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Introduction to Self-Funding November 2, 2016

ACA and Health Care Reform

- For more than a century, Americans have debated how to extend health care to all Americans. After decades of failed attempts, **President Barack Obama** made history.
  - On March 23, 2010, HR 3590, "The Patient Protection and Affordable Care Act" (PPACA) (Public Law 111-148) was signed into law.
  - Then on March 30, 2010, the PPACA was modified when President Barrack Obama signed into law HR 4872 "The Health Care and Education Reconciliation Act (the "Reconciliation Act") (P.L. 111-152).
- On June 28, 2012 after a 5-4 decision, the Supreme Court largely upheld the PPACA as constitutional and Congress had the ability to tax.
  - **Mandatory Medicaid expansion was not held to be constitutional**
- Since then the Congress has tried a dozen of times to repeal.
- King v. Burwell (June 25, 2015) Supreme Court (6-3 ruling) ruled that the federal subsidies that helped nearly 6.4 million people pay for their health care plans are legal under the ACA.

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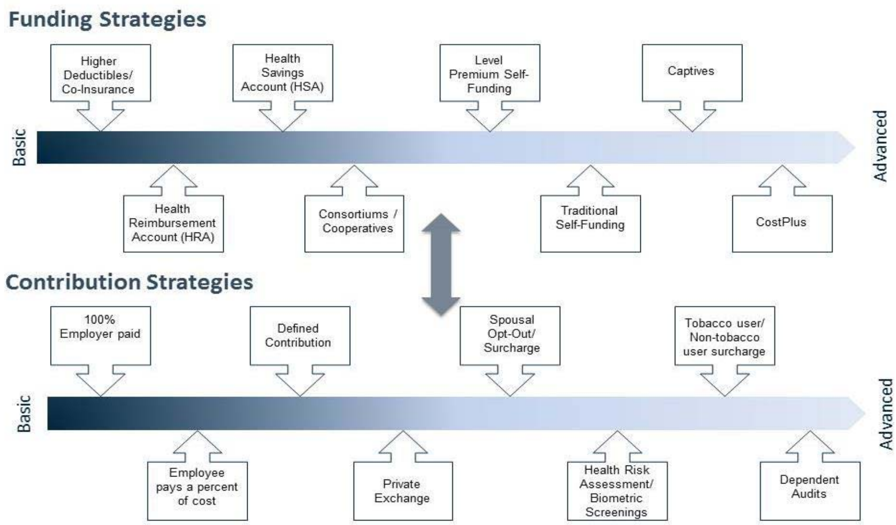
Healthcare Continuum



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Self-Funding Basics

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Fully Insured or Self -Funded?

- Fully Insured
  - **Risk Bearer is the Insurance Company**
  - Premium covers all risks and costs

- Self Funded/Self-Insured
  - **Risk Bearer is the Employer**
  - Claims are paid from Employer funds
  - Employer pays for claims administration

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How Does Self-Funding Work?

A fully insured plan's fixed premium is like paying for cable....

...it doesn't matter how many hours you watch, you still pay the same bill each month!

A self-funded plan works more like your electric bill...

...there will inevitably be costs, but some are controllable, like how efficiently you use lights or A/C!

A wise consumer will pay less

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How Does Self-Funding Work?

HRA | Level Funding | Group Captive (Buy Stop Loss) | Stand Alone (ER Buys Stop Loss) | Self-Funded

Employer assumes more risk

Health Care Regulation in the U.S.

- McCarran-Ferguson Act of 1945 – "*business of insurance*" is to be regulated by the states.
- Employee Retirement Income Security Act (ERISA) of 1974 – which applies to private, employer sponsored plans, pre-empts state regulation of employee benefit plans, including employer sponsored health plans.
  - ERISA offers self-funded plans the advantage of not being controlled by state laws that relate to insurance [ERISA § Section 514 (29 U.S.C. § 1144)]
- GAO Report (1995):
  - "ERISA pre-emption of state regulation of self-funded plans results in different applicable regulatory frameworks depending on whether the employer purchases health care coverage from an insurer, which the state regulates, or self-funds its health plans avoiding many states regulations."

