

Guide to Alternative Funding

SOLUTION TOOL

A growing number of U.S. employers are making the switch to alternative funding as a way to reduce costs and improve the benefits in their employee health plan. This Solution Tool describes alternative funding arrangements and defines the major components of each type to help you decide if alternative funding is a good option for your company's group health plan.

Traditional Health Plan Designs

Health Maintenance Organization (HMO)

An HMO plan covers services performed solely by providers in a network and generally requires a referral from a Primary Care Physician (PCP) for access to specialists. This tends to be a low cost system, but more restrictive than other plans.

Preferred Provider Organization (PPO)

A PPO has a network of discounted providers, but also allows the use of doctors outside of the plan's network. These plans are more flexible, with members being able to utilize specialists within the network without referral, but also tend to be more expensive.

Point of Service (POS)

A POS combines elements of an HMO and a PPO. Each time employees need health care, they can choose how it will be received. If an employee initially sees a PCP and stays in-network, then their cost will be less than if they choose to see a specialist on their own.

High Deductible Health Plan (HDHP)

A HDHP is PPO with, as its name describes, a high deductible. This results in a lower monthly premium, but on its own, also leaves the member with a significant financial risk. Many employers have paired HDHPs with tax-advantaged accounts to pay for medical expenses as a way to control costs and provide their employees flexibility.

California Rating Methodology

- **1 to 100 Employees** – Now considered Small Group, each member is given a rate based on their age and zip code. These rates are underwritten for the entire population of small employers and preapproved by the Department of Managed Health Care, so there is no broker negotiation.
- **101 to 250 Employees** – Generally considered Mid Market, these groups fall into a pooled underwriting arrangement where the insurance carrier focuses on analyzing the experience for the entire block of business to determine premiums. There may be some room for broker negotiation, but each carrier works differently.
- **250+ Employees** – Often referred to as Large Group, groups that have 250 or more employees in the *same plan* are rated on either a portion or all of their claims experience. There may be significant room for broker negotiation if the group is healthy.



Alternative Funding

Alternative funding refers to a group health plan in which the employer assumes **some** of the financial risk for providing health care benefits to its employees, instead of paying an insurance carrier to do so. According to federal statistics, alternatively funded plans cover 60% of the private sector workforce, including 17% of small companies and 56% of mid-sized companies. Types of Alternative Funding include:

Health Savings Account (HSA)

An HSA is a tax-exempt savings account, owned by an individual employee, for the purpose of paying for the qualified medical expenses not covered by the employee's health plan. Used in combination with a HDHP, an employer will provide a HDHP as a plan option, and then encourage its employees to set up an HSA to pay the expenses under the deductible. Both the employer and the employee may put money into this account, but once the money is deposited it becomes the employee's whether or not they continue to be employed by the employer.



Alternative Funding

HSA plans have grown in popularity because they offer significant tax benefits and potential health care cost savings to both employers and employees.

Health Reimbursement Arrangement (HRA)

HRAs are similar to HSAs in that they are accounts set up for the purpose of paying for qualifying medical expenses and they are generally offered in combination with a HDHP. The primary difference, however, is that it's an employer-funded and employer-owned account that is typically managed by a Third Party Administrator (TPA).

HRAs give employers a great deal of flexibility. You can require employees to pay a portion of the deductible along with a co-pay or co-insurance, or offer first dollar coverage not requiring any contribution by the employee. At the end of the plan year, any unused balance can be absorbed back into the employer group, often eliminating significant financial liability.

High deductible health plans coupled with an HRA or HSA are generally still considered fully insured health plans for state and federal tax and reporting purposes.

Level Funding

Level funding is a self-funded plan option where an employer pays 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.

