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Why Smaller and Mid-size Employers Are Considering Self-Funding & Other Funding Alternatives

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Historically, self-funding health insurance was an option that was more attractive to big employers, but that is changing. Self-funding – as opposed to buying insurance from a traditional fully insured carrier – has become a popular topic among small and medium sized employers.

The primary advantages of self-funding are the opportunity for cost savings and plan flexibility. Very simply, if an employer self-insures and claims come in under projections, the employer pays less for the coverage. That said, when an employer decides to self-insure, it is making a bet. So what are the factors you should consider when deciding whether to make this wager?

FACTOR #1

A key determinant is your claims experience. An employer that has a significant number of large claims or a high volume of claims ends up paying correspondingly high premiums. There may be a temptation to get away from those high premiums, but a smart employer will think like an insurance carrier thinks. If history points to a lot of claims in the past, this could be a barometer that poor utilization may continue. Therefore, it's important to understand your specific situation.

For example, a client with less than 100 participants on their insurance decided to self-fund the plan. On the surface, that might seem risky, but it made sense to them because they understood their workforce: Young employees who were not heavy insurance utilizers. Based on this knowledge, the company was willing to make the move to self-funding, and that move saved them 24% on their insurance costs over five years.

Funding alternatives, like self-funding, work best when employers understand their population and their claims experience.

Generally, self-insured plans work best for small to mid-size businesses when they have very engaged employees, a younger or healthier workforce and good wellness plans.

FACTOR #2

Another consideration for employers is risk tolerance. Self-insured firms pay whatever their claims are out of their own pocket. So, if your employees use their insurance a lot one year, you're going to feel the pain, as opposed to having a locked-in payment to a carrier. This can be managed somewhat through stop-loss provisions. A stop-loss policy puts a cap on out-of-pocket expenses; in other words, the employer is responsible up to the agreed-upon threshold, and the carrier is responsible for claims over that threshold. The employer pays a stop-loss premium for this protection.

Your tolerance for "lumpy" cash flow is also a factor. Employers who go for a self-insured plan have to be comfortable with the ups and downs of monthly or more frequent payments. Unlike traditional insurance with 12 equal monthly payments over the course of a year, self-insurers generally/usually must pay claims as the bills come in. Therefore, it becomes important to budget conservatively and be prepared for that big payment.

There is also growing interest in a "reference-based" pricing model. Here, employers pay for high-cost medical services, like facility procedures, based on what Medicare pays (the "reference") plus a specific percentage, rather than a percentage discount of billable charges. This aims to reduce the expenses of the employer's biggest claims. However, implementing and administering this model involves additional complexity, so organizations should carefully weigh this option with their advisors.

For employers who are intrigued by the concept of self-insurance but don't think they're quite ready to take the leap, there are alternative approaches that are becoming increasingly popular.

One option that carriers have been rolling out is minimum premium plans, a kind of hybrid between self- and fully insured. As in a self-insured plan the employer pays administrative fees and claims, but a monthly cap is placed on out-of-pocket costs. Typically carriers charge a higher rate for these plans than for a fully-insured plan, but if the program runs well the employer could save by not paying to the maximum funding.

Some employers self-fund a portion of their coverage, such as prescription coverage. It's a way to ease into self-funding while minimizing the downside risk. Even if things go awry, the total cost is not going to be as great as it would have been for self-insuring all medical coverage. You can mitigate that risk by purchasing stop loss on the self-funded pharmacy plan. Additionally, it's an opportunity to collect data on plan members, allowing for risk assessment and to get a better feel for how self-funding could work.

As employers strive for new ways to provide quality group employee benefits to their employees while also keeping costs down, self-funding is likely to continue to grow as a viable option for smaller firms.

But that doesn't mean it's a winning formula for every employer. The key is to follow this one important commandment: Know thyself.

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