ERISA's Section 514 Preemption Clause

- Section 514 bars direct state interference in the design and administration of plans, and only allows indirect regulation of insured plans through the states' authority to regulate insurance.
- Three basic sections:
  - **Section 514 (a) – is called the ERISA preemption clause**.
  - Section 514(b)(2)(A)) - called the "savings clause," in effect says that ERISA does not impede the state's ability to regulate insurance.
  - Section 514(b)(2)(B), called the "deemer clause," says in essence that states cannot avoid preemption by simply calling benefit plan regulation insurance regulation.

- The purpose of Section 514, as recognized in the case law, is to enable employers to offer uniform benefit plans across states without the burden of conforming benefits and administration to the demands of each state.

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Self-Funding At A Glance

- The percentage of workers in private-sector self-insured health plans has been increasing.
  - In 2015, **63 percent** of workers with health coverage were in self-insured plans, up from 40.9 percent in 1998.[1]
  - Large employers (with1,000 or more workers) have driven the upward trend in overall self-insurance. The percentage of workers in self-insured plans in firms with fewer than 50 employees has been close to 12 percent in most years examined.

- The prevalence in self-insured plans varies by state, from a low of 30.5 percent to a high of 73.8 percent, with **Massachusetts** having the third-highest prevalence of self-insurance in the small-group market (**behind Hawaii and Alaska**).[2]

Source: [2]EBRI November 2012, Vol. 33 No. 11 Self-Insured Health Plans: State Variation and Recent Trends by Firm Size
http://www.ebri.org/pdf/notespdf/EBRI_Notes_11_Nov-12.Slf-Insrd1.pdf24

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Why Self-Funding?

- Employer is still the risk bearer
- Cost-effective alternative to traditional insurance
- Can significantly reduce the overhead costs associated with traditional health care coverage
- Lower premiums and certain tax breaks, and better control over financial reserves without sacrificing the quality of health care coverage for employees
- Employer can purchase Stop Loss Insurance to protect against high claims

How Self-Funded Plan works

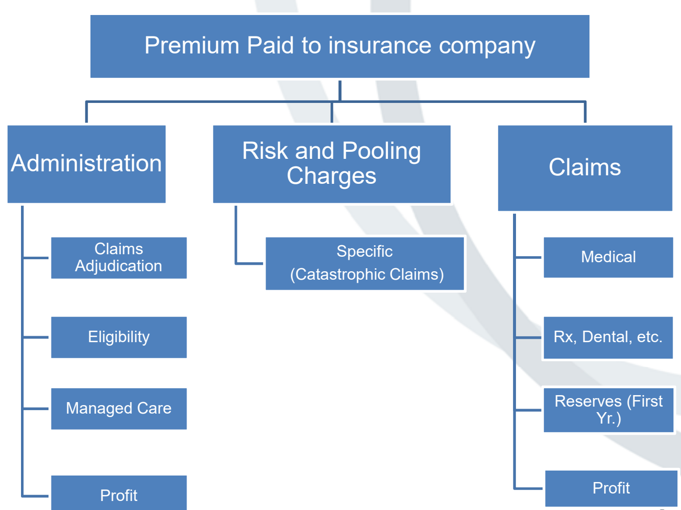
- Employer offers a self-funded ERISA Plan
- Employer writes a Summary Plan Description (SPD)
- **Employer hires a TPA or a BUCA to administer claims and remit premiums**
- Employer buys Stop Loss coverage to cap risk to plan from excessive claims
- Types of Self-Funded plan
  - Group medical or health plans is the focus of a self-funded plan
  - Other self-funded benefits are **dental**, prescription drugs, vision and STD

