Benefits Toolkit

Reducing Costs With Self-insured Health Plans

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Introduction

As health care costs continue to climb, employers are actively looking for impactful mitigation strategies. Expanding cost-sharing methods, such as offering high deductible health plans, has been one approach; yet, shifting costs onto employees might affect recruitment in a tight labor market. Instead, some employers are switching to self-insuring to reduce costs and improve service.

Self-insuring may not be not suitable for every organization, but for some, it can be an extremely effective way to control health plan expenses. A self-insured health plan is funded entirely by an employer, who pays for employee health claims instead of an insurance company. This allows employers great control over their plan designs. For instance, they can set employee cost-sharing limits, choose their health care networks and establish stop-loss limits so they're guaranteed to never spend over a certain amount in a given year.

However, a switch from a fully insured health plan to a self-insured plan is a major undertaking, and curious employers will need to closely analyze the advantages and disadvantages before making a final decision.

This toolkit aims to help employers' decision-making and serves as an introductory guide to self-insurance. It provides a general overview of what self-insurance is, discusses how it differs from fully insured health plans and outlines its growth over time.

Note: This toolkit is not intended as legal advice. An employer should consult a legal professional or plan administrator before changing its health plan's funding structure. Employers should also consider any pertinent state or local laws that may affect their plan designs.

Background

This section briefly defines self-insurance and outlines its rising popularity in the market.

Self-insurance Overview

A self-insured health plan is one in which an employer assumes the financial risk associated with providing health care benefits to their employees. Instead of paying fixed premiums to an insurance company—which, in turn, assumes the financial risk of paying claims—the employer pays for medical claims out of pocket as they are incurred. Essentially, fully insured and self-insured health plans can be identical in their plan designs (depending on setup); the main difference is how the plan is funded.

The Past and Future of Self-insurance

Historical Trends

The percentage of private employers offering at least one self-insured health plan has generally increased year over year since the 1990s; in 1999, the percentage was 26.5%, and it rose to 40.7% by 2016, according to the Employee Benefits Research Institute (EBRI). While this upward trend has been relatively consistent across workplaces, it has varied significantly between employer sizes. The most noticeable trend is that smaller employers are adopting self-insured plans at a greater rate than large employers in recent years.

Nonetheless, large employers have utilized and continue to implement self-insuring to a much greater extent. Large employers (over 500 workers) are still far more likely to have at least one self-insured health plan compared to small (fewer than 100 workers) or medium-sized employers (100-499 workers).

Consider these recent workplace trends sourced from EBRI data:

- **Small employers**—Between 2018 and 2020, the rate of small employers offering at least one self-insured health plan increased from 13.3% to 16.1%.
- **Medium-sized employers**—Since 2015, the rate of medium-sized employers offering at least one self-insured health plan has steadily remained around 30%.
- **Large employers**—Between 2013 and 2020, the rate of large employers offering at least one self-insured health plan decreased from 83.9% to 75.2%.

Historically, worker enrollment in self-insured health plans has fluctuated but has remained relatively consistent in recent years. Between 2016 and 2020, worker enrollment in self-insured plans across all workplaces increased from 57.7% to 59.4%.

Current and Future Projections

According to the Kaiser Family Foundation and the Health Research and Educational Trust's Employer Health Benefits 2021 Annual Survey, 64% of covered workers are currently enrolled in a self-insured health plan. Covered workers in large organizations are significantly more likely to be enrolled in a self-insured health plan (82%) than those in small organizations (21%)*.

However, the increase in the percentage of workers covered under a small employers' health plan is particularly noteworthy. Between 2018 and 2020, this rate grew by 10%—rising from 13% to 23%, according to Kaiser data. This significant increase is a much higher leap than what has been seen over the last several years.

A variety of market factors may have influenced more small employers to offer self-insured offerings in recent years beyond their own motivations and decision-making. Some potential influences include:

- The COVID-19 pandemic—The pandemic upended most aspects of daily life, with health plans included. As the pandemic continued, employers needed solutions to lower their surging health care claims. Offering self-insurance was one method for taking greater control over health care spending, especially as premiums rose in the wake of the pandemic.
- Greater visibility—Self-insurance has existed for decades, but it's only recently seen a notable uptick among smaller-sized organizations. One theory attributes this to more success stories shared by self-insured groups. For instance, there has been a recent shift away from fully insured plans; a greater number of insurance experts are encouraging small employers to consider self-insuring than in years past.
- Attraction and retention differentiation—Attraction and retention are other factors that may be contributing to the upward self-insuring trend. Self-insurance gives an employer more control over how their health plans are structured. In other words, self-insured employers can set worker cost sharing or design plans in ways that make them more attractive to current and potential employees.

