

# Self-Funding

## An Alternative to Controlling Health Care Costs

BY MARC FLOOD

This past fall, health insurance companies across New York State and other parts of the country patted themselves on the back. Insurance premiums for employer-sponsored plans had risen an average of “only” 7.7 percent—the second consecutive year the industry had experienced a single-digit increase.

But the fact remains that health care premiums have increased 87 percent over the past six years – and continue to outpace the overall inflation rate twice over. Adding fuel to the fire is a recent PriceWaterhouseCoopers survey of insurance carriers predicting a return to double digit premium increases (11.9 percent) for this year.

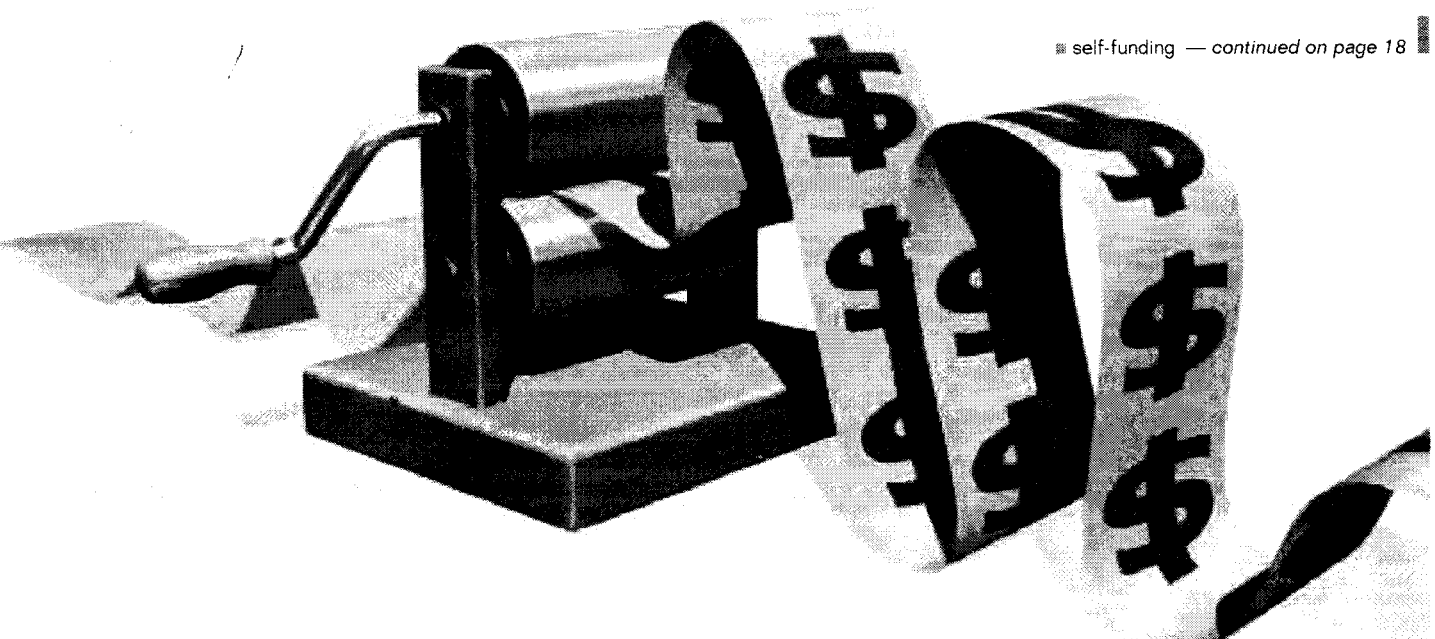
Even Health Maintenance Organizations (HMOs) – once considered a good way to curb rising medical costs – are feeling the heat, and facing the same double-digit premium increases as their Point-of-Service (POS) and Preferred Provider Organization (PPO) counterparts.

What is an HR executive—charged with holding the line on a company’s health care spending, while at the same time continuing to offer quality coverage to employees—to do? For an increasing number of organizations, the answer is self-funding the company’s health benefits.

### What Is Self-Funding?

Self-funding (also known as self-insurance) is a financial strategy alternative to costly traditional benefits insurance. With a self-funding strategy, the employer – not an insurance company – assumes direct responsibility for providing health care benefits to employees, while also managing the assets of the plan. While a company can choose to administer the plan completely internally, most choose to work with a professional benefits administrator. An administrator can help design a medical benefits plan to best meet the unique needs of the company’s workforce. An administrator also can pay eligible

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claims, maintain, track and generate health records and reports, and assure the necessary compliances.

As Keith Wolf, senior vice president for St. Barnabas Hospital, an acute care community hospital and Level I Trauma Center in New York City, puts it, "From ongoing plan design and HIPAA compliance to physician and hospital network development, the time saved and expertise provided by working with a TPA (Third Party Administrator) are difficult to match versus trying to do it all ourselves."

## **Who Self-Funds?**

Once considered an option for only the largest employers, self-funding has become an attractive benefits management alternative for mid-sized and even many smaller employers. According to the Kaiser Family Foundation, more than half of all U.S. workers from companies with 200 to 1,000 employees had self-funded insurance in 2005, with an additional 10 percent of employees in companies under 200 also self-funding. And because of the cost advantages and greater control over company assets inherent in self-funding, these numbers are continuing to rise.

## **Self-Funding Advantages**

Perhaps the greatest advantage self-funding offers over traditional insurance coverage is better cash flow. Employers set aside funds in an interest-bearing account until the funds are

needed to pay a claim. Because a self-funded strategy enables employers to pay for each claim as it is incurred -- rather than paying a fixed premium to a carrier -- the employer (not the insurer) has full use of working capital and interest earnings of any monies in the fund throughout the year.