Advantages of Self-Funding

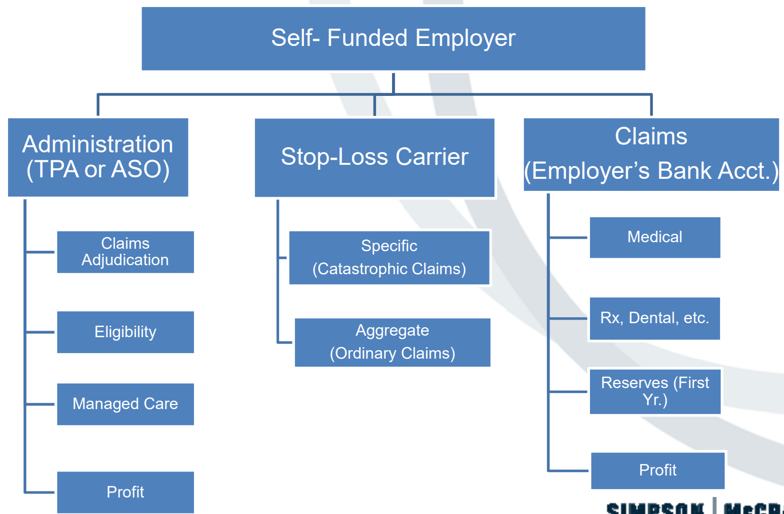
- **Not subject to state mandatory benefits**
- More freedom to tailor plan design to meet the group's loss history and future goals
- Reduced state premium tax*
- Employer holds claims dollars until actually needed and keeps margins and reserves
- Employer and Consultant have access to claims data needed for effective plan decision making
- No loss-sharing of other groups covered by insurer

* Premium tax paid on stop-loss premiums only, which are much smaller than fully insured premiums

Cost Elements of a Fully Insured Medical Plan



Cost Elements of a Self–Insured Medical Plan



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Stop-Loss Research

- The Fourth Annual Sun Life Research Report: Spring 2016:
  - The total of all stop-loss claims payments during the four-year study was $2.3 billion. If we add those stop-loss claims payments to first-dollar claims costs for catastrophic conditions, the overall cost for catastrophic conditions was $5.3 billion. Here are the key findings:
  - The top ten costliest claims conditions comprised over half (53%) of the $2.3 billion in claims that Sun Life reimbursed to stop-loss policyholders between 2012 and 2015.
  - Cancer was the most costly catastrophic illness and represents over one quarter (26.6%) of all stop-loss reimbursements (which includes the sizeable cost of intravenous medication) during the four-year period.
  - Less than 1.7% of claimants produced claims over $1 million, but those claimants accounted for a disproportionate 18.5% of the overall claims costs.
  - Although treatment costs declined, chronic/end-stage renal disease maintained its #3 position due to high rate of incidence.
  - Transplants moved into the #6 position, and the previous #10 condition “complications of surgical and medical care, not elsewhere classified” was replaced by septicemia (infection).

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Top 10 Catastrophic claims conditions

Total payments

33% Top 3 of all conditions

53% Of all catastrophic claims were top 10 conditions

	Medical condition	Percentage of total paid stop-loss claims 2012-2015	Value of paid stop-loss claims 2012-2015
1	Malignant neoplasm (cancer)	18.5%	$429,500,000
2	Leukemia/lymphoma/multiple myeloma (cancers)	8.1%	$188,600,000
3	Chronic/end-stage renal disease (kidneys)	6.7%	$156,600,000
4	Congenital anomalies (conditions present at birth)	4.1%	$96,300,000
5	Disorders relating to short gestation and low birth weight (premature births)	3.2%	$75,200,000
6	Transplant	2.7%	$62,200,000
7	Congestive heart failure	2.5%	$57,800,000
8	Cerebrovascular disease (brain blood vessels)	2.5%	$57,400,000
9	Pulmonary collapse/ respiratory failure (lungs)	2.4%	$55,000,000
10	Septicemia (infection)	2.4%	$54,700,000
✓	All other conditions	47 %	$1,090,000,000

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IRS Reporting

- Under ACA, beginning January 1, 2016, employers who self-fund their employee health care will be required to submit information reporting about “MEC” to the IRS
- Employers are required to submit a separate report for each individual health care recipient on **Forms 1095-B and 1094-B** that specifically provides:
  - The name of each individual enrolled in MEC as well as the name and address of the primary insured or other related person (for example, a parent or spouse) who submits the application for coverage.
  - The return also must report the taxpayer identification number (TIN) and months of coverage for each individual who is covered under the policy or program.
  - The name, address and employer identification number (EIN) of the employer maintaining the plan and whether coverage was enrolled in through the government marketplace
- Employer deadline for employees March 31, 2016, and must submit to the IRS by May 31, 2016.

