Understanding ERISA Plans

(aka. Self-Funded or Partially Self-Funded Plans)

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Legalities

When a typical employer in America sponsors a health plan, that health plan is governed by a series of laws which apply to the design and administration of the health plan. Under most circumstances, either the plan is regulated by State insurance code (See McCarran Ferguson Act), or a Federal code known as ERISA. ERISA plans are commonly and mistakenly confused with the term "Self-Funded" and plans regulated by the states are commonly called Fully-Insured plans. Very few ERISA plans are truly "Self-Funded".

With State regulated plans (aka. Fully-Insured) the entire concept is rather simple and easy to understand. This type of business is called the "business of insurance". As the State Regulates the product design, the State mandates that the premiums are given directly to the insurance company. In exchange, the insurance company maintains its contractual obligation to the buyer. With "Fully-Insured" arrangements there is a direct relationship between the insurance company and the plan participants on whose behalf premiums are being paid and the State has regulative authority over that relationship. Among other things the state also mandates what a covered medical expense is, how the costs will be shared for that covered medical expense and the state retains the right to collect a "premium tax" in exchange for its oversight of the relationship and product design.

ERISA plans are largely exempt from State interference. ERISA plans can therefore work across state lines, deviate from state mandated benefit designs and avoid premium taxes and expensive regulatory oversight. But there is a catch, with ERISA plans (Self-Funded), the employer sponsors the health plan and takes on the risk directly. This doesn't represent a problem if a professional Third Party Administrator (TPA) is hired to perform the daily management duties of the plan. As one of the daily management duties of the plan, the TPA may help the employer obtain "stop-loss" reinsurance for its plan to stabilize the financing of the plan. Only the largest employers choose not to purchase stop-loss and therefore are truly "Self-Funded" in the sense that they purchase no stop-loss protection.

Finance

ERISA does not dictate how much of the financial risk associated with the health plan must be borne by the Employer Plan Sponsor. The employer may sponsor his plan under ERISA, therefore exempting itself from State regulation and still outsource the large majority financial risk to a stop-loss carrier. How much risk is borne by the employer can be discussed in a fact finding interview with a trained broker or TPA professional. Once the appropriate risk tolerance is determined, the TPA shops the available stop-loss markets for a reasonable arrangement and presents different financial options to the employer and broker.

ERISA vs. State Regulated