated each year and is expressed on a per employee basis to compensate for any change in the number of covered employees.

  Example: $4,500/employee attachment point. Aggregate stop-loss typically is carried at 125% of expected annual claims, but can range from 105% to 150% of expected annual claims.

2. Understand the volume and nature of your employee health claims for the past five years. Knowing facts such as whether your workforce is mostly young or old, whether the majority of claims were due to chronic illnesses or one-time incidents and the total dollar amount of claims will help you budget for claims in the future. Self-funding should be viewed as a long-term strategy in which good and bad years average out in the employer's favor.

3. Cash flow analysis. Self-insured plans work best for companies that have a strong cash flow or reserves. Understand what your cash needs are so you have money available to make timely claim payments.

4. Administration. Decide whether it makes sense to administer the plan internally or through a TPA. If you decide that it is best for your organization to use a TPA, make sure you factor TPA fees into your decision to self-insure. Obtain several different TPA quotes. Your TPA should offer a strong plan for monitoring the plan.

5. Coverage goals. Decide on such things as eligibility, benefit coverage, exclusions, cost-sharing, policy limits and retiree benefits. Weigh the self-insured plan advantages of flexibility and lower average cost versus the increased risk and administrative responsibilities.

The most important step you can take to assure that you make the best decision is to have an experienced professional assist you. Your Clarke & Company Benefits, LLC representative has experience with self-insurance programs, and can answer your questions and assist you with your decision to self-insure your company health plan.

Clarke & Company Benefits, LLC welcomes the opportunity to help your organization examine its plan designs and make recommendations for improvement.