

## Small Business and Self-funding: Dispelling Some Myths

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Small business consistently has said that its No. 1 concern is controlling the escalating cost of health insurance premiums. As health costs continue to climb, smaller employers increasingly are turning to self-insurance as a cost-effective way of managing health plans they offer employees.

However, as many small employers declare independence from health insurance companies, some critics observe that self-insurance (also referred to as “self-funding”) is too risky for small firms and only large firms should be allowed to self-insure.

Now, in two newly released white papers, the Self Insurance Institute of America (SIIA) responds, “While it is generally true that larger employers self-insure at higher proportions, there is no valid reason why smaller employers should be restricted from this often advantageous financing option.”

### Smaller Firms Pay Higher Premiums

Recent surveys confirm that premiums paid by small firms in 2009 alone were 18 percent greater than those paid by large companies. During the 10 years from 1999 to 2009, overall premiums increased 120 percent, or four times faster than prices, according to the Kaiser Family Foundation.

With employers absorbing a greater share of the overall health care cost bill, small employers are bearing an increasingly larger share of premium costs, according to the Commonwealth Fund.

Higher premiums are driven by increased medical costs and administrative loads, including insurer profits, according to a 2009 Kaiser/HRET Report. A 2010 study by the American Medical Association reporting on the

two-thirds of U.S. cities states that “when insurers dominate a market, people pay higher health insurance premiums than they should.” So it is not surprising that smaller employers are exploring alternatives to commercial insurance to help bend the cost curve downward.

### Self-Insurance Is Not for Everyone

Over the 30-plus years since passage of ERISA, financially qualified employers of all sizes have shown they are capable of self-funding, with more than 77 million workers and their dependents covered by self-insured group health plans in 2009.

Clearly, however, self-funding is not a viable option for everyone. While larger firms — up to 90 percent by some estimates — self-insure group health benefits, small business owners typically cover employees with fully insured plans. In small firms with 3 to 199 employees, 88 percent were in fully insured plans in 2008, according to the non-profit Employee Benefit Research Institute (EBRI).

However, mid-size and small firms increasingly are turning to self-insurance as a cost-effective alternative to ever rising commercial health insurance premiums. While only a small fraction of the nation's 28 million small firms self-insure, the trend to self-funding has gained momentum. Between 2008 and 2010, the trend to self-funding by small employers increased by as much as 20 percent, according to Price Waterhouse Coopers.

Though self-insurance is not widespread in the small group market, it has grown steadily, with some 12 percent of small company health plan sponsors (3 to 199 employees) in self-insured plans in 2009 — up from 6 percent earlier in the decade. An important contributing factor is employer reliance on professional consultants who are able to objectively evaluate whether an employer is capable of retaining the financial risk of self-insuring.

## What Constitutes a ‘Small Employer’?

Unfortunately, Congress did not use a consistent definition of a “small employer” in the Patient Protection and Affordable Care Act (PPACA) and figures vary widely as to what constitutes a “small employer,” depending on the specific provision. While many changes are mandated without regard to employer size, PPACA provisions specifically applicable to “small employers” range from fewer than 26 employees for tax credit eligibility to 100 employees or less to qualify for exchanges.

Starting 2014, companies with 50 or more employees must either offer health coverage (employer mandate) or pay a \$2,000 annual fee for every employee (after the first 30) if any employee receives a health care tax credit.

“The conventional wisdom that you need at least 250 employees to self-insure is proving wrong,” says Curtis Donley, president of Indianapolis-based Donley Consulting Inc. and former president of a third-party administrator (TPA) firm. “My experience shows that self-insurance is a viable alternative for financially qualified small employers. Over the past quarter century, we’ve routinely set up and administered self-funded health plans for financially qualified groups as low as 25 employees and up.”

As the economy struggles to revive itself, small employers in greater numbers view the self-insurance option as a favorable way to save money without sacrificing health care quality. Self-insurance lets companies take control of their plans and offer benefits uniquely suited to their workers’ needs, free of many of the costliest state government mandates.

Nevertheless, critics suggest that small employers are not able to bear the financial risk of self-insurance. This echoes a refrain from the mid-’90s debate when the Clinton administration unsuccessfully advanced proposals initially to restrict self-insurance to very large firms with 5,000 employees, then to 1,000 employees and up. Opposed by industry, these attempts and a later drive to limit self-funding to firms with 500 employees and up were defeated on Capitol Hill.

The same issue has surfaced once again in connection with the government operated insurance exchanges to be set up under PPACA where small employers will be able to elect coverage starting Jan. 1, 2014.

