The 14 most commonly asked questions about health insurance self-funding

Despite its financial viability, self-funding is underutilized in smaller companies. The probable reasons for this are the smaller companies' unfamiliarity with the concept, their brokers' inexperience, or a fear of large claim losses. None should stop the smaller firm from doing a serious evaluation of self-funding. To save your company from missing out on the benefits of this valuable employee health insurance method, here are 14 questions to ask yourself when giving serious consideration to self-funding.

1) What do you mean by self-funding?
   We really mean *partial* self-funding. You don't pay <u>all</u> your company's health claims. Rather, you partner with an insurer: you pay the smaller claims and let them pay the larger claims that no one can afford.

2) What is the basic philosophy behind self-funding?
   The 80/20 Pareto Principal exists in health insurance as it does everywhere – 80% of groups overpay for health insurance so as to subsidize the sickest 20% of groups. If you prefer to pay your own way, carry a bit more of the risk for your group and your group alone, self funding is a tool to let you do that.

3) How do I know if self-funding is for me?
   Look at your employees. If they're younger, healthier, thinner, fewer smokers than average, or if you're a risk-taker by nature, then self- funding could be attractive for you.

4) What can I gain by self-funding?

   a) You'll almost always save money the first 12 months. (Claim payments don't start until about the third month, so you save 12 months' premiums while only paying 10-11 months' claims.)

   b) The reserve for "incurred but unreported claims" is carried on your books, not the insurer's.

   c) You save on premium taxes, which are only levied on a small portion of your costs instead of your total premium.

   d) You can custom-design your plan to meet your group's particular needs.

   e) You directly save from disease management and other salutary practices.

5) Do many companies self-fund?
   Not as many as should. One study said 75% with over 200 employees self-fund but that 90% would benefit from it. Another showed 41% of companies with 100-250 employees self-funded. Over 70% of self-funding firms do so for multiple years, so they must like it.

6) Need I be large to self-fund?
   No, companies down to 25 employees can potentially self-fund, and even smaller companies can create a "do-it-yourself" self-funding.

7) Does self-funding involve a lot a risk?
   No. Stop-loss insurance policies limit your risk to an acceptable level.

8) How does self-funding work?
   For a fee, an administrator pays claims (using your money), and a stop-loss carrier covers risks above a certain level. When any one claim reaches a trigger level (called the “stop loss point”) the administrator begins using insurance company money.

9) Is self-funding complicated?
   Not really — it’s different, not complicated. The terms and the pitfalls are different, but understandable. If your broker is familiar with self-funding, it’s no more complicated than traditional insurance.

10) What if someone gets seriously and expensively ill?
   Don’t worry, they eventually will. You buy “specific stop-loss” insurance policies (see #8 above) to cover “shock,” or catastrophic, claims. That policy will stop one person’s misfortune from ruining the entire plan’s experience.

11) What if a lot of people get sick?
   Clearly, the more people who get sick, the more the plan will cost you. But besides buying insurance to cover specific catastrophic claims, you can also protect against the total cost of a large number of smaller claims via an “aggregate stop-loss” policy. So you’ll always know in advance how much your plan will cost in both the worst-case and best-case scenarios.

12) Will I save money *every* year?
   Unfortunately, no. However, most companies save money about four out of five years. In most of those four years, the savings are significant (perhaps 15 –30 percent of a fully insured plan’s cost). In the worst year, they may spend 15-20 percent more than a fully insured plan would have cost.

13) What are the “traps” should I watch for?
   First, cash flow can fluctuate significantly, so maintain adequate reserves. Moreover, the aggregate and specific stop loss policies’ contractual provisions can cost you more than planned, if poorly chosen. Some brokers try to make self-funding look good by providing limited-protection policies, which reduces fixed costs. By lowering costs that way they look good initially, but you may be hurt at the end of the contract year.

14) What if self-funding doesn’t work out?
   You return to traditional funding. There are some terminal costs (called “runout”) that typically recapture all the money you saved in the initial three-month period.

Properly planned for, self-funding can work for companies of surprisingly small size. Find a good broker and evaluate your alternatives — this is a tool you shouldn’t ignore.

Jim Edholm is President of Business Benefits Insurance (BBI), an employee benefits planning firm in Andover, MA. He has worked with employers for more than 25 years and can be contacted at (978) 474-4730, via his website (www.bbibenefits.com), or via e-mail jedholm@bbibenefits.com