6 things to consider before switching to self-funding

By Raymond DePaola | Director of Underwriting | 3.24.2015

The new health benefits landscape has changed the way employers approach providing health insurance to employees. One strategy we’re seeing more of is the move toward self-funding health insurance. For a lot of employers, moving to a self-funded model makes sense. However, before they consider this route they need to ask the right questions and understand what they might be getting themselves into.

But first, what has spurred self-funding’s increasing popularity? As with just about everything in the employee benefits industry, all signs point to the implementation of the Affordable Care Act. The ACA imposed three new taxes; all three apply to fully insured plans but only two of them apply to self-insured plans. The one that doesn’t is called the insurer’s fee, which represents approximately 3.5% of an employer’s premium, which can be significant.

Consequently, employers looking to avoid this tax may consider self-funding their healthcare insurance.

Even smaller employers, those with fewer than 100 employees, are considering making a switch from their fully-insured plans. Carriers have noticed this trend and are beginning to create products that qualify as self-funded plans under the ACA, but offer more protection and include features not available with the more traditionally designed self-funded programs of the past. However, it’s important to know that this option doesn’t make sense for every organization.

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Here’s a checklist of factors to consider before you make the leap to a self-funded plan, and if you do leap, what you need to stay on top of:

- Understand the basic differences between fully-insured and self-insured. The primary differences include new administrative processes, the involvement of multiple
parties, the partitioning of costs and most importantly—risk uncertainty.

- **Know what it will take to administer this plan.** In addition to administrative expenses paid to outside entities, internal staff administrative time and additional expertise will be needed.

- **Consider the uneven nature of monthly costs.** With a fully-insured plan, an employer typically pays its premium in 12 monthly installments. However, under a self-funded plan, the employer may be paying the cost of their members’ claims as they occur through the course of the year. This can lead to irregular cash flow and make it difficult to plan.

- **Understand your risks.** When an employer sits down with its benefits consultant to examine its organization’s risk profile, it’s important to examine catastrophic occurrences among the covered population and to determine whether they’re expected to continue. If so, then it may not be the time to make the move.

- **Consider stop-loss issues.** Speaking of catastrophic occurrences, switching to a self-funded approach will require you to purchase stop-loss insurance. In other words, the employer is responsible up to the agreed-upon threshold (per individual and in aggregate), and the carrier is responsible for claims over that threshold. When setting this threshold, the consultant looks at the employer’s recent claims history. Other key stop-loss issues include whether prescription drugs are included, guaranteed renewals, renewal rate caps and the evaluation of “aggregating spec” options. Additionally, a stop-loss carrier may identify certain individuals that they will not cover or “laser” them, which means they’ll set different (higher) limits on these individuals.

- **Don’t get fooled when you see big first-year savings.** When a firm moves to self-funding it will potentially see savings in the first plan year. This seems like cause for celebration, but it’s really just a timing issue. That’s because under fully-insured plans employers pay a set premium that covers all incurred expenses for that 12-month period. In a self-funded situation, the employer pays claims as they occur, and these outgoing payments can often get delayed by a month or two. This might be attractive on a cash flow basis for year one, but it ultimately catches up with the organization. This point brings us back to the carrier, who in recognizing the self-funded trend among smaller employers have developed products whereby the employer can pay a level premium (like in a fully insured environment) which is inclusive of the entire incurred liability.

Diving deep to assess each of these items can get very complex. HR professionals should speak with an informed employee benefits consultant to ensure they don’t get lost in a labyrinth of issues.
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