A new paper published by the National Health Policy Forum (NHPF) once again advances old, misguided assumptions saying that small employers that self-insure are likely to cover healthier workers and then elect coverage in the insurance exchanges. The paper observes

this could have an adverse selection impact that will trigger higher premiums in exchange pools and that only larger employers should be allowed to self-fund health benefits.

This rankled the industry, which fired back that these conclusions are without foundation. “We are working to head off a DOL report that concludes smaller employers should not self-insure due to solvency concerns and a separate HHS report suggesting that self-insured health plans will negatively impact health insurance exchanges due to adverse selection,” says Mike Ferguson, SIIA’s chief operating officer.

These conclusions are incorrect for the following reasons:

### Dispelling the Myths

• **Myth 1:** *Self-insured plans cover healthy employees.* Not true. Federal laws prohibit plan sponsors — whether insured or self-insured — from selecting only the most favorable risks among individuals in plans they sponsor. PPACA bars coverage denial based on pre-existing conditions and prohibits discrimination based on employee health status, including such factors as claims experience, medical history, genetic data, evidence of insurability and disability. Moreover, these practices have been prohibited for more than 20 years since the passage of HIPAA.

• **Myth 2:** *Self-insurance will result in adverse selection.* Employer sponsored self-insured plan membership includes a broad cross-section of workforce risk, covering low, medium and high employee health risks. Since insured and self-insured plans have similar membership demographics, there is no basis for the highly speculative assumption that self-insured plans enroll a more favorable selection of health risks. There is no historical basis for the speculation that small employers that self-insure under PPACA will skim healthier and better risk out of exchange pools. This observation is inconsistent with empirical evidence and published research studies.

• **Myth 3:** *Small employers can’t bear the financial risk of self-insurance.* Not true. Employers must meet sound actuarially determined financial requirements (good cash flow) in order to demonstrate they are capable of self-funding. To protect against year-to-year variations and the expenses of complex illnesses, small employers purchase stoploss insurance to indemnify them for potential high costs of large or catastrophic claims. Self-insured employers with stop-loss are reimbursed for individual employees’ medical costs above a certain predetermined amount. Following the passage of the PPACA, most stop-loss insurers amended policies and now cover unlimited annual and lifetime benefit costs.

Moreover, as the white papers note, PPACA contains anti-adverse selection reforms that will keep coverage rates in check regardless of pool risk exposure. The tax credit subsidy available to eligible small employers is only available for employers who purchase insurance in the exchanges. Employers now have a guaranteed right of renewability regardless of plan risk profile changes. Also, the new premium review process will help combat against excessive increases for small groups.

The white papers are titled “Why Self-Insured Health Care Plans Will Not Contribute to Adverse Selection Under PPACA” and “Companies of All Sizes Can Operate Viable Self-Insured Group Health Plans” can be accessed via e-mail at [mstrickfadden@siia.org](mailto:mstrickfadden@siia.org), or by calling 202-463-8161.

### **PPACA Reports to Congress On Self-funding**

The Patient Protection and Affordable Care Act (PPACA) requires the U.S. Departments of Labor (DOL) and Health and Human Services (HHS) to prepare and submit an annual report to Congress on self-insured plans, with both reports due March 23, 2011. Based on Form 5500 data, the DOL report will include general information on self-insured group health plans (including plan type, number of participants, benefits offered, funding arrangements and benefit arrangements). Using data from financial filings, the report will also include information on assets, liabilities, contributions, investments and expenses.

The HHS report will cover insured and self-insured employer characteristics (including financial solvency, capital reserve levels, the risks of becoming insolvent), and the extent to which new insurance market reforms are likely to cause adverse selection in the large group market.

SIIA reported recently on a series of meetings with DOL and HHS officials to discuss PPACA-mandated studies on self-insurance. “Our assumption is that there at a minimum there is ignorance among regulators, but more likely a negative bias pervades,” said SIIA Chief Operating Officer Mike Ferguson.

### **The Options Under PPACA**

Under PPACA, small business owners with fewer than 26 employees and average annual wages of less than \$50,000 can now claim a tax credit of up to 35 percent of the premium cost — increasing to 50 percent in 2014. If they choose to offer insurance coverage, an estimated 4 million

small companies will be eligible for the tax credit on 2010 tax returns, according to a Families USA report. Though some insurers already saw a dramatic increase in plan enrollments in 2010, millions of small employers in this size range that exceed the average annual wage limit will not be eligible for the tax credit.