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Benefits of Stop-Loss Insurance

- Reduces liability for health care costs
- Minimizes financial risk
- Helps improve employer's cash flow
- Serves as buffer against rising health care costs
- Maintains the advantages of self-funding
  - Employer can customize plan features
- Provides long-term cost control
- **Indemnity type contract**

Types of Stop-Loss Insurance

- Specific Stop-Loss
  - Designed to **protect the employer from large medical claims from any one individual** by providing coverage for liabilities above a "specific" dollar amount set by the employer. Sometimes called **individual stop-loss**.
- Aggregate Stop-Loss
  - Protects employers from higher than anticipated claims for the group as a whole.

“Specific” Stop-Loss Insurance

- Most stop-loss insurance is Specific stop-loss
  - **Covers a self-funded medical plan for the claims of one individual**
  - Employer can choose its deductible; the self-funded medical plan pays for claims below that deductible for each individual
  - The specific stop-loss deductible payable by the employer typically ranges from $20,000 to $500,000
  - **Dental benefits may also be covered**
- **Specific stop-loss is more expensive than Aggregate stop-loss**
- For an employer (ER) purchasing both coverages Specific stop-loss premium will typically make up 90-95% of the total premium

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Specific Stop-Loss Benefits and Features

- Employer Benefits:
  - Minimum deductible, for example: $35,000
  - Comprehensive selection of contract types
- Embedded Features
  - No lasering required*
  - Disclosure forms on new cases only
  - Rate Caps

* Definition of a “laser”

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Underwriting Aggregate Coverage

- Aggregate Stop-Loss is a function of the group's actual claims experience
- The future is highly predictable from past results
- Therefore, premium required to insure this risk is relatively small compared to Spec Cover.
- Expected Claims + Margin = Aggregate Attachment Point or "worst case"

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Aggregate Stop-Loss Benefits and Features

- Employer Benefits:
  - Standard attachment point is 125%
  - Broad range of contract types available
  - Sold with Specific Stop-Loss

- Embedded Features:
  - Attachment point finalized with 10 months of claims

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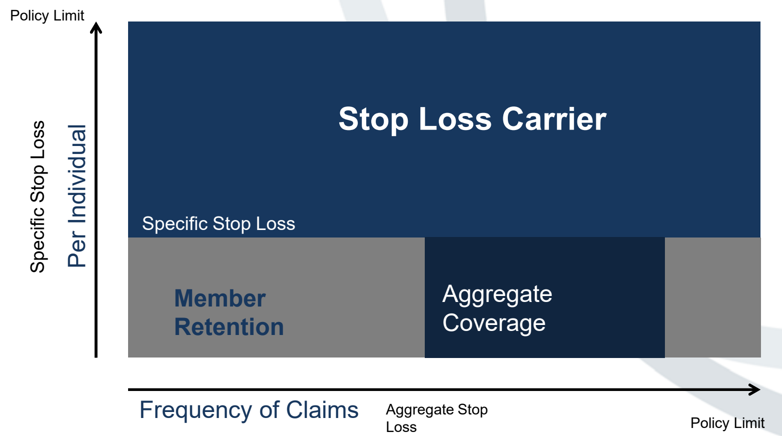
Traditional Stop Loss Policy Structure



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Stop-Loss

Prevalence and Average Attachment Points of Stop-Loss Insurance, by Firm Size and Region, 2015

