



Self-Funding

Achieve the Benefits

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Good news: Self-funded health plans are not just for corporate giants anymore

If you think the benefits of self-funded health plans are reserved for companies with sizeable workforces, expertise in health benefits management, and the ability to take significant financial risks, think again.

The advantages of self-funding—**cost control, cash flow improvement, and plan design flexibility**—are available to companies with as few as 50 participants. Today, the health benefits industry and related ancillary services offer an array of resources to help smaller businesses overcome the obstacles that formerly made it difficult for them to self-fund. For example:

- Stop-loss carriers are becoming adept at working with smaller companies to mitigate financial risk.
- Today's Third Party Administrators (TPAs) provide a broad range of services to supplement the human resource capabilities of small and mid-sized companies.
- Experienced health plan consultants help companies design plans to meet the needs of diverse workforces.

These resources put the benefits of self-funding within the reach of companies of all sizes and financial circumstances.

What is a self-funded health plan?

A health plan under which an employer assumes the responsibility and related financial risk for paying plan participants' health care expenses is known as a **self-funded health plan**.

Stop-loss coverage is often purchased to protect self-funded companies from high claims by putting a ceiling on financial risk.

In contrast, under a **fully insured plan**, the employer pays fixed monthly premiums to an insurance carrier, and the carrier assumes the responsibility and related financial risk for paying plan participants' claims.

The unrelenting problem: Fully insured premium costs mount and mount and ...

Year after year, fully insured companies across the country face hefty increases in their health insurance premiums. The 2003 Employee Health Benefits survey by the Kaiser Family Foundation and Health Research and Educational Trust revealed that fully insured premiums for employer-based health benefits rose by 13.9 percent in 2003. This increase made 2003 the third consecutive year of double-digit increases, with a higher rate of growth than any year since 1990.

Small Companies Hit Hardest by Premium Cost Increases¹

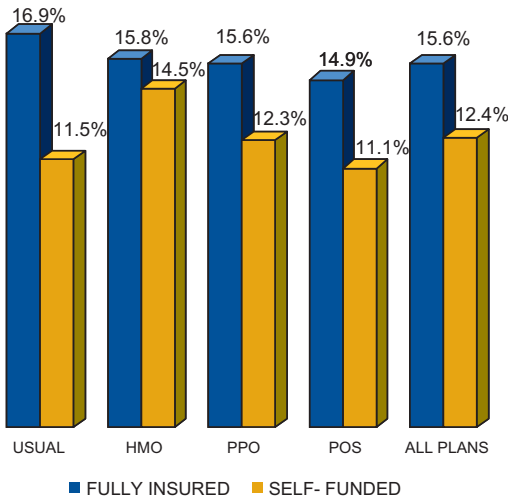
	Usual	HMO	PPO	POS	All Plans
Firm Size					
Small Firms (3-199 Workers)	19.9%	14.3%	15.4%	15.6%	15.5%
Large Firms (200+ Workers)	10.4%	15.6%	12.8%	11.8%	13.2%
All Firm Sizes	14.3%	15.2%	13.7%	13.2%	13.9%

Small, fully insured companies experienced a 15.5 percent premium cost increase, while premium costs of larger companies increased by a lesser 13.2 percent.

The survey also showed that in 2003, fully insured premium increases exceeded the overall inflation rate by nearly 12 percent. Moreover, premiums for fully insured plans are rising at a much higher rate (15.6 percent) than premium equivalents for self-funded plans (12.4 percent). (Increases in premium equivalents are a proxy measure of the growth in underlying medical claims.)

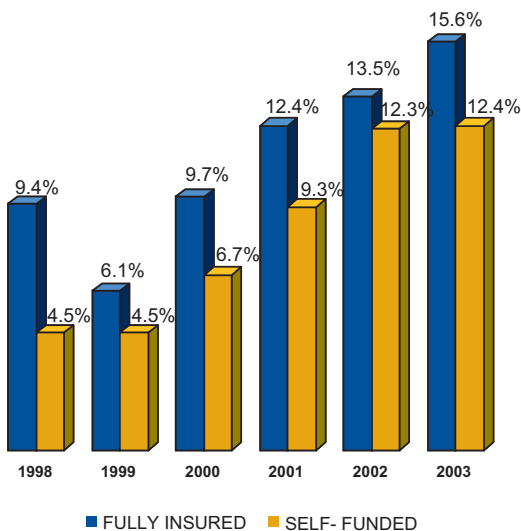
This is not news. As the Kaiser survey shows, premium increases for fully insured plans have outpaced premium equivalent increases for self-funded plans for many years.

Premium Increases, by Plan Type and Funding Arrangement, 2003²



Premiums for fully insured plans rose by 15.6% in 2003, while self-funded plan premium equivalents rose by 12.4%.

