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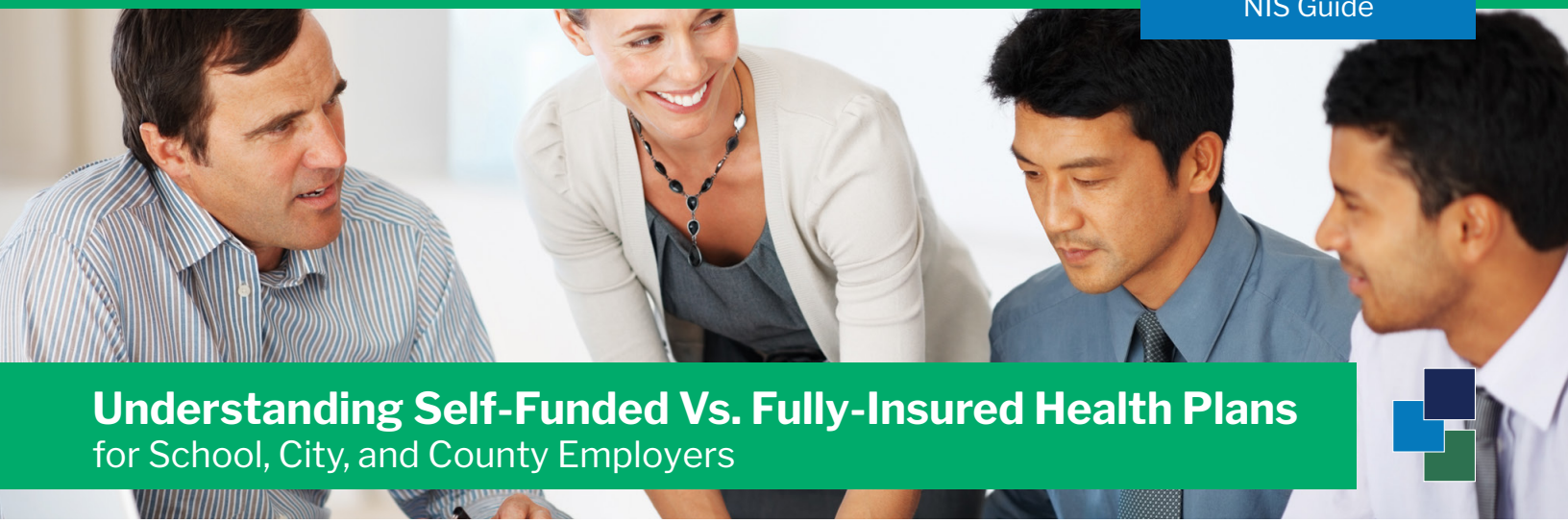

Understanding Self-Funded Vs. Fully-Insured Health Plans
for School, City, and County Employers

Understanding Self-Funded Vs. Fully Insured Health Plans

With school district and other governmental employer budgets stretched tightly, some are considering a switch to a self-funded healthcare plan. Because health insurance costs are a significant expense for most organizations, saving money in this area can have a dramatic impact.

When using a self-funded plan, employers assume an established amount of liability and risk associated with healthcare costs in exchange for a number of significant financial benefits. While not without risks, self-funded health insurance plans can give organizations better cash flow, tax benefits, a greater degree of flexibility over the plan's design, reduced administration costs, and long term control of healthcare costs.

The employer can set the premium rates based on their claims history and adjust the plan in other ways to cut costs. If claims are lower than anticipated, the employer can invest any savings and earn interest. In the event that claims are higher than usual, stop-loss insurance coverage can pay for excess costs, as well as protection against a poor utilization year.

The Structure and Workings of Self-Funded Plans

In a traditional fully insured health plan, the employer, insurance provider, and employees have fairly fixed roles. An organization will pay premiums based on its projected claims, but won't get reimbursement if they come in lower than projected.

In the transition to a self-funded health insurance plan, the employer creates its own coverage plan based on its needs by working with a Health Insurance Company (ASO) or through a third-party administrator (TPA). In self-funded plans, there is greater flexibility in plan design and administration. An employer can choose what coverage it wants and avoid paying for what it doesn't.

Then, the employer essentially pays claims out-of-pocket from collected premiums rather than using predetermined premiums to compensate an insurance provider for assuming financial risk.

To protect against unpredictable or above-average claims, the organization purchases stop-loss coverage as a way to limit risk. The stop-loss provider pays any claims higher than that pre-set amount.

