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Is Self-Insurance Right for You?

With the passage of the Affordable Care Act ("ACA") and rising insurance costs, many mid-market sized plan sponsors are exploring the switch from insured to self-insured medical plans. During this process, plan sponsors will need to evaluate their appetite for risk and to navigate, for the first time, the maze of terms and conditions within a medical stop-loss contract. Self-insurance is usually best suited for plan sponsors with the financial wherewithal to absorb variable claim payment streams.

Under a traditional insured medical plan, there is a true risk transfer. The plan sponsor pays a premium and in return, the insurance company assumes 100% of the risk. Under a self-insured plan, the plan sponsor assumes 100% of the risk. However, to mitigate this claims risk, plan sponsors usually purchase Stop-loss Insurance. This insurance can protect the plan sponsor from a catastrophic claim on an individual participant ("Individual or Specific Stop-Loss") or total claims in excess of the expected or budgeted amount ("Aggregate Stop-Loss"). While stop-loss insurance mitigates the plan sponsor's risk, it is not first dollar coverage (i.e., the insurance company only pays claims after the plan sponsor has absorbed a portion of the claim, i.e., the deductible). One leading Stop-Loss underwriter suggests setting the Individual Stop-Loss ("ISL") deductible at 5% to 15% of the group's total expected claims. Using this rule of thumb and assuming a $12,000 claim cost per employee, the chart below shows recommended ISL levels for groups in the middle market.

# of Covered Employees	Minimum ISL Deductible	Maximum ISL Deductible
100-149	$75,000	$150,000
150-199	100,000	200,000
200-249	125,000	250,000
250-499	150,000	300,000

Depending on one's appetite for risk, a plan sponsor can choose from the minimum ISL deductible shown (higher premium cost and greater risk transfer), maximum ISL deductible (lower premium cost and lesser risk transfer), or a level in between. With regard to Aggregate Stop-Loss ("ASL"), the most common deductible amount is 125% of expected claims. Thus, if expected claims were $2 million and actual claims came in at $3 million, the plan sponsor would pay the first $2.5 million (125% of $2 million) and the insurance company would pay the remaining $500,000.

Some of the advantages of self-insurance

- Potential for increased cash flow if actual claims are less than expected claims.
- The ability to hold the money associated with Incurred But Not Reported ("IBNR") claims. These reserves are held by the insurance company under an insured plan and can represent 15-20% of paid claims. For a group with $2 million in expected claims, switching to self-insurance can result in a cash flow advantage of $300,000 to $400,000 in the first year.
- Avoidance of state insured mandated benefits. In New Jersey, some experts have pegged the additional costs associated with mandated benefits at 4%-8% of premium. Of course, plan sponsors can continue with these benefits if they so desire.
- Lower expense levels since state premium taxes and ACA insurance company taxes are eliminated. This could result in a 5% cost reduction.
- Increased access to claims data since you will receive claims data every time you need to fund your claim account.

Some of the disadvantages of self-insurance

- The plan sponsor is taking on additional risk if claims exceed budgeted levels.
- A separate bank account is established to pay claims, usually on a weekly basis. Thus, there is additional administration.
- Under a self-insured plan, the plan sponsor now becomes the claims fiduciary under ERISA. There may be ways to mitigate this risk through paying an additional fee to your administrator.
- Stop-loss coverage which needs to be purchased is complex and could create gaps in coverage.

For plan sponsors who would like to "dip their toe" in the pool of self-insurance, there are various insurance companies in the marketplace that offer "level funding" products which offer some of the best aspects of traditional insurance with those of self-insurance.

If you have any questions about this article, please contact James DiOrio at Bankers Cooperative Group, Inc. (908)272-8500 x606 or jdiorio@bankerscoopgroup.com.

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