Saving money on employee benefits with

STRATEGIC ALTERNATIVE FUNDING

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A trend toward self-insurance

In today's tight labor market, it is more important than ever for employers to offer benefit packages that attract and retain top candidates. As health care utilization and its associated costs continue to escalate, however, you need new options for managing costs while maintaining quality benefits for your workers.

Employers have traditionally relied on outside carriers to provide group health insurance but more and more are choosing to bypass insurance carriers by self-funding their medical risks. While self-funding has traditionally been reserved for larger organizations, small and medium-sized businesses are increasingly opting to self-fund their benefit plans. There are two key reasons for this shift:

- The **Affordable Care Act (ACA)**, under which small groups are now community rated. Organizations with younger, healthier employees may face large rate increases under community rating, prompting them to consider self-funding as a cost-saving alternative.
- While assuming **partial claims risk** was once only considered viable for employers with more than 100 covered employees, safer contracts with smaller, more manageable risk assumption have made partial self-funding available to employers with as few as 15 covered lives.

Is self-funding right for your organization? This guide provides an overview of self-funding and outlines issues to consider when making this important strategic decision for your organization.

Self-funded

A plan where the employer assumes the financial risk associated with providing health care benefits to its employees and pays for medical claims out of pocket as they are incurred.

Fully-insured

A plan where the employer contracts with a third-party to assume financial responsibility for the enrollees' medical claims and for all incurred administrative costs.

Source: https://www.bls.gov/ncs/ebs/sp/healthterms.pdf

Advantages of fully-insured plans

Cost stability: At the beginning of the year, you know what your healthcare costs will be and these rates remain in place until your next renewal date. Also, the health insurer assumes all the risk.

Ease of administration: The carrier handles claims administration so you don't need to manage a third-party admnistrator (TPA) or stop-loss insurance carrier.

Disadvantages of fully-insured plans

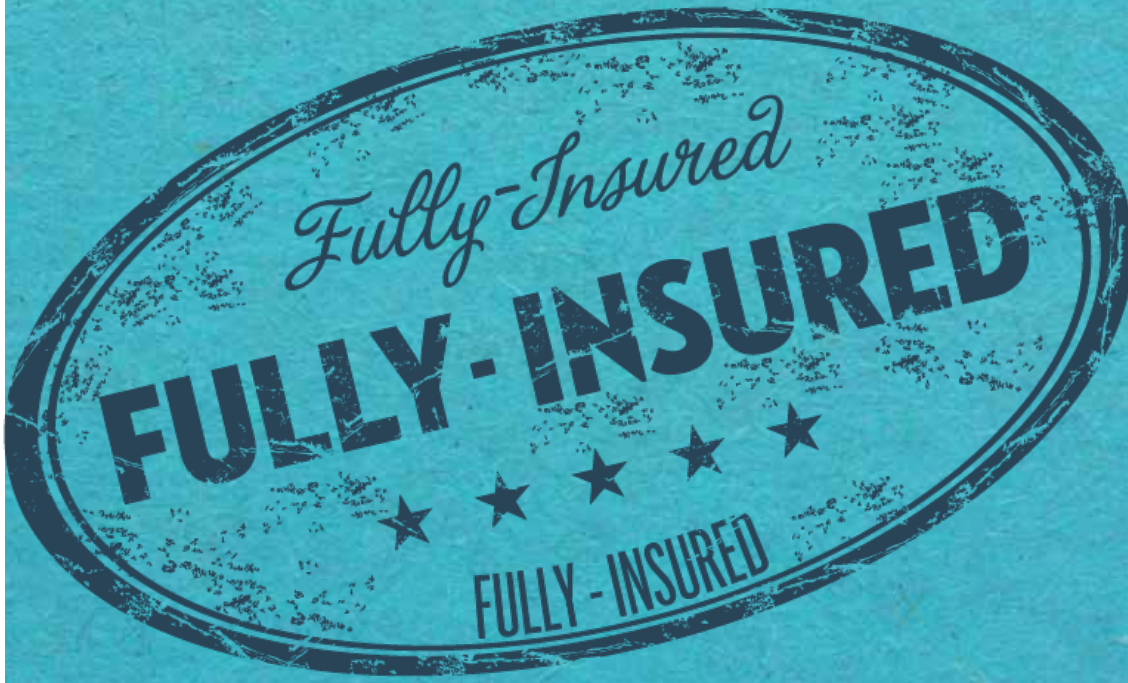
Lost cost-savings opportunity: Remaining in a fully-insured arrangement, you may miss the opportunity to achieve significant cost savings for your organization.