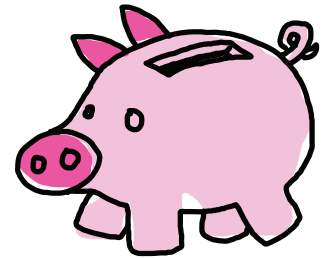
The advantage of level funding is that if your plan experience exceeds expectations, the carrier will provide an agreed upon level of reimbursement. Additionally, many level funding plans

provide detailed reporting on claims and utilization trends, giving you important information on where employees may be overspending and how well your organization will do under an ASO or self-funding arrangement.

Self-funding

An employer has a self-funded (or self-insured) group health plan if the employer assumes **some** of the financial risk associated with providing health care benefits to its employees. This is generally managed in one of two ways:

Administrative Services Only (ASO): An ASO arrangement is when an employer pays an administrative fee to a traditional insurer to use its Network, Claims Administration Services and Stop Loss Insurance. This is often a good first step into self-insurance because it simplifies the process for the employer.



Independent Providers: This arrangement is used when an employer has the resources to get more involved in the administration of their health plan and is looking to work with independent TPAs, Networks, and Stop Loss Carriers that grouped together, will provide benefits at the lowest cost.

Even in a self-funding arrangement, an employer is only taking on some of the financial risk of their health plan because a significant component of employer self-insurance is the purchase of outside Stop Loss Insurance:

Specific Stop Loss Insurance: Protects the employer when the claims incurred by any one individual exceed the specific liability limit. This amount is determined by actuarial recommendations and the company's risk tolerance.

Aggregate Stop Loss Insurance: Protects the employer when claims incurred by the entire group exceed the annual aggregate liability limit. This amount is typically set at a level not to exceed 125% of expected claims.

Advantages of Alternative Funding

The primary reasons employers cite for using alternative funding are **cost control** and **increased flexibility**. Carriers assess a risk charge for insured policies (approximately 2% annually), but alternative funding reduces or removes this charge altogether. Self-insured programs, unlike insured policies, are not subject to state premium taxes. The premium tax savings is about 2-3% of the premium dollar value.

Employers have much more flexibility if they are paying for the claims. Self-insured employers are free from state regulations that mandate coverage, as well as the carrier negotiation typically required with changes in insured coverage. By using alternative funding, employers are able to design their own customized health benefit packages.



Self-funding requires an employer to have on hand the financial resources to meet its obligations

Challenges with Alternative Funding

While the primary advantage of alternative funding is the potential cost savings, it also requires the assumption of **greater risk**. A year that brings large, unexpected medical claims requires the company to have on hand the financial resources to meet its obligations.

The other challenge that comes with alternative funding is the **increased employee communication** that may be necessary. These plans can often be designed so that employees are not even aware the employer is partially self-funding the plan's expense. But, for example, if you are implementing a plan that requires the use of a second debit card, this will require increased employee communication to ensure the plan is used correctly.

Timing

It's never too early to be looking at alternative funding options. Plans are available in the small group market that allow an employer to utilize a HDHP with an HSA or HRA, and should be looked at along with more traditional HMO and PPO plans on an annual basis. Level funded plans are available for employers as small as 25 employees. The attractiveness of these options really depends on the employer's location and the demographics of its employees.

For mid-size and large employers, some sort of alternative funding almost always makes sense, but its attractiveness will depend on each individual company's demographics, prior claims experience, tolerance for risk, financial and administrative resources, and interest in promoting wellness.

A Long-term Approach

Just about any organization can consider some form of alternative funding and these plans can be implemented at any time. Some organizations are immediately ready and others may want to take a more cautious approach by adopting a HDHP coupled with an HRA, or a level funded product, before moving into a self-funded ASO program.

Your evaluation of these programs and their fit in your organization will help determine the right program for you. The key is to work with a consultant that is experienced in the implementation and management of these plans. Now is a good time to meet with your consultant to discuss your organization's claims experience, tolerance for risk and resources. We can put together expected cost scenarios and discuss the various plan designs to help ensure you understand the potential changes to your health plan.

Filice Insurance welcomes the opportunity to partner with your organization to analyze your options and make recommendations for future success.



The key is to work with an experienced benefits consultant

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