While the factors listed above are speculative, they serve as examples of market influences that can possibly affect an employer's self-insuring decision-making.

Moreover, these considerable influences have the potential to continue shaping self-insuring trends for years to come. In the future, small and medium-sized employers are expected to increase their self-insuring buy-in as they have been doing for years; the number of workers covered under a self-insured plan among these employers has gradually increased for a decade with some ebb and flow.

*EBRI and Kaiser define employer sizes differently in their reporting.

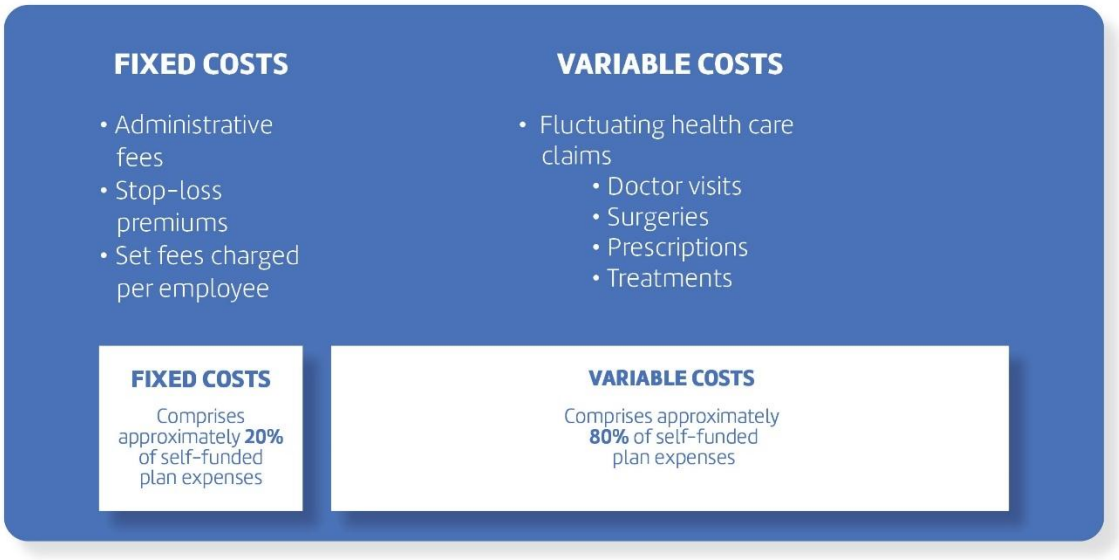
Self-insured vs. Fully Insured Plans

A **fully insured health plan** is the traditional way to structure an employer-sponsored health plan. With a fully insured health plan:

- The company pays a premium to the insurance carrier.
- The premium rates are typically fixed for a year, based on the number of employees enrolled in the plan each month.
- The monthly premium usually only changes during the year if the number of enrolled employees in the plan changes.
- The insurance carrier collects the premiums and pays the health care claims based on the coverage benefits outlined in the policy purchased.
- The covered persons (that is, employees and dependents) are responsible for paying any deductible amounts or copayments required for covered services under the policy.

With a self-insured health plan, employers operate their own health plan as opposed to purchasing a fully insured plan from an insurance carrier. One reason that employers choose to self-insure is that it allows them to save the profit margin that an insurance company adds to its premium for a fully insured plan. However, self-insuring can expose the company to much larger risk in the event that more claims than expected must be paid. With a self-insured health plan:

- There are two main costs to consider: fixed costs and variable costs.



- Some employers use stop-loss or excess-loss insurance to limit risk. This coverage reimburses the employer for claims that exceed a predetermined level. It can be purchased to cover catastrophic claims on one covered person (specific coverage) or to cover claims that significantly exceed the expected level for the group of covered persons (aggregate coverage).