The professional benefits administrator works together with the company to determine how much to set aside for predictable and unpredictable claims. Self-funding predictable claims often results in direct savings of medical insurance premium loads. To cover for unpredictable catastrophic illnesses or injuries, most self-funded plan designs include the purchase of stop-loss insurance.

Janis Porter, SPHR, who oversees many of the health benefit programs for a large policy research organization in New York, says she would not recommend self-funding without some kind of stop-loss insurance for medium-sized to smaller organizations. Says Porter, "We set our individual stop-loss limit at \$50,000, with an aggregate stop-loss of \$1,000,000. Under this kind of arrangement we get the best of both worlds: the advantages of self-insurance plus the protection against catastrophic illness and injuries."

## **Plan Savings**

A properly designed and administered self-funded plan can realize as much as 30 percent savings over a traditional style fully-insured product, while mirroring the traditional plan's benefit design.

According to Wolf, a self-funded benefits strategy has proven very cost effective in allowing his company to retain benefits,

while significantly containing long-term health care costs – particularly as compared to fully-insured market averages. “By using a self-insured plan, more of our funds go to pay our employees’ claims. In short, working with our TPA helps us provide better benefits at lower costs to our employees.”

### Other Advantages

There are other advantages, as well, to adopting a self-insured model for health care benefits:

- **Greater employer control.** Instead of purchasing a one-size-fits-all plan from an insurer for a fully insured product, the employer and the professional benefits administrator, working together, can develop a benefits plan custom-tailored to that employer’s workforce. This enables the employer to address the specific health issues affecting his or her workforce – not the broader population covered by a traditional insurer.
- **Reduction in risk, retention and overhead.** Because only a portion of total self-funded plan costs are composed of insurance premiums, these amounts are reduced (*see illustration 1*).
- **Good experience.** Stop-loss insurance protects employers in “bad claims” years. Savings in paid claims are immediately available in “good claims” years. And because the employer maintains control over health plan reserves, interest income is maximized — income that otherwise would be usurped by an insurance carrier through investment of premium dollars.
- **Easier review of progressive claims.** Professional benefits administrators regularly review a company’s claims information to determine specific needs areas to address. The online technology tools provided enable the employer to look at the company’s claims database in many different ways — and help determine how best to spend their wellness and prevention budget.

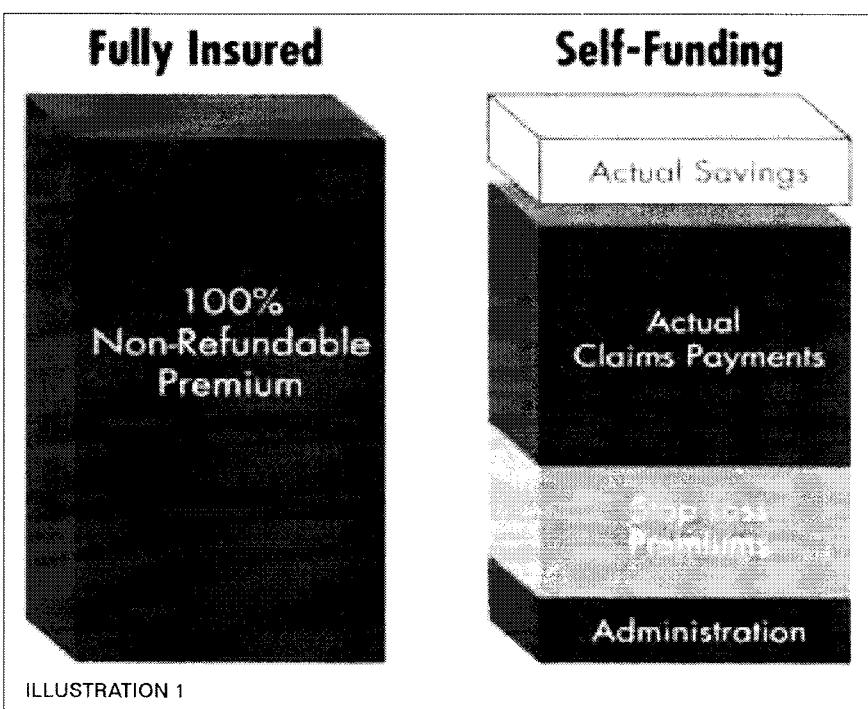


ILLUSTRATION 1

- **Not subject to state regulations and mandates.** The employer is not subject to conflicting state health insurance regulations and mandates. Self-funded plans are federally regulated under the Employee Retirement Income Security Act (ERISA).
- **Not subject to state insurance premium taxes.** This accounts for approximately two to three percent of a premium dollar’s value.

### Why Doesn't Everyone Self-Fund?

With all the advantages that self-funded plans have over fully-insured plans, why isn't everyone self-funding? While it's true that an ever-increasing number of companies are opting for a self-funded benefits strategy, it isn't right for every organization. Companies with fewer than 100 covered employees have an increased risk potential simply because of their smaller size. In addition, a volatile work force can make future claims difficult to predict, and a self-funded strategy more risky. There are exceptions to this rule, so it's wise to consult with an experienced self-funding expert before making this decision.

If you're uncertain about whether to consider self-funding health benefit plans, one step you can take is to talk to your company's insurance broker. “While some brokers might be inclined to steer their clients to large traditional insurance carriers,” says Brian Duffy of Lawley Duffy Associates, an upstate New York brokerage firm, “a good broker will consider and present all viable benefit management options that can help their clients’ bottom lines.”

The bottom line: if your company's medical premiums are increasing faster than you'd like, transitioning to a self-funded model may be a good way to go. ▶

\*2006 Employer Health Benefits Survey, Kaiser Family Foundation and Health Research and Educational Trust



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