	Percentage of Covered Workers in Partially or Completely Self-funded Plans	Percentage of Covered Workers Enrolled in a Self-Funded Plan that Purchased Stop-Loss Insurance	Percentage of Covered Workers Enrolled in a Self-Funded Plan that Purchases Stop-Loss Insurance Which Includes a Limit on Per Employee Spending	Average Per Employee Claims Cost at Which Stop-Loss Insurance Pays Benefits
Firm Size				
50-199 Workers	29%*	68%	92%	$180,000*
200-999 Workers	56%	90%*	90%	170,000*
1,000-4,999 Workers	82%*	85%*	93%	270,000
5,000> Workers	94%*	43%*	94%	470,000*
All small firms (3-199)	**17%**	**64%**	**86%**	**210,000***
All Large Firms (200>)	**83%**	**59%**	**93%**	**340,000**
Region				
Northeast	70%	57%	93%	$340,000
Midwest	64%	71*	93%	300,000
South	68%*	56	92%	350,000
West	48%*	58	90%	310,000
All Firms	**63%**	**60%**	**92%**	**$330,000**

*Estimate is statistically different from estimate for all other firms not in the indicated size or region category
Source: Kaiser Family Foundation; KFF/HRET http://kff.org/report-section/ehbs-2015-section-ten-plan-funding

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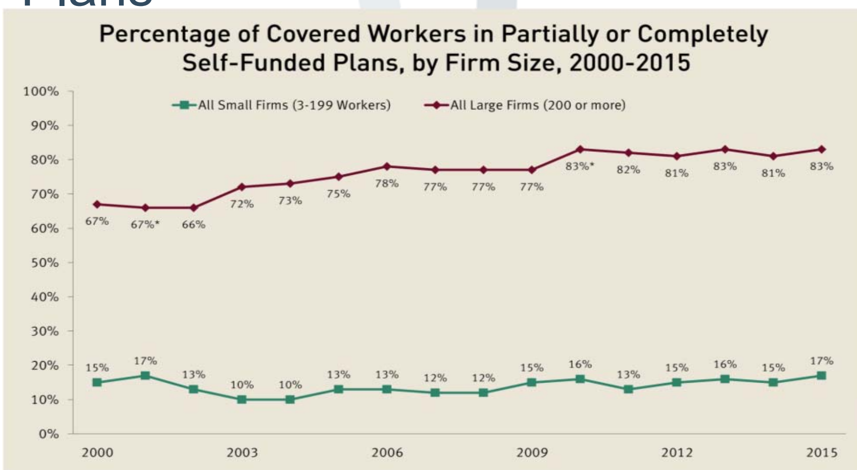
Covered Workers in Self-Funded Plans



*Estimate is statistically different from estimate for the previous year shown (p<.05). **Note:** Sixty-three percent of covered workers are in a partially or completely self-funded plan in 2015. Due to a change in the survey questionnaire, funding status was not asked of firms with conventional plans in 2006. Therefore, conventional plan funding status is not included in the averages in this exhibit for 2006. For definitions of Self-Funded and Fully Insured plans, see the introduction to Section 10. **Source:** Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 2000-2015.

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How Are Self-Funded Contracts Different?

Fully insured contracts cover claims incurred during the policy year and paid during or after the policy year.

January December 31

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How Are Self-Funded Contracts Different?

Employers can choose from a variety of Stop-Loss contracts to meet their needs.

12/12 Policy Period

January 1 December 31

Incurred & Paid 12/12: Charges incurred and paid during the policy period

15/12 Run In

October 1 January 1 December 31

Paid 15/12: Charges incurred up to three months prior and during the policy, and paid during the policy period

12/15 Run Out

January 2 December 31 March 30

Incurred 12/15: Charges incurred during the policy year, and paid during and up to three months after the end of the policy year

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Stop-Loss Underwriting Requirements

- Complete employee census that includes: Date of birth, gender, dependent status, location and plan
- At least 2 years of:
  - Month by month claims, enrollment and shock loss history
  - **All claims that have exceeded 50% of the lowest Specific deductible**
- Current plan and any plan changes in the last 2 years
- Any proposed plan changes

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Underwriting Specific Coverage