Self-insured Health Plans and Stop-loss Insurance

An extra component many self-insured plans use is called stop-loss insurance. The purpose of this insurance is to provide financial protection to a self-insured plan sponsor by capping and further defining the plan's financial exposure. A stop-loss contract operates differently from general insurance because it is actually insuring the employer and not the individual employee. When a plan is self-insured, the stop-loss contract insures the employer against catastrophic losses under the plan. In general, the employer accepts the responsibility for paying providers' claims for individuals but limits its risk with stop-loss coverage.

Stop-loss is most closely comparable to a catastrophic coverage plan that indemnifies a plan sponsor from abnormal claim frequency and severity. Stop-loss claim reimbursements can be made for a variety of benefits, including medical, prescription drug, dental and others. Severe, high-dollar claims such as cancer, organ transplants and dialysis are considered "shock loss" claims, giving plans the most concern when assessing self-insuring. But, the protection afforded by a comprehensive stop-loss coverage shows its value in helping to financially manage these catastrophic events.

Stop-loss insurance provides protections in two forms:

1. Specific stop-loss—Also referred to as individual stop-loss, it protects a plan against individual catastrophic claim occurrences. This type of stop-loss coverage shifts responsibility for a claim to the insurer once that claim exceeds a certain dollar amount.

    - Example: An employer with a specific stop-loss attachment point of $25,000 would be responsible for the first $25,000 in claims for each individual plan participant each year. The stop-loss carrier would pay any claims exceeding $25,000 in a calendar year for a particular participant.

2. Aggregate stop-loss—This limits a self-insured plan's financial exposure for the entire plan year (or policy year) and protects against abnormal claim frequency across the entire group of individuals. This type of stop-loss coverage protects the employer against high health plan claims, cumulatively (i.e., the total sum of claims for the entire group, rather than an individual claim).

    - Example: Aggregate stop-loss insurance with an attachment point of $500,000 would begin paying for claims after the plan's overall claims exceeded $500,000. Any amounts paid by a specific stop-loss policy for the same plan would not count toward the aggregate attachment point.

Pros and Cons of Self-insurance

Each company will have its own unique considerations when it comes to self-insurance. Therefore, self-insuring advantages and disadvantages will vary by organization, perhaps most notably when it comes to the size of a workplace.

However, there are still some general self-insurance factors that are important for employers to think about. The following section outlines common pros and cons.

Self-insurance Advantages

The primary reasons employers cite for self-insuring include:

The COVID-19 Pandemic and Rising Health Expenses

Expectedly, the pandemic has caused premium rates to grow even above the typical year-over-year increase of 5%. Self-insurance is a method employers can use to control these rising costs through careful plan design.

Attraction and Retention Advantages

In a tight labor market, offering the right perks can make all the difference. Self-insured health plans give employers more control over their offerings. For instance, they can set worker contribution levels and design plans to provide more benefits than a typical health plan. And, when health plans are designed with employees in mind, top performers are enticed to stay with a company longer.

Reduced Insurance Overhead Costs

Carriers assess risk charges and profit margins for insured policies (approximately 3%-5% annually), but self-insurance removes this charge.

Reduced State Premium Taxes

Self-insured programs, unlike insured policies, are not subject to state premium taxes, which typically amount to around 2-3% per year.

More Cost Control

When paired with stop-loss insurance, self-insured plans allow for a more accurate prediction of how much the employer may need to spend in a plan year. With this coverage, any costs over a certain amount are paid for by the carrier.

Avoidance of State-mandated Benefits

Although both fully insured and self-insured plans are governed by federal law (predominantly ERISA), self-insured plans are exempt from state insurance laws. State benefit mandates can add to the cost of insured employer benefit programs. For multistate employers, self-insuring can help create national consistency by elimination of the need for state-by-state compliance.

Employer Control, Generally

Employers who want to revise covered benefits and the levels of coverage are free from state regulations mandating coverage and the carrier negotiation typically required with changes in insured coverage. By self-insuring, employers are able to design their own customized health benefit packages.

Improved Cash Flow

Claims are paid as they become due; employers do not need to prepay for coverage. There is also a cash flow advantage in the year of adoption when "runout" claims are being covered by the prior insurance policy. Employers pay for claims rather than premiums and earn interest income on any unclaimed reserves.