Premium Increases, by Funding Arrangement, 1998-2003³



NOTE: Data on premium increases reflect the cost of health insurance premiums for a family of four.

Premium increases for fully insured plans have historically outpaced self-funded plan premium equivalent increases.

More costs, less control for fully insured companies

If the Kaiser survey data is not sufficiently discouraging to fully insured companies, consider the enormous frustration that fully insured companies experience when they see their employees' annual health claims fall below the total cost of premiums.

It is important to remember that small and mid-sized companies that fully insure often are community-rated—that is, their rates depend not on their specific claims experience but on the claims of other companies in their geographic region. Even if a company's claims experience is good and falls below the total cost of premiums, the company still may receive the same rate increases as other companies in its area.

Also remember that fully insured companies bear additional costs in the form of up-front administrative expenses charged by their insurers. Typically, these charges add another 10 percent to a company's total health benefits expenses.⁴ While it is true that self-funded companies have their own administrative expenses to pay, self-funded companies are able to exert controls that can increase administrative efficiency and effectiveness, resulting in lower administrative costs.

The Employee Retirement Income and Security Act of 1974 (ERISA) exempts self-insured plans from state regulation, including reserve requirements, mandated benefits, premium taxes, and consumer protection regulations.⁵

Smaller companies more apt to fully insure

But who are the fully insured? Certainly not the corporate giants. Large companies with ample financial resources and internal expertise in benefits administration are commonly considered ideal candidates for self-funding. Conversely, small and mid-sized companies with less extensive resources are more likely to take the fully insured route. At least in part, these companies have been influenced by consultants, whose lack of comprehensive, up-to-date knowledge of the evolving mechanics of self-funding leads them wrongly to conclude that self-funded plans are ill-advised for small and mid-sized businesses.

Growth in self-funding predicted for small and mid-sized companies

Fortunately, there are many who know better. Consequently, the appeal of self-funding is rapidly expanding among small and mid-sized businesses. “Self-funding has grown many thousand percent in the past 15 years ... and most of that growth has been among small and very small employers,” said Frederick Hunt, Jr., President of the Society of Professional Benefit Administrators. Hunt attributes this growth in part to the different attitudes of insurance companies toward large and small businesses. According to Hunt, large companies looking to fully insure “can exercise the clout of their size to demand special rates and flexibility from insurers [while] small employers tend to get inflexibility at higher prices (or no insurance offered at all).”

Hunt concludes: As small companies with fully insured health plans realize that they can “safely custom design a plan for the needs of their particular workers ... and save as much as 40 percent the overall cost,” the choice to self fund becomes clear.⁶

And in a December 2003 article, *The Wall Street Journal* quotes Roger Edgren, consultant with Marsh & McLennan Co.: “We are definitely seeing a trend in companies looking at self-insurance.” Edgren, too, predicts growth among small and mid-sized companies opting for self-funding in the coming years.⁷

Self-funding offers big advantages to companies large and small

Small and mid-sized companies gain the same advantages as their larger counterparts when they implement self-funded health care plans:

- Financial and administrative control.
- Improved cash flow.
- Plan flexibility.

Financial and administrative control.

Administration of a health plan is an invisible process to a company whose health plan is fully insured. Each month, the company pays a premium, which includes charges for administration of the plan as well as reasonably expected claims, and the insurer performs all administrative tasks—outside the company’s vision or control.

When a company makes the change to self-funding, it assumes responsibility for administration of the health plan. With this responsibility comes the ability to:

- Operate efficiently and effectively.
- Detect areas where modification of systems and processes may be desirable or necessary.
- Make continual improvement in plan operations, with a goal of optimizing plan performance, improving employee satisfaction and, ultimately, saving money.

Improved cash flow.

Companies that self-fund their health plans receive significant cash flow advantages. These advantages are:

1. Pay as you go. Under a fully insured health plan, a company pays premiums to pre-fund claims and other costs. The insurer uses these pre-paid funds to pay plan participants’ claims. In addition, the insurer retains a portion of the premiums to cover overhead costs and to compensate itself for the services it performs and the financial risk it assumes.

A company with a self-funded plan does not pre-fund its claims costs. Rather, the company pays claims as they are incurred.⁸ This allows the company, not the insurer, to invest and receive returns on unused claims funds. Of course, many small companies use TPAs for claims administration and plan management; however, TPA charges typically are lower than those of traditional insurers.

2. Claims liability. At the end of a plan year in which claims have been lower than anticipated, a traditional insurer keeps the premiums, and no savings are returned to the fully insured company. When claims paid by a company’s self-funded plan are lower than anticipated, the savings belong to the company alone.