While some large organizations might be able to handle the plan internally, most use a third-party administrator to oversee the plan. How much responsibility the employer and administrator each bear will vary. This can allow employers the flexibility of a self-funded plan without assuming management responsibilities.

Self-Funded Plan Costs

In a self-funded plan, the employer must set fixed costs per employee and take into account claims expenses, or variable costs. These cannot be perfectly predicted for a given month, although careful studies of past history are the basis for setting rates. The costs will depend on the coverage provided and number of employees enrolled.

Variable costs, on the other hand, include the healthcare expenses of employees participating in the plan. While employee utilization can vary between high and low, and isn't guaranteed, organizations purchase stop-loss insurance coverage to protect against any catastrophic issues.

This coverage has three general features, which can insulate employers from higher claims. For individual issues, Specific Stop-Loss Insurance kicks in if any individual claims exceed a set limit.

Re-insurance coverage can also step in during a year when claims for the entire organization are significantly higher than projected. For example, the Aggregate Stop-Loss Policy may go into effect when claims exceed a certain percent of projections. Smaller organizations with smaller revenues may also benefit from Aggregate Cap Insurance, which will help pay for medical costs if claims are particularly heavy to start the year, resulting in cash-flow issues.

The Advantages of Self-Funding a Plan

One of the biggest advantages of a self-funded health insurance plan is that it can have a positive impact on the organization's cash flow. To start, self-funded plans are also generally exempt from premium taxes in most states, lowering employer costs in that area immediately.

With fully insured health insurance plans, employers pay an insurance provider in advance to cover projected claims, in addition to the insurer's overhead and administrative costs.

However, in a self-funded plan, the money collected by the organization is only paid out when claims actually occur, and can stay in a reserve account accruing interest until it is needed. In addition, if claims during a particular month are lower than anticipated, that money adds to the reserve and earns additional interest, creating a long-term financial benefit.

The fact that employers are directly paying for health insurance claims also makes wellness programs and other incentive programs more relevant. With fully insured plans, wellness initiatives generally do not result in significantly lower health insurance costs.

However, in a self-funding scenario, an overall improvement in employee health can lead to an immediate reduction in claims, which means a lower spend and feeds back into the organization's reserve fund. If those trends continue, there may be a reduction in the necessary contributions made by both employers and employees.

As another advantage, organizations may be able to customize self-funded plans to a degree. While collective bargaining agreements may require certain benefits be covered by any employer-sponsored plan, self-funding can allow for flexibility. This flexibility can also be advantageous in the event an employer's healthcare requirements or needs change.

In addition, since a specialized third-party provider completes much of the administration of the plan, employers can refocus their internal resources on other relevant issues.

Disadvantages of Self-Funding

The main risks of self-funding involve situations when, for unforeseen reasons, claims are higher than anticipated. While stop-loss coverage will protect employers from paying excessive claims in a given year, the cost of that coverage will likely increase, and it may be more difficult to get rates from other stop-loss providers.

Higher-than-expected claims in a self-funded plan may also make it more difficult for insurers to go back to a fully insured plan in the future.

For organizations that choose to run their self-funded plan internally, the administrative costs involved with it can be significant. However, most use a third-party administrator to operate the plan and will still involve lower administrative costs than those associated with fully insured plans.

What Type of Employer Can Benefit From Self-Funded Plans?

Generally, most employers can benefit from self-funding as long as they make an accurate assessment of the costs they are likely to face, set rates accordingly, and are prepared to delegate the administrative responsibilities. Roughly 50 percent of workers in the U.S. are already covered under a self-funded plan, even though they may not be aware of it.

However, self-funding is not a quick fix, and employers should not automatically assume that they will save money immediately. For this reason, public sector organizations should approach the potential shift patiently and get advice from those who specialize in school districts or other governmental employers.

When assessing whether a self-funded plan is a wise choice, factors to study include past coverage utilization, cash flow, and the status of the employees being covered. Different employee populations will have their own health characteristics and patterns of care use.

In short, self-funding can benefit both large and small employers by helping them reduce healthcare costs and put those gains back into the organization.

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You may also be interested in the following resources:

- Case Study: Anoka-Hennepin School District, Minnesota
- Whitepaper: Health Insurance Rx
- Video: NIS Learning Series - Self-Funding 101:
  - What is Self-Funding?
  - Stop-Loss Insurance Overview
  - Advantages and Disadvantages
  - Is Self-Funding Right for Your Organization?

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