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Are Self-Funding Health Plans on the Rise Because of Health Care Reform?

By William Norris
Partner
Moss Adams LLP

By Francis Orejudos
Senior Manager
Moss Adams LLP

By Lissa Thomson
Senior Vice President, Chief Consultant
Lockton Companies

The cost of health care in the United States has been increasing for the last 15 years, and it continues to outpace other expenses and eat away at corporate profits. Indeed, the average employer health premium now costs more than twice what it did in 2001.

Further raising premium costs are regulated benefit levels imposed by individual states and the Patient Protection and Affordable Care Act, the health care reform bill, which has added a financial and administrative burden to employer plans.

In light of these increases, many companies are refocusing their attention on containing their costs through various strategies, which include reducing benefits, emphasizing wellness programs, and increasing cost sharing to members. One strategy that has proved successful in reducing costs while providing a similar level of benefits to employees is self-funding.

Self-funding is an arrangement where an employer provides health care benefits to employees with its own funds. This is different from a fully insured plan, where the employer contracts an insurance

company to cover employees and their dependents under a fixed-rate arrangement. In a self-funded health plan, the employer assumes the direct financial risk and responsibility of paying benefit claims. The terms of eligibility and coverage are established in a plan document that includes provisions similar to those found in a typical group health insurance policy.

In addition to assuming financial risk, self-funded health care plans offer companies an opportunity to save money by avoiding an insurer's risk charges and margins, taxes, and many state regulations.

While self-funded plans avoid most state regulations with very few exceptions, they must follow federal laws, including ERISA, COBRA, HIPAA, and the Mental Health Parity Act. Self-funded plans currently carry additional responsibilities related to privacy, fiduciary management, and nondiscrimination rules.

The Benefits of a Self-Funded Plan

In addition to avoiding many state regulations and taxes that apply to insured benefits, multistate companies with self-funded plans can customize their offerings to create uniform plans across their locations, often increasing benefit levels in the process. And, in an era governed by HIPAA rules where insurance companies will not release utilization data for fully insured plans, self-funded plans can use their data to model and develop more effective health plans for the future. These benefits plus efficient administrative fees added to the reduction of insurer margins, profits, risk fees, and state taxes have allowed self-funded plans to historically save between 7 and 9 percent of their total cost compared to traditional plans.

An additional financial advantage of self-funding is increased cash flow. Self-funded plans don't prepay claims; instead they pay a claim after medical services have been provided and the claim has been adjudicated by the administrator and presented by the medical provider for funding. This amounts to a cash float of one and a half to two months for medical claims, but it's less for prescription drugs.

Unlike in the fully insured carrier market—where major insurers continue to acquire regional carrier networks and their memberships—there is a sufficient number of administration firms and reinsurance or stop-loss markets to ensure competition for self-funded plans, which helps keep costs low.

As the third year of health care reform approaches, companies have become increasingly aware of the law's significant financial and administrative burden impacting their already costly health plans. Part of this burden comes in the form of four additional taxes that will be assessed on health products, insurers, and plan administrators. Three of the taxes—the consumer tax, the tax on pharmaceutical manufacturers, and the tax on medical device makers—will impact both fully insured and self-funded plans.

The fourth and most costly of the taxes applies to health insurance providers, who, starting in 2014, will be subject to an $8 billion annual excise tax. The excise tax increases to $11.3 billion in 2015 and 2016 before increasing again to $13.9 billion in 2017. Although a small portion of this tax obligation will be transferred to self-funded plans through a transitional reinsurance program, these self-funded plans will be able to avoid the majority of the tax on health insurers. This translates to an additional 2–2.5 percent savings for self-funded plans.

Major elements of health care reform take effect January 1, 2014, which may prove costly for certain industries. For executives needing to develop new strategies to mitigate the financial effect, a self-funding plan may be the right choice to improve purchasing efficiencies, better manage plans, and reduce costs.

Make Sure Your Plan Is Working for You

Once a plan becomes self-funded, it's important for employers to note that it becomes the largest unaudited expense in the entire organization. And as the majority of self-funded employers rely on third parties to administer their benefits, it's crucial that employers have mechanisms in place to ensure that benefit administration is occurring efficiently and costs are kept to a minimum. This is needed because the performance reports provided by administrators are usually self-reported and may not be the most objective measure needed for effective plan management, even if employers are generally satisfied with the results.

To this end, an administrative claims review offers the best opportunity to create accountability, measure performance, and establish processes for continuous

quality improvement. This type of review gauges the administrator's ability to pay claims accurately and efficiently by measuring the financial, payment, and procedural accuracy levels of claims against industry-wide standards. This review is critical because, according to the experience of Moss Adams LLP reviewing administrator performance, third parties fail to meet industry-standard financial and payment accuracy measures 60 percent of the time.

Performing such a review helps the employer fulfill its fiduciary responsibility as a plan sponsor. Specifically, it helps the employer evaluate whether claims are being paid correctly and in accordance with the plan's intended benefit provisions. Also, results from an administrative performance review can serve as a benchmark for establishing or renegotiating performance guarantees between employers and plan administrators.

With the cost of claims representing the largest expense component of an employee health care benefit plan, it's imperative that employers confirm that the claims administration process is operating exactly the way it should. Getting out in front of the issue with regular administrative performance reviews can help verify that employers are getting the most from their health care expenditures.

The Bottom Line

The impact of the health care reform law on employer-based health care remains uncertain. But regardless of possible political change regarding health care reform, employers can still proactively control their health care costs and positively impact employee productivity by using a self-funded plan. If you're interested in learning more about self-funded plans, contact your Moss Adams advisor.

William Norris has provided Healthcare Consulting expertise for over 19 years and has worked with some of the largest Payers in the country. He has provided extensive support in the areas of claims administration, revenue recovery, IS implementation, operations redesign, and process improvement. He can be reached at (949) 623-4172 or william.norris@mossadams.com.

Francis Orejudos has over nine years of experience serving managed care organizations. He has led payer initiatives related to claims auditing, contracting, operational assessments, and business process redesign. He can be reached at (949) 221-4033 or francis.orejudos@mossadams.

Lissa Thomson is a recognized benefits expert with more than 30 years serving in executive positions at some of the nation's top consulting brokerage firms. She participates in nationwide leadership committees, including ***Health Reform Business Implications****, to establish strategies, solutions and delivery standards. Her experience in financial plan management and optimizing alternative benefit strategies including alternative delivery, consumerism, defined contribution, outcomes-based wellness, etc., support Lockton clients who choose to be among the top performers in maximizing health care dollars.*

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