

Self-funding Considerations

Planning/Managing Health & Welfare Benefits

THE SELF-FUNDING RISK-REWARD CONTINUUM

As insured premium costs continue to rise, self-funding of plans is becoming more popular and financially attractive. Is this a good option for your company? You have choices.

Many employers assume there is only one approach to purchasing group insurance coverage: pay a fully insured premium each month. What you may not know is that there are other ways to purchase insurance that can be more advantageous to you. Alternative funding arrangements can pave the way to cost savings, design flexibility, improved employee communications and streamlined administration.

Why are these options “well-kept secrets”? Possibly because many brokers are generally unfamiliar or uncomfortable with self-funding arrangements (and associated risk management elements), or your broker is concerned that his/her commissions may be negatively impacted. Perhaps your company’s size or product mix is not suitable for funding alternatives.

Actuarial consultants, as risk management specialists, help you determine your possible options and make informed decisions by identifying and explaining:

- Anticipated rewards or advantages of self-funding
- Available funding arrangements and their “pros” and “cons”
- Which benefits are viable for self-funding, as well as
- Additional considerations, given specific facts about your organization.

Advantages: Why Self-Fund?

By self-funding, you can:

- **Reduce premium increases** for next year and years to follow (at least 2-5%).
- **Offer uniform benefit designs across state lines**, as self-funded plans are not subject to state-mandated benefit provisions.
- **Increase your flexibility** in benefit design and pricing.

Available Funding Arrangements and Implications Funding arrangements run from conventional fully insured -- minimum risk -- to full self-funding -- maximum risk. Other arrangements that fall in-between these two “extremes” are:

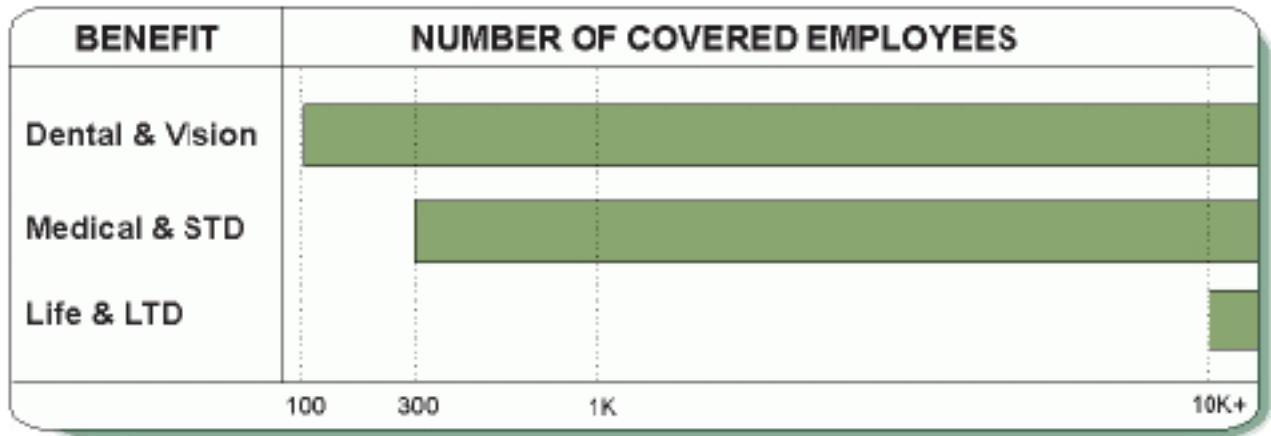
- 1) fully insured minimum premium and
- 2) partial self-funding arrangements.

Arrangement	Pros	Risks/Cons
<p>Fully Insured - Conventional Everyone is familiar with this option and how it works! You pay a steady premium each month in return for insurance coverage.</p>	Costs are predictable and risk level is lowest.	Highest premium costs and broker commissions. While costs are steady during the year, significant premium changes may occur at renewal time.
<p>Fully Insured - Minimum Premium You pay claim costs as they are paid by the insurer (up to a maximum monthly limit) and monthly premiums to cover administration. You hold your own reserves (as much as 30% of a fully-insured premium), payable upon termination.</p>	Slightly lower premiums, improved cash flow, and earnings on the reserve. Lower broker commissions.	The reserve portion of your premiums still must be paid -- on termination of your contract. This arrangement is typically not available for Life or Disability plans.
<p>Partial Self-Funding -With Individual or Aggregate Stop-Loss Coverage You pay claim costs as they are paid by a third-party administrator. Liability is limited in the form of individual stop-loss (limits on claim dollars for an individual per year) and/or aggregate stop-loss (limits on the total amount spent on claims per year) agreements and administration fees. You hold your own reserves.</p>	Aggregate costs and commissions are much lower. Allows employers the flexibility to offer uniform benefits in all locations and to choose among several administrators and network providers. Relieves employers of state premium taxes and state insurance mandates.	The occurrence of a catastrophic illness may cause you to pay higher up-front claims during a given year. Carefully determined budgeting arrangements are a must.
<p>Self-Funding -No Stop-Loss You pay administrative fees and all employee claims. This option is rarely chosen.</p>	Greatest access to health care dollars and maximum relief/savings from premium taxes, state insurance mandates and ERISA requirements.	Highest risk -- one catastrophic illness can be catastrophic financially unless you have many low-claim employees to offset this cost.

Choosing Benefits to Self-Fund There are three important factors to consider when determining which benefits will be most successfully self-funded:

1. According to the “Law of Large Numbers,” the viability of self-funding a particular benefit rises as the number of employees enrolled in the benefit increases.
2. The choice of which benefit to self-fund also depends greatly on potential claim liability associated with the benefit: The higher the possible claim risk for a particular benefit, the greater the recommended number of covered employees.
3. The choice also depends on the need to avoid anti-selection: You do not want to self-fund a plan that has a high likelihood of not being selected by employees due to cost.

This chart indicates approximate employee population thresholds for determining benefit plans to self-fund.



Additional Considerations

- **Self-funding for high-dollar (high risk) benefits requires stop-loss coverage** - at least on an individual, if not aggregate and individual, basis. Low-dollar benefits, such as dental and vision care, usually do not require stop-loss protection.
- **Your company should be able to withstand financial fluctuations over time.** If your monthly expenditures must be within a 5-10% variation of budget, self-funding might not be suitable.
- **You should consider self-funding ALL plans for each benefit:** A fully-insured HMO option offered along with a self-funded plan option can produce anti-selection by employees. You should consolidate risk pools.
- **You need to examine how many employees are opting out of coverage.** Again, you must avoid anti-selection: if “good risk” employees opt out of a particular benefit coverage for financial reasons, more of your costs are required to fund that benefit. For this reason, completely voluntary, employee-paid benefits must be examined very closely prior to self-funding.

There are several additional considerations, including the level of anticipated cost savings over the short and long term. A good actuarial consultant can assist you in making these projections, as well as designing the most suitable funding arrangement for your company.

You do not have to take full risk for your employees’ claims to self-fund. The critical question may not be whether to self-fund, but what and how much to self-fund!

Cost savings are there, waiting to be found!

Marsh Consulting Group works closely with large and small employers throughout the U.S. to tailor, establish, communicate, manage and measure successful employee health care benefit cost control strategies.

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