- Specific Stop-Loss is a function of the risk associated with large claims
- Generally, insurers begin with a "base rate" that is determined by certain factors, such as the specific deductible, the insurer's pool of business, industry benchmarks, and the insurer's overhead
- Then, the base rate is adjusted for a variety of factors

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Specific Pricing Example

Factor	Explanation
Base Rate	Based on Specific deductible
Location	For example: Louisiana vs. Wyoming
Industry	For example: banking vs. manufacturing
Age of Employees	For example: 25 vs. 50
Gender Content	# of males vs. # of females
PPO Network	For example: ABC vs. XYZ network
Managed Care Programs	Case management, pre-certification, utilization review, etc.
Special Programs	Pregnancy management, transplant, neonatal, tertiary care
Prescription Drug Coverage	Included vs. excluded and managed vs. non-managed
Third Party Administrator	ABC vs. XYZ Third Party Administrator
Mental/Substance Abuse	Based on level of benefits
Claims Basis	Type of contract – 12/12, 15/12, etc.
Lifetime Maximum	High vs. low
Other	For example: broker commission level
= Final Base (or Manual) Rate	
+/- Experience Adjustment	Based on group's historic experience
= Final Rate	

Additional adjustments may be made for other contract provisions

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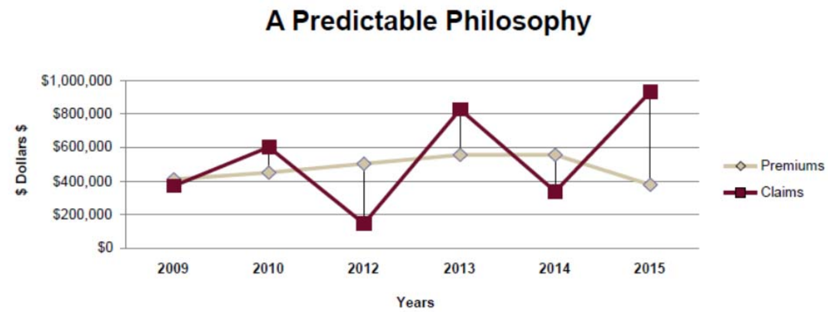
Specific Stop-Loss Claim and Premium Pattern



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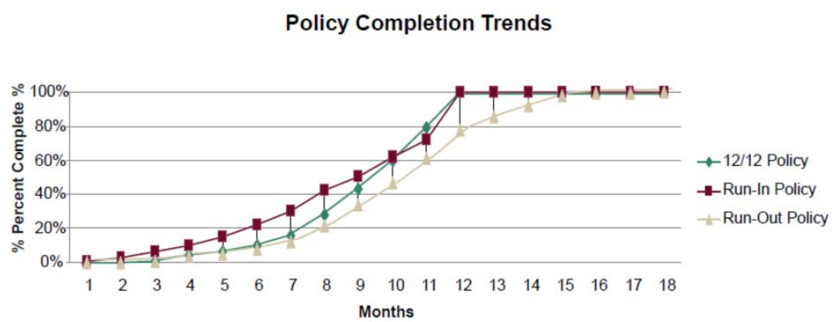
Specific Stop Loss Completion Factors

"We can't always call the winner at the half!"



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HIPAA

- HIPAA gives insurance carriers the right to use employee health information to:
  - **Determine the plan,**
  - **Conduct underwriting,**
  - Create pricing, and
  - Submitting stop-loss claims.
- **Gramm-Leach-Bliley Act protects:**
  - How private financial information is shared.
  - Protects nonpublic personal information (NPPI)

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Market Size - Health Care Reform

- No Consensus on How Health Care Reform will Impact Total Size of the Stop Loss Market
- Some Believe that HCR will Increase the Size of the Market as Employers with Higher than Average Paid Employees Attempt to Keep Control of Health Care Costs
  - These employees will not qualify for subsidies on the exchange
  - May open opportunity for new/expanded product innovation, such as limited medical to fill some gaps and specialty carve-out products to limit employer exposures
- Very Large Employers will buy Stop Loss for the First Time due to Unlimited Benefits and Increased Liability for Catastrophic Claims

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Market Size – Health Care Reform

- An issue brief by the National Health Policy Forum concluded that,

"in 2014 and beyond, smaller employers with relatively healthy workers…may find it financially advantageous to pay for their own firm's risk [rather] than to purchase a plan through the exchanges."