3. Premium taxes. Self-funded health insurance plans are liable for state taxes only on stop-loss premiums. Conversely, fully insured plans are liable for state premium taxes on total plan cost. According to industry experts, this disparity results in direct, automatic savings to a company that self-insures. These savings are estimated to be two to three percent of the premiums’ dollar value.⁹

The cash flow bottom line: all cost savings resulting from the above advantages can be invested, producing a positive return on investment for the company that self-funds its health plan.¹⁰

Plan flexibility.

Traditional insurers offer “one-size-fits-all” health plans. As a result, a company with a fully insured health plan may be forced to pay for benefits its employees will not utilize. In addition, the company may be unable to offer other benefits its employees particularly need.

The flexibility of self-funding allows a company to custom-design a cost-effective health plan tailored to employees’ specific needs. For instance, high-cost benefits that employees do not value can be eliminated, replaced by benefits that employees particularly want—often for a lower cost.

With the help of experienced plan design specialists, a company can identify additional cost-saving opportunities while custom building a plan that supports corporate objectives and offers a range of options matching the needs of a diverse workforce. For example, a company may—

- Develop a more cost-effective plan by excluding or limiting benefits, while still meeting employees’ needs.
- Implement a care management program to direct participants toward the most efficacious and cost-effective medical care.
- Offer new alternative health plan options, such as consumer-directed health plans.
- Provide coverage for alternative treatment procedures, such as chiropractic services and acupuncture.
- Design prescription drug plans that provide cost-saving opportunities.

The flexibility of self-funded health plans offers another important advantage to companies with multiple locations. Because self-funded plans are not bound by state law requirements, a multi-location company is not burdened with managing multi-state plans. Instead, the company can design and manage a single self-funded plan that fits the needs of employees in diverse locations.

Challenges of self-funding

When small and mid-sized companies explore the potential benefits of self-funding, they may encounter challenges not faced by larger corporations. For instance, small and mid-sized companies may—

- Lack internal resources (e.g., personnel and specialized expertise) to manage and administer self-funded plans.
- Experience large cost fluctuations due to the unpredictability of the timing of claims.
- Be wary of taking on the financial risk inherent in self-funding.

Fortunately, these challenges can be met through accurate claims administration, appropriate risk management strategies, and effective plan design.

Claims administration and plan management.

Frequently, a small or mid-sized company’s self-funded health plan is managed and administered by a TPA. Third party administration is not a new industry. Since the inception of self-funded health plans, TPAs have provided services such as claims administration and eligibility management.

Services offered by TPAs to administer self-funded plans include:

- Managing plan eligibility and enrollment.
- Issuing identification cards.
- Conducting enrollment meetings.
- Providing employee education.
- Responding to plan participants’ questions and resolving issues.
- Negotiating, obtaining, and renewing stop-loss coverage.
- Managing/monitoring stop-loss administration.
- Providing (or contracting with vendors to provide) case management, disease management, pharmacy benefit management, and provider network management.
- Negotiating provider discounts.

There is some evidence that the financial risk associated with self-funding for small companies may actually be lower than the risk associated with self-funding for larger companies. For example, self-funded health plans with 200 employees have a 14 percent probability that actual claims will exceed projected claims. This risk increases to 26 percent for companies with 1,000 employees. The reason? The larger the number of employees in a group, the larger the chance that a member or members of the group will incur catastrophic health care costs.¹¹

Alleviating risk through strategic plan design.

As discussed earlier, self-funded plans have a great deal of flexibility when it comes to plan design. As a result, companies that self-fund can custom-design their health plans to drastically reduce risk. Effective strategies to reduce risk include excluding or limiting certain benefits and implementing strong care, disease, and pharmacy management programs.

Alleviating risk through stop-loss coverage.

Stop-loss coverage protects self-funded companies from high claims by putting a ceiling on financial risk. Practically speaking, stop-loss coverage changes a fully self-funded plan into a partially self-funded plan that still offers the same cost control opportunities.

While it may be easier for large companies to obtain stop-loss insurance, “the stop-loss industry has matured and become more and more adept at tailoring services for small plans.”¹²

There are two types of stop-loss coverage: specific and aggregate.

- **Specific stop-loss coverage** protects a company against claims above a specified amount on a per-participant or per-family basis. An experienced consultant can work with a company to set the amount at a level that reflects the company’s risk tolerance.
- **Aggregate stop-loss coverage** protects a company against accumulated claims that exceed a specified ceiling. The stop-loss insurer is responsible for any claims above this ceiling.

Aggregate stop-loss coverage generally is provided on an annual basis; however, it also can help protect a

company from interim cash flow problems that arise when monthly claims fluctuate above projections. The difference is made up as claims in other months fluctuate below projections. At year-end, an annual reconciliation is performed. At that time, an adjustment can be made if overall claims for the year were higher or lower than projected.

