

THE FUTURE OF SELF-FUNDING

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By David T. Kettig | Illustration by Roy Fox

There is no more hotly debated domestic issue today than health care financing — and with good reason. While there is consensus that reform is necessary, it is a mistake to take a “throw out the baby with the bath water” approach. Since their creation with the passage of the Employee Retirement Income Security Act of 1974, (ERISA), self-funded health plans — with stop-loss insurance for mid-size companies and larger — have often been successfully implemented by employers. These plans are well-suited to provide an enhanced emphasis on disease management and healthy lifestyles.

Why do employers choose to self-fund their medical benefits? There are a myriad of reasons, both financial and operational.

Financially, assuming appropriate stop-loss insurance is in place, some employers find self-funded plans attractive because they can reduce insurance company overhead charges such as commissions, premium taxes, profit margins, and program management/consulting fees. In addition, thanks to their customizable nature, they give employers more control over total health care spending, especially when it comes to determining deductible and employee contributions. >>

Operationally, it is burdensome for employers with multiple locations in multiple states to maintain separate plans subject to widely differing state regulations and mandates. Employers want the flexibility to design a nationwide plan, with benefits tailored to their employees. For example, employers that are committed to promoting healthy lifestyles can design a plan that incentivizes workers to take advantage of disease-management programs. By federal law, ERISA plans are not subject to state mandates that might cripple these innovative measures. Unlike high-deductible plans that have been criticized by some as merely shifting costs to employees, today's self-funded plans may actually be designed to pay more for certain drugs and medical services in order to encourage participants to better manage chronic diseases.

Since self-funded employer plans ultimately bear a major part of the financial risk, employers are more willing to invest in the prevention of large claims than if the risk were borne entirely by an insurance company. And, plan designs that encourage wellness ultimately may benefit employers by reducing absenteeism and workers' compensation claims. Employers who have a stake in their employees' health have the most to gain from sponsoring wellness initiatives. By contrast, insurers can never be sure if they will reap the benefit of paying for wellness because the average employer account stays with an insurer for less time than it typically takes for the insurer to recover the cost of an embedded wellness program.

In the past, self-funded plans were more prevalent among large employers who were in a better financial position to manage claims' risk by spreading it over a large employee population. However, in today's environment of skyrocketing premiums, self-funded plans are an attractive alternative to traditional fully insured plans for some small and many mid-sized employers. Brokers owe it to themselves to learn more about these plans, which may very likely be on the radar of their employer group clients.

THE STOP-LOSS COMPONENT

When considering a well-structured, self-funded medical plan, it is important to evaluate the role of stop-loss insurance, as well. Prior to making the decision to self-fund, it is critical to assess how to manage the risk and volatility involved. Generally, for plans covering fewer than 10,000 participants, the principal strategy for managing risk is by purchasing medical stop-loss insurance.

This coverage allows employers with

self-funded plans to manage the risk of large medical claims subject to payment after the deductible and aggregate maximums have been met — the point at which the medical stop-loss benefits become payable. It also reduces financial volatility from one year to the next. Companies that are not in the business of insuring health risks do not want to see their operating results adversely affected by unusually high claims in a given year.

Specific coverage insures against a single, catastrophic claim that exceeds a specified dollar threshold. For example, a plan may have a \$50,000 specific deductible, which means that the plan would pay the first \$50,000 of a single large claim and the stop-loss insurer would reimburse the plan for eligible claims above \$50,000 up to an agreed upon limit. An aggregate coverage limit insures against claims incurred by all participants in the plan exceeding a total dollar amount in a given plan year. The amount is usually 125 percent of expected claims as determined by the stop-loss carrier.

A stop-loss policy generally reimburses an employer for medical claims if they are incurred within a one-year policy coverage period and are in excess of the policy's attachment point — the dollar amount above which specific stop-loss protection begins to pay. A claim is deemed to have been incurred at the time service is provided. Most stop-loss policies require that claims be paid within a specified period, such as three months, following the end of the policy coverage period. Since stop-loss policies typically provide protection to the plan sponsor and not the plan, stop-loss is not considered to be involved in the funding of a plan and is, therefore, not subject to ERISA.

INFLUENCE BEHAVIOR, IMPROVE PROFIT

Now that we've looked at the stop-loss piece of the equation, let's further explore why self-funding and stop-loss insurance are ideally suited to leverage the trend toward wellness and disease management.

Most of us spend more of our waking hours at work than we do at home, which means that our employers may have more frequent opportunity to influence our behavior than our family members.

In addition, most of us are used to having our work performance tied to economic consequences — bonuses, raises, overtime, or the ability to keep the job that provides our weekly pay. It is not a stretch to think about how our employers could reward us for healthy lifestyle choices or

adhering to a drug protocol by reducing premiums or lowering deductibles.

However, we generally do not expect family members to financially reward us for such behaviors. From the employer's perspective, healthier employees improve the company's bottom line by reducing the overall cost of providing health benefits, decreasing workers' compensation claims, and increasing productivity through reduced absenteeism or presenteeism — the phenomenon represented by people who come to work even when they are sick, contagious, or generally feeling lousy, resulting in their being present but not productive.

In many cases, employers that self-fund their medical plans have a greater incentive to achieve these results than those who have fully insured plans. Not only do they capture this "profit" below their stop-loss attachment point, as opposed to paying it to a "first dollar" insurance company, but their improved experience should lead to lower stop-loss premiums upon renewal.

Just as importantly, self-funded plans are better positioned to institute creative features because they are not subject to the restrictive mandates and requirements that are often imposed by state laws and regulations on fully insured plans.

As you follow the health care financing debate, take note of a common theme. Both sides of the discussion support reducing overall spending on health care by making everyone more accountable for spending dollars wisely. In some cases, this may mean lowering deductibles for certain drugs and services to make sure there is no barrier to appropriate treatment and that much larger costs are ultimately avoided.

It also could mean the introduction of higher deductibles and HSA-type arrangements to help make physicians, employees and dependents more responsible for managing their use of medical services.

Ultimately, the best way to lower the cost of coverage health care (and insurance to cover it) is to improve people's health. When you take a closer look, you'll see a compelling argument exists for employers having the greatest interest in managing the health of employees. ■

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