Source: K. Linehan, Self-Insurance and the Potential Effects of Health Reform on the Small-Group Market, (Washington, D.C.: National Health Policy Forum, Dec. 2010).

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Actual Client Results

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Fully Insured vs. Self-Insured Illustration

SIMPSON & McCRADY LLC
Risk Management and Insurance Brokerage

	2013-14 Maximum Liability	2013-14 Expected Liability	2013-14 Actual Liability	2013 Fully Insured Premium & HRA Payments*
Fixed Costs	208 employees	208 employees	231 employees	
Specific Premium-*50k Spec. Deductible* (Annual)	$407,882.00	$407,882.00	$441,596.00	
Aggregate Premium (Annual)	$13,129.00	$13,129.00	$14,581.00	
ASO/TPA Premium- *Health America* (Annual)	$83,616.00	$83,616.00	$88,540.50	
TOTAL FIXED COSTS	**$504,627.00**	**$504,627.00**	**$544,717.50**	
Variable Costs				
Total Claims (Annual)	$1,934,656.00	$1,547,725.00	$1,579,937.01	$2,341,391.54
Stop Loss/ HRA Claims Payments	*Attachment Point*		-$98,917.16	$186,000.00
TOTAL ANNUAL COSTS	**$2,439,283.00**	**$2,052,352.00**	**$2,025,737.35**	**$2,527,391.54**
Self-Insured vs. Fully Insured Savings	**-$88,108.54**	**-$475,039.54**	**-$501,654.19**	

*2013 Fully Insured Premium is Health America 18.66% renewal + HRA claims Payments

Notes:

- Employee enrollment growth
- Client was with Highmark and received a 26.5% renewal for July 2013. If they moved to a match plan with Health America on a fully insured basis, their increase would have been 18.66%

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Group Captive Insurance Program

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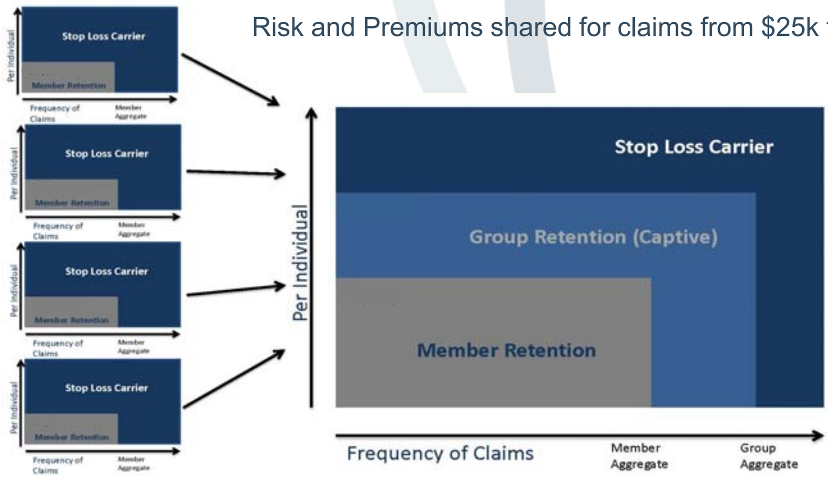
Captive Stop Loss Policy Structure