How much stop-loss coverage does a company need, and how much will the coverage cost? The answers to these questions depend on a number of interrelated factors. These factors include the company’s assessed level of risk, the size of its workforce, and the amount of risk it is willing and able to assume. The majority of companies that self-fund typically obtain both specific and aggregate stop-loss coverage.

Is Self-Funding a Good Fit?

This question should be explored with the help of a specialist in health plan design. Factors to be considered in evaluating whether a self-funded plan meets a specific company’s objectives and fulfills the needs of its employees include the following:

- Current and projected health care cost trends.
- The company’s health care claims history.
- The company’s projected future claims.
- Makeup of the company’s workforce.
- The projected cost of plan management and administration.
- Availability of stop-loss coverage.
- Financial risk tolerance.

An experienced plan design specialist also can help a company explore the potential benefits of developing a health benefits program with multiple plan options, including consumer-directed health plans and traditional PPO plans, and assist in obtaining stop-loss coverage.

Self-funding as a long-term solution

Small and mid-sized companies across the country continue to bear the brunt of rising health care costs—with no end in sight. For these companies, self-funding may be a lifeline, connecting them to valuable opportunities for increased cost control and improved cash flow. And the flexibility of self-funding

allows for the development of comprehensive health benefit programs with options matching the needs of employees from diverse backgrounds and lifestyles.

About Meritain Health

Meritain Health is the country's largest independent manager of health benefit plans, offering employers comprehensive, integrated wellness and cost management services. Health benefit costs continue to increase at uncontrolled rates, and employers place a high value on a health benefits manager who can help control these costs. At the same time, employees need an affordable, user-friendly, high-touch healthcare experience.

A Total Solution to Employers' Health Benefit Requirements

Meritain Health services are comprehensive, fully integrated and customized to each client's unique needs.

Comprehensive Services

- Consultation and innovative plan design.
- Healthy MeritsSM wellness and incentives programs.
- Long-term cost management solutions.
- URAC-accredited medical management programs.
- Multi-media employee education.
- High-touch member services.
- Efficient plan administration.
- Pharmacy benefits management.
- PPO administration.

Employee Wellness, Education and Communication

Meritain Health is an industry leader in promoting healthy lifestyles for employees. Healthcare industry experience and research has shown that health and wellness programs are critical drivers in creating health-conscious members. The Meritain Health Healthy MeritsSM wellness and incentive programs provide employee health screenings and assessments, smoking cessation programs, weight loss programs, and online health education and decision-support tools. These, and other program components, are fully integrated with an employer's overall health benefits plan.

Meritain Health also delivers triple-URAC accredited in-house medical management programs. These programs, which incorporate personal health coaching, online wellness tools and informational mailings, improve employees' abilities to select effective, appropriately priced healthcare services. This, in turn, leads them to become more independent, knowledgeable healthcare consumers.

Customized, Flexible Plan Design

Meritain Health consultants are knowledgeable, experienced industry professionals. Working closely with clients and their brokers, Meritain Health consultants design customized benefits plans that include innovative cost-management strategies and support the client's short and long-term goals. As the pioneer, and now the leading independent provider of Consumer-Directed Health Plans (CDHPs), Meritain Health proudly offers these plans, as well as traditional PPO plans, for incorporation into flexible plan designs. Throughout the plan year, Meritain Health consultants monitor plan activity and results, routinely meeting with clients to review plan reports and analyses. By developing lasting client relationships, they are able to identify opportunities and formulate recommendations to strengthen plan performance.

Meritain Health History and Operations

Meritain Health has been exceeding the expectations of clients for more than 30 years. As the country's largest independent provider of services for self-funded health plans, Meritain Health has more than 1,400 clients with over a million plan participants in all 50 states. To serve these clients, the company has offices in 28 cities and more than 1,350 employees.

For more information, visit www.meritain.com.

SOURCES

¹ The Kaiser Family Foundation and Health Research and Educational Trust, Employee Health Benefits: 2003 Annual Survey.

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³ *Ibid.*

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⁵ *Ibid.*

⁶ Hunt Jr., Frederick D., President of Society of Professional Benefit Administrators, "Self-Funding, An Overview and Explanation of Misconceptions."

⁷ Windham, Chris, *The Wall Street Journal Online*, "Self-Insurance Plans Gain as Premium Costs Jump," December 30, 2003.

⁸ Harker, Carlton, *Self-funding of Health Care Benefits*, International Foundation of Employee Benefit Plans, Inc., 2003, pp. 2-5.

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¹¹ Windham, Chris, *The Wall Street Journal Online*, "Self-Insurance Plans Gain As Premium Costs Jump," December 30, 2003.

¹² Hunt Jr., Frederick D., President of Society of Professional Benefit Administrators, "Self-Funding, An Overview and Explanation of Misconceptions."

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