Choice of Claim Administrator

An insured policy can be administered only by the insurance carrier. A self-insured plan can be administered by the company, an insurance company or independent TPA, which gives the employer greater choice and flexibility. When selecting a TPA, employers should consider whether the TPA efficiently handles claims; has contacts with stop-loss carriers, a strong reputation, cost management skills and negotiating clout; has medical expertise on staff; and provides excellent customer service and claims administration.

Greater Claims Projection

When a health plan is fully insured, a carrier owns the plan data. Self-insured plan data is completely owned by the employer, giving them access to more accurate claims analytics and health care utilization data that may otherwise be incomplete. Such data enables an employer to precisely budget for their annual health care spending.

Self-insurance Disadvantages

While self-insuring has its advantages, switching from a fully insured model can be a lengthy process for employers, and it can sometimes be a long time before they see cost benefits. This section outlines potential disadvantages to self-insuring.

Potential Payment Lag

Under a self-insured health plan, an employer pays for claims as they are incurred. Some claims have the potential to be very high and may trigger stop-loss insurance, which would make them eligible for reimbursement. However, there can sometimes be a significant delay between an employer paying for stop-loss-eligible claims and getting repaid by a carrier. Despite possible delays, self-insured employers are still responsible for paying for claims right away.

Greater Risk

The main risks of self-insuring involve situations where claims are higher than anticipated. While stop-loss insurance 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. Claims that are higher than expected in a self-insured plan may also make it more difficult for employers to go back to a fully insured plan in the future. Furthermore, an employer's assets may be exposed to liability as a result of any legal action taken against the plan. Legal matters in regards to self-insured plans can be complex.

Greater Administrative Burden

The administrative costs can be significant for organizations that choose to run their self-insured plans internally. However, using TPAs to operate the plans will still likely involve lower administrative costs than those associated with fully insured plans.

Determining if Self-insurance Is Right for Your Workplace

When deciding if self-insuring is right for your organization, consider the following best practices to ensure your self-insuring strategy is appropriate and effective.

1. **Evaluate stop-loss coverage.** Most self-insured employers purchase stop-loss insurance on their self-insured health care benefit plans to reduce the risk of large individual claims or high claims for the entire plan. The employer self-insures claims up to the stop-loss attachment point, which is the dollar amount above which claims will be reimbursed by the stop-loss carrier. Obtain stop-loss quotes at several different levels.
2. **Understand the volume and nature of your employee health claims for the past five years.** Accounting for facts about your workforce—such as whether your employees are mostly young or old, whether the majority of claims were due to chronic illnesses or one-time incidents, and the total dollar amount of claims—will help you budget for claims in the future. Self-insurance should be viewed as a long-term strategy in which good and bad years average out in the employer's favor.
3. **Analyze cash flow.** Self-insured plans work best for companies that have a strong cash flow or reserves. Understand what your cash needs are so you have money available to make timely claim payments.
4. **Decide whether it makes sense to administer the plan internally or through a TPA**. If you decide it is best for your organization to use a TPA, make sure you factor TPA fees into your decision to self-insure. Obtain several different TPA quotes. Your TPA should offer a strong plan for monitoring the plan.
5. **Make coverage goals.** Decide on such factors as eligibility, benefit coverage, exclusions, cost sharing, policy limits and retiree benefits. Weigh the self-insured plan advantages of flexibility and lower average cost versus the increased risk and administrative responsibilities.

Conclusion

Self-insuring health plans can provide many advantages for employers. However, it is important for employers to do their due diligence before deciding whether self-insurance is the right choice.

To successfully manage their health benefits, an employer must have certain attributes, including the following:

- A high risk tolerance
- A steady employee population
- A stable claims experience
- Employee involvement in cost-saving strategies

Because the employer assumes the financial risk of providing health care benefits, a company can either save or lose money depending on the level of claims incurred by its employees. The most important step to ensure you make the best decision is to have an experienced professional assist you. Your Davevic Benefit Consultants representative has experience with self-insurance programs and can answer your questions and assist you with the decision to self-insure your company health plan.

Davevic Benefit Consultants welcomes the opportunity to help your organization examine its plan designs and make recommendations for improvement.