Higher Taxes: Fully-funded health insurance incurs both state taxes and pass-along ACA taxes, which are not incurred by self-funded plans.

State-specific benefit requirements: Fully-insured health plans are subject to state mandates for employees who live in each state. For certain fully-insured plans, these may include requirements to have different benefit levels as well as separate contracts for employees in different states. The result may be various plans and rates for employees strictly based on where they live.

Who fully-insures their benefits?

Employers with under 200 employees often opt for traditional insurance. Despite the trend toward self-funding, many organizations prefer the predictability afforded by fully-insuring medical risk. This is particularly true for organizations with older or less-healthy employees who may incur significant healthcare claims.



Source: https://www.bls.gov/ncs/ebs/sp/healthterms.pdf

Who self-funds their benefits?

Many employers with more than 200 employees self-insure at least some of their employee health benefits. Many employers with fewer than 200 employees also self-fund but these employers require greater stop-loss insurance protection than larger employers.

What is self-funding?

When your organization self-funds its employee benefits, it assumes the financial risk associated with providing healthcare benefits. Rather than paying fixed premiums to an insurance company, you pay for medical claims as they are incurred.

A self-funded benefits program includes both per-employee fixed costs and projected claims expenses. Fixed costs depend on the number of employees enrolled and the coverage provided. Variable costs are the actual healthcare expenses that the covered employees incur.

While you can't precisely predict claims expenses, analysis of historical claims can provide the basis for setting rates. Your organization also protects itself from fluctuating claims costs by purchasing stop-loss coverage, which limits its exposure in the event of catastrophic health issues or unexpectedly large claims.

SOURCE: Zywave Benefits Insights, *"Employee Medical Benefits: Self-funded vs. Insured"*

Advantages of self-funding

Claims cost-saving opportunity

With self-funding, your organization only pays for actual paid claims, plus fixed costs. If claims are lower than projected, the difference is retained by your business. This can deliver significant cost savings over fully-insured contracts where the carrier keeps the difference and negotiates premiums annually. Also, for small groups, fully-insured contracts pool the rates, which can create a wider gap in the premiums-to-paid-claims ratio and deliver more profit to the insurer at your expense.

Improved cash flow

Unlike insurance premiums, self-funded coverage is not prepaid so self-funding your health plan can improve cash flow. You can also control the health plan cash reserves and maximize interest income in the same way insurers invest premiums to generate interest income.

Tax advantages

As a self-funded employer, your organization is not subject to state health insurance premium taxes, generally two or three percent. Additionally, Section 9010 of the ACA imposes a tax on carriers who, in turn, pass most of this tax along to policyholders through higher premiums. The tax applies to plans purchased from an insurance company but not self-insured health plans—even if you contract with an insurer to process claims and administer the health plan.

Cost transparency

With self-funding, each component of the premium (including claims, administration and reinsurance costs) is fully disclosed and broken down in detail so you can better identify the factors driving plan costs. This helps you make key changes to improve employee behavior and lower future costs. (i.e. increasing emergency room cost if that benefit is being overused).

Elimination of state benefit requirements

Fully-insured plans must meet state mandated benefit levels. This may mean different insurance carrier contracts—and even different plans and rates—for employees in different states. Self-funded plans are not subject to conflicting state health insurance regulations and benefits mandates. Instead, they are regulated by federal law, which allows for one contract for all employees.

Plan design flexibility

Instead of settling for a “one size fits all” health plan, you can customize a self-funded plan to fit your needs. Under the ACA, fully-insured plans must offer mandated benefits, such as pediatric vision and dental, which may already be covered by ancillary insurance products. These mandates don’t apply to self-funded plans, so you can avoid this double coverage and recoup the revenue. You can also contract with the providers or a specific provider network that will best meet employee needs.

Disadvantages of self-funding

Claims cost fluctuation

The main risks of self-funding involve situations when claims are higher than anticipated. While stop-loss coverage will protect your organization from paying excessive claims in a given year, the cost of that coverage will likely increase, making it more difficult to obtain affordable stop-loss coverage moving forward. Higher-than-expected claims in a self-funded plan may also make it more difficult for employers to return to a fully-insured plan in the future.

Administrative costs

Administrative costs can be significant for organizations that manage their self-funded plan internally. However, using a TPA to operate the plan can often involve lower administrative costs than those associated with fully-insured plans.

HIPAA requirements

When you self-fund your benefits, you have access to employee medical information and must comply with privacy and security rules under the Health Insurance Portability and Accountability Act of 1996 (HIPAA). These rules include requirements regarding uses and disclosures of health information, notification of breaches, preparation and distribution of notices of privacy practices and procedures, updating of business associate agreements, and training of personnel who have access to protected health information.

SOURCES: Zywave, Know Your Benefits, *"Group Health Insurance: Self-Funded Health Plans"*; (www.americanactionforum.org/research/impact-of-the-health-insurance-annual-fee-tax/#ixzz4s6WEi9ca); (Self-Insured Institute of America -https://www.siia.org/i4a/pages/index.cfm?pageID=4546)

Level-funding

Level-funding is an option that makes self-funding employee benefits easier and more predictable for employers. With level-funding, you pay a set amount each month to a carrier. This amount typically includes the cost of administrative and other fees and the maximum amount of expected claims based on underwriting projections, as well as embedded stop-loss insurance. The carrier then pays your employees' claims throughout the year. At the end of the year, if your payments exceeded claims, you receive a refund from the excess you paid in monthly claim allotments. If the claims exceeded what you paid into the program, your stop-loss insurance will cover the overage amount in most cases.

Who opts for level-funding?

Employers who want the flexibility and cost savings of a self-funded insurance plan but need more certainty and consistency for their budgeting concerns often opt for level-funding.

Source: https://www.bls.gov/ncs/ebs/sp/healthterms.pdf

Advantages of level-funded plans

Flexibility and cost savings: Level-funding provides you with all the advantages of self-funding, including cost savings, flexibility, improved cash flow, tax advantages, elimination of state-specific benefit requirements and transparency.

Ease of administration: Level-funding offers easier administration because your selected carrier handles the administration and the embedded stop-loss insurance coverage.

Better budget management: Level-funding offers better budget management than both fully-funding and self-funding benefits. If your monthly claims allotment goes unused, you receive a year-end refund—unlike a fully-insured plan where you pay your set premium regardless of claims. Level-funding also offers a more budget-friendly method of paying monthly claims than standard self-funding.

Disadvantages of level-funded plans

Claims cost fluctuation: Level-funding carries the same risks of self-funding where unexpectedly high claims can make it harder to obtain affordable stop-loss coverage or return to a fully-insured plan.

Administrative costs: Administrative fees can erode the savings gained from self-funding, so make sure to evaluate the relative cost effectiveness of administering your self-funded plan in-house, hiring a TPA or choosing a level-funded option with built-in administrative fees.

Advantages of captives

A captive can offer significant savings and become a substantial long-term investment. By creating and owning its own captive insurance company, an employer is able to keep all of the savings and interest income it earns from the captive. This means that instead of spending money on insurance, an employer can actually earn money from its captive policy over time. This is particularly beneficial for large employers or companies that pay higher insurance premiums due to the large number of employees receiving benefits.

Disadvantages of captives

If an employer's insurance premiums and claims costs are already relatively low, a captive may not provide a significant return on investment. In addition, smaller companies may find that the cost of obtaining traditional employee benefits insurance is lower than the cost of creating and maintaining a captive.

What is captive insurance?

A captive is an independent insurance company created and owned by a non-insurance company for the purpose of insuring the employee benefits risks. Captives are a form of self-insurance in which the insured owns the insurer.

Who forms a captive?

Employers choose to form a captive as an alternative to traditional insurance in order to better control costs and manage the risks associated with providing employee benefits. Because of escalating insurance costs, many large employers, especially those with 5,000 or more employees, opt to cut out insurance carriers and fund their own group employee benefits risks with captives.

SOURCE: ZYWAVE , Benefits Insights, *"Alternate Funding: Captives"*

Key issues to consider

The following are some important issues to consider when determining whether an alternative funding arrangement is right for your organization:

ERISA vs. state regulation

Self-funded health plans are governed by the Employee Retirement Income Security Act of 1974 (ERISA). ERISA preempts state insurance regulations, meaning that employers with self-funded medical benefits are not required to comply with state insurance laws that apply to medical benefit plan administrators. On the other hand, insured plans must comply with some ERISA requirements, but are primarily governed by the state where covered employees reside.

The distinction between state and ERISA regulations is important when determining if self-funding is right for your organization. Multi-state companies with insured health plans must comply with the regulations of each state in which they have plans and covered employees. Multi-state self-funded plans need only comply with ERISA.

Premium vs. unbundled fees

The risk an insurance company takes with an insured plan can be translated into a dollar amount for the employer. That dollar amount is the monthly premium an employer pays for the group medical benefits. The premium amount includes:

- Current and predicted claims costs
- Administrative fee
- Premium tax paid to the state
- Federal taxes and fees
- Insurance company profits

Employers who self-fund their medical benefits do not pay the premium tax or insurance company profit. They do, however, assume the costs of paying for claims and administrative functions. Typically, employers with self-funded health plans will outsource plan administration to a TPA or insurance company who charges the employer a fee for performing administrative services.

Stop-loss insurance

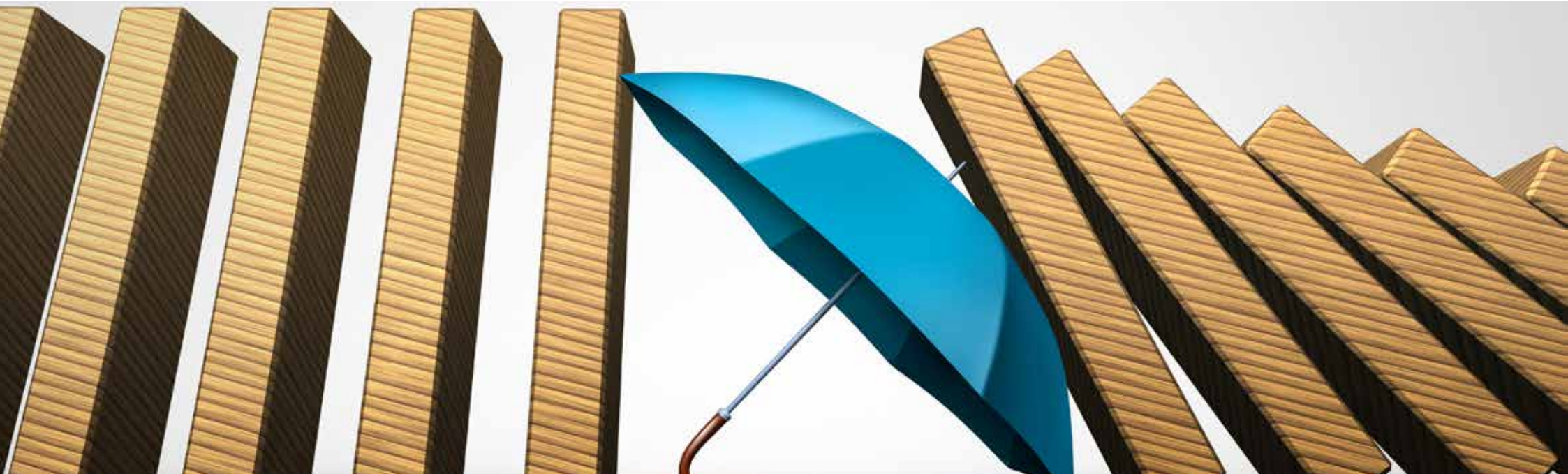
Employers with self-funded health plans typically carry stop-loss insurance to reduce the risk associated with unpredictable or above-average claims. The employer self-insures up to the stop-loss attachment point, which is the dollar amount above which the stop-loss carrier will reimburse claims. Stop-loss insurance comes in two forms: individual/specific stop-loss and aggregate stop-loss.