Risk and Premiums shared for claims from $25k to $250k



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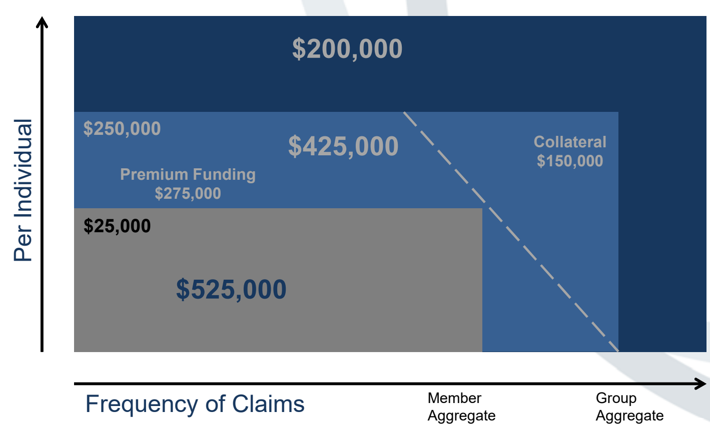
Captive Risk Layer Funding



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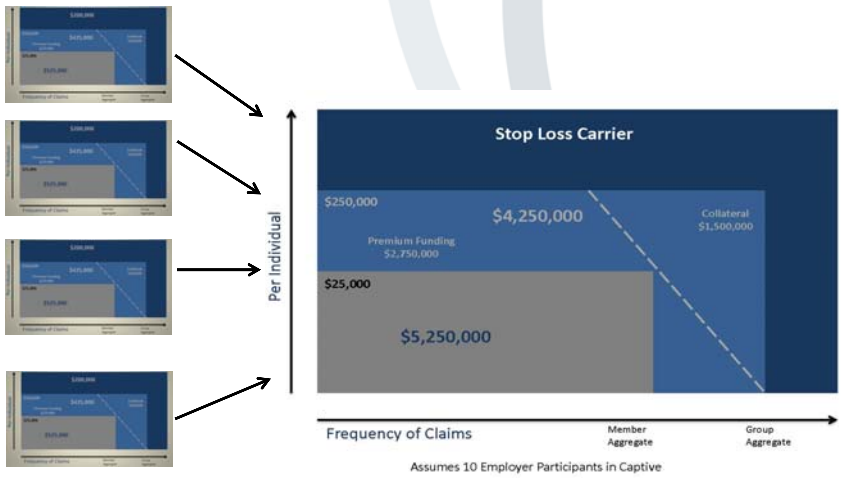
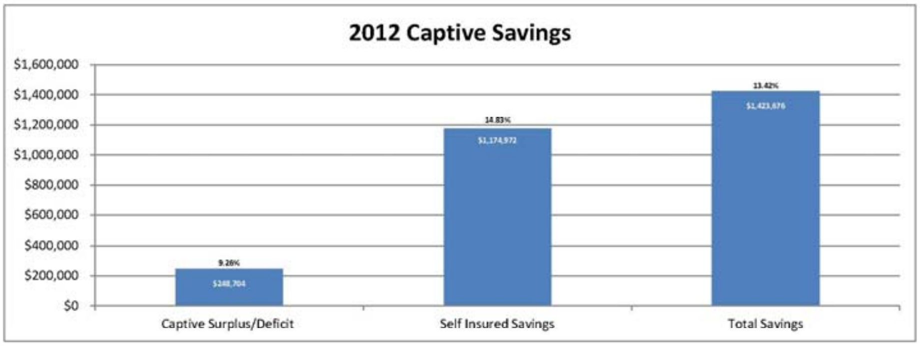
Captive Risk Layer Funding
(Multiplicative Effect)



2012 EmCap Actual Results

2012 Actual Results

33 Companies Participating



Captive Surplus/Deficit		Self Insured Savings (Expected Claims)		Total Savings	
Ceded Risk Premium	$2,685,890	Self Insured Retention	$7,924,974	Expected Funding	$10,610,864
Savings	$248,704	Savings over Expected Claims	$1,174,972	Savings	$1,423,676
Savings %	**9.26%**	**Savings %**	**14.95%**	**Savings %**	**13.42%**

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Summary

- Self-funding is a great alternative for employers who want more control over their cash flow, benefit plan design and overall costs
- Employers with self-funded plans typically outsource the administration and other aspects of their plan
- Stop-loss insurance can help cap an employer's exposure to the financial risks

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Questions?

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