Self-Insurance: A Game Changer for Businesses Battling Healthcare Costs

By Ron E. Peck

Just a few weeks ago, a report from the Kaiser Family Foundation revealed insurance premiums for employer-sponsored family plans topped $18,000 this year. As the price of health care and health insurance skyrockets, employers and employees alike are digging deeper and asking: "What is health insurance? Is it all the same? Can we do something to save money but maintain benefits?"

Health insurance generally comes in two flavors -- self-funded and traditional fully-funded insurance. Fully-funded insurance is the type of coverage most people are accustomed to -- from automobile to homeowners insurance. People are accustomed to having an agent assessing them and the risk they pose, then charging a premium to provide coverage.

Enter self-funding.

A self-funded health plan is established when an employer -- the primary plan sponsor -- sets aside some of its funds to pay for its employees' medical expenses. Those workers contribute to the plan instead of paying premiums -- although the similarity of the actions means it's not uncommon to hear employees and employers refer to such contributions as "premiums."

Here are some reasons why an employer would self-fund.

Plan Control

Self-funding begins with drafting a plan document or summary plan description. This is where the employer chooses what to cover and what to exclude. Within parameters set by federal law, the employer customizes the plan to be generous where their particular workforce needs it, and stingy where benefits aren't needed. For example, if someone owns a yoga studio where the workforce is in tip-top shape, they can go lean on benefits meant to help those who are suffering from morbid obesity.

In addition to customizing the benefits, the employer can customize the partnerships. Fully-funded carriers have selected their provider networks, vendors and other programs that they package and force upon policy holders. A self-funding employer, however, can shop around and select partners to customize their team.

Interest and Cash Flow

When an employer purchases fully-funded insurance, they pay premiums when they are told to pay. That money is gone. It sits in the carrier's account until it's needed to pay claims. While it sits, it's working for the carrier.

With self-funding, the funds are in the employer's hands until they're needed, meaning interest on those assets belongs to the employer. Likewise, the money is in hand and usable where needed, when needed.

Federal Preemption and Lower Taxes

In the United States, we are governed by both federal laws and state laws. However, when you can't comply with a state law without violating a federal law, the state law is moot and federal law preempts the state. The Employee Retirement Income Security Act of 1974 states that a private, self-funded health plan is administered in accordance with its terms and federal rules. As such, these plans are not subject to conflicting state health insurance regulations or benefit mandates. Likewise, such self-funded plans are also not subject to state health insurance premium taxes.

Data

These days, everyone talks about "big data," and leveraging data to predict future needs and expenses. A fully-funded insurance carrier owns the claims data they receive and produce. Employers with self-funded plans, however, can examine the claims data, study trends, allocate resources and form partnerships to address their actual needs.

Sharing Is Not Caring

A fully-funded insurance carrier sets premiums based not only on what they anticipate you will cost them, but they add a buffer to cover other employers' employees, to soften the pain of underestimating how much one of those other policyholders will cost. In other words, all policyholders are contributing towards their own expenses and the expenses of others. As such, the steps an employer takes to make their own population healthy don't much impact the bottom line unless all other policyholder employers do the same thing.

With self-funding, the employer pays only the claims of their own population -- so steps taken to reduce the cost directly impact the employer's bottom line. Employees of self-funded companies generally have lower single and family premiums than those with fully-funded insurance.

Overall, these benefits result in net savings for the self-funded plan over a three- to five-year span, compared to a comparable fully-funded insurance policy. Yet there are risks. Among them: the threat of catastrophic claims, inability to fund claims and new fiduciary responsibilities to the members of the plan.

Most self-funded health plans purchase "stop-loss," a form of reinsurance that reimburses self-funded plans for claims they pay in excess of a specific deductible. This is hardly a sure thing. As claims paid by the plan exceed what the plan actually covers or are otherwise excluded, the stop-loss carrier won't reimburse the self-funded plan -- leaving the employer holding the bag.

Finally, a self-funded employer is -- or appoints -- a plan administrator. That administrator is a fiduciary of the plan and its members. Applicable law dictates the fiduciary must act prudently, protect the plan and apply its terms judiciously. Failure to comply with these terms, mismanaging plan assets or otherwise doing something not in the plan's best interest could expose the plan sponsor to claims of fiduciary breach, resulting in steep penalties. Fortunately, there are third party organizations that will step in, aid in decision making and act as a fiduciary as it relates to those decisions. This indemnifies the self-funded plan administrator.

Self-funding has its risks, but also presents numerous rewards. As the price of health care continues to increase, many employers who previously had been too risk-averse are second-guessing their decision -- and self-funding.

My company, for example, made the decision to self-fund our health plan nearly a decade ago. Although self-funding is an obvious choice for employers with more than 1,000 lives that can spread the risk among their employees, employers with 100 or fewer workers are at greater risk. If one catastrophic claim is submitted, and the company lacks the population or assets to absorb the hit, the results can be devastating. Yet my company – with fewer than 100 lives at the time -- made the leap.

Over the time we have been self-funding, our contributions dropped drastically from the premiums we had been paying -- by nearly 30 percent in two years. Since then, they haven't increased by more than a few percentage points annually and we have yet to submit a single stop-loss claim.

Our ability to customize and control our plan certainly has helped. We've drafted terms into plan documents empowering participants to notify the plan administrator anytime a costly procedure is being sought. We also reward participants for collaborating with the plan sponsor to identify the most effective yet cost efficient options.

Our health plan already has saved thousands of dollars this year, and awarded employees thousands in incentives as well. A plan member recently sought to obtain surgery with an anticipated fee of $60,000 for the facility, and another $10,000 for the surgeon. After research, we determined the fee was on the high end of the spectrum.

We communicated with some area hospitals and found one facility that would take $20,000 cash up front for everything involved -- with the procedure being performed by the same surgeon. We saved more than 70 percent and a portion of that saving was given to the participant as a reward.

With some companies already facing nearly 40 percent premium hikes in 2017, employers might be wise to explore self-funding. Many already are: self-insurance among mid-sized businesses jumped almost 20 percent from 2013 to 2015.

Self-funding isn’t for everyone. But for employers willing to get hands-on about their health care, the savings could be monumental -- enough, in fact, to save the employer-based health benefits industry.

Ron E. Peck, Esq. is senior vice president and general counsel at The Phia Group, LLC.