Individual/specific stop-loss insurance

This protects a self-funded employer against large individual health care claims. Essentially, it limits the amount that the employer must pay for each individual. For 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.

Aggregate stop-loss insurance

Smaller organizations with smaller revenues may also benefit from aggregate stop-loss insurance, which will help pay for medical costs if claims are particularly heavy to start the year, resulting in cash-flow issues. This protects the employer against high total claims for the health care plan. For 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.



Additional compliance

Nondiscrimination rules

These rules ensure employers offer employee benefits that don't favor some employees over others. Fully-insured plans don't have Section 105(h) nondiscrimination rules for group medical benefits, provided you follow the policy requirements of the sponsoring insurance carrier. However, employers with self-funded plans must comply with 105(h) nondiscrimination rules. Failure to comply can result in some employees' benefits being treated as taxable income.

Reporting and disclosure requirements

Employers with either type of group medical plan must comply with reporting and disclosure requirements, usually by providing tax and other pertinent documents to the U.S. Department of Labor or to their state.

Typically, self-funded plans are required to provide copies of plan communications such as summary plan descriptions (SPDs) and summary of material modifications if the plan language changes.

Employers with insured plans that require employee contributions must file financial documents with the U.S. Internal Revenue Service (IRS). IRS filings are also required of self-funded plans, including Form 5500 and any accompanying documents.

Plan administration

Self-funded groups need internal or external expertise to address the strategic and administrative issues inherent in retaining claims risk, whic can include:

Employee Benefit Expertise

- Plan benefit coverage and policy issues
- Actuarial concepts: selection, benefit changes and reserves
- Stop-loss coverage and policy issues

Legal and Regulatory Compliance

- ERISA disclosures and reporting requirements
- Compliance with federal mandates and audits
- TPA and other vendor agreements
- Stop-loss coverage agreements

Finance and Accounting

- Complex billing of claims and administration
- Cash flow budgeting and monitoring
- Reserve funding structure
- ERISA reporting / IRS tax code

SOURCE: Zywave Benefits Insights, *"Employee Medical Benefits: Self-funded vs. Insured"*

Choosing the right plan

Self-funding is a strong option for employers and is gaining momentum as a cost-saving strategy. Options such as level-funding are making it easier for smaller employers to self-insure their benefits. Generally, most employers can benefit from self-funding as long as they make an accurate assessment of the costs they are likely to face, set rates accordingly, and efficiently manage the administrative responsibilities. In short, self-funding can benefit both large and small employers by helping reduce healthcare costs and put those gains back into the organization. In fact, roughly 50 percent of workers in the U.S. are already covered under a self-funded plan. However, self-funding is not a quick fix, and employers should not automatically assume they will save money immediately. When assessing whether a self-funded plan is a wise choice, factors to study include past coverage utilization, cash flow and the status of the employees being covered. Different employee populations will have their own health characteristics and patterns of care use.

The expert employee benefit consultants at PeopleStrategy® can conduct an analysis to determine if self-funding, level-funding or other types of alternative funding can help your organization save money while offering high-quality benefits to your employees. Our powerful employee benefit program leverages your employee data to improve decision-making, increase efficiency and control costs.

A single solution for effective & simple employee lifecycle management

PeopleStrategy provides a single source for today's employers to build an effective and competitive human capital management program through a strategic combination of HCM technology, employee benefits and managed services. Our Cloud-based eHCM® Suite empowers the entire organization through intuitive self-service tools and mobile access to help all employees manage their professional lives as easily as they do their personal lives – anytime and anywhere.

- Talent Acquisition
- Core HR & Onboarding
- Workforce Management
- Payroll
- Benefits Administration
- Performance Management

PeopleStrategy supplements our HCM solution with a full range of managed services to include: compliance & HR support; retirement services & employee benefits; and other administrative services. The synergy of PeopleStrategy's technology and services enables clients to streamline employee lifecycle management so they can focus on their people and their strategy. To learn more, call us at 855.488.4100 or visit us online at www.peoplestrategy.com.

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