Small employers (up to 100 employees) looking ahead to 2014 when the well-publicized exchanges will be in place need to decide whether to continue health insurance coverage or scrap their plans and pay the \$2000-per-employer penalty. They will need to weigh not only the impact on their bottom line, but also “what is the right thing to do for employees.” There is no clear answer; this will be a business-by-business decision.

Employers in this size range that decide to continue health plan coverage will need to choose the funding method — insurance or self-insurance — that does the most to lower health costs and improve employee health care quality. The other option, coverage in state health insurance exchanges, is expected to benefit from negotiated prices with insurers, but will be subject to new HHS-regulated “essential benefits” mandates and other requirements.

Some insurers have announced they will not participate in the exchanges but will offer their products only outside the exchanges. Many employers not eligible for coverage in exchanges (mainly due to size) can be expected to continue funding health benefits outside the exchanges through commercially insured plans. However, these plans will be subject to the same mandated state benefits, premium taxes, rating restrictions and other costly requirements that have resulted in soaring premiums.

### **The Self-insurance Advantage**

“Increasing medical costs and willingness to assume more risk are driving many employers, even small employers, to shift to self-insured health plans,” according to Sheri Sellmeyer, vice president of analysis for Health Leader InterStudy, a leading provider of health care market intelligence. From January to July 2008, self-insured health plan enrollment grew by 1.6 million lives, or 2.2 percent nationwide, according to a 2009 HealthLeaders study.

Self-funded plans are appealing to small employers because of the greater flexibility that comes with freedom under ERISA to tailor plans to specific workforce needs (including medical, dental, vision and prescription drug benefits) without being impacted by costly state mandated benefits and premium taxes. “We’ve just finished our first year on a self-funded plan backed by stop-loss insurance and we’ve saved over \$600,000 in the first year by being

self-funded,” said Tad Roane, CFO of Crescent Directional Drilling, a small employer in Houston, Texas.

Unlike employers that purchase insurance from a commercial insurer licensed by a state, employers that self-fund health benefits can offer the same uniform health plan in multiple states, as permitted by the federal ERISA provisions. This is a significant advantage for the many small employers that do business across state lines and operate in multiple states.

The PPACA sets forth new federal standards and mandates applicable to fully insured as well as self-insured plans. However, self-insured plans are exempted from some PPACA reforms that apply specifically to insurers such as medical loss ratio (MLR) standards, rating restriction rules and insurer fees.

Starting July 1, 2011, any planned rate hike of 10 percent or more in the small-group insurance market must undergo extensive review by the state involved or by the U.S. Department of Health and Human Services (HHS), according to new PPACA rules issued by HHS — another reason to consider the self-funding alternative.

### **Taking Control**

Under PPACA, a small employer that self-funds is able to gain more control quickly over costs associated with employee health benefits. Working with their TPA, employers that don't know much about the health of their workforce — and what is driving costs — now can use innovative technology (analytics, metrics, predictive modeling) to help employees make healthy lifestyle choices and reduce health care costs.

Insurers have worked hard to keep employers — the payers — in the dark about what's going on in their health plans. Lacking detailed plan data, employers have been forced to swallow premium increases year after year. But self-funded plan sponsors have direct access to historical plan claims data and can use new technology to see where their benefit dollars are going.

Self-funded employers can access their own plan clinical and prescription-drug claims data, without an insurance company standing in the way. Working with their TPA, employers can use innovative technology to leverage HIPAA-compliant claims data that unveil a real-time snapshot of plan health risk. They are able to gain insight into potential costly catastrophic conditions in the workforce before high-cost claims are filed. With this information, employers can adopt actionable plan design and employee outreach prevention campaigns to mitigate risk.

Proactive employers can launch educational activities that engage employees in programs such as care management, disease management and nurse coaching. By offering employee incentives, some self-funded employers report better than 50-percent voluntary employee participation rates in targeted outreach programs — far in excess of the 30-percent national benchmark on voluntary participation. Implementing this strategy has already saved many companies money. For example, a self-insured South Carolina-based long-term care company used innovative software programs to reduce its health care costs by 19 percent. An Atlanta-based self-insured radio station company employed technology and saw a four-fold increase in employee enrollment in wellness programs.

### **Conclusion**

In the post-PPACA world, escalating costs will represent one of the most predictable outcomes of health reform for employers. As employers face higher costs and expanded requirements, many will turn to alternative risk transfer funding methods such as self-insurance to better manage their health plans and control costs. While embraced by larger firms for years, self-insurance is becoming an increasingly popular option for mid-size and small employers as well. In the new health care marketplace, self-insurance is a viable solution to rising health care costs — whether for financially qualified employers considering self-funding as an alternative to fully insured coverage, or for employers with self-funded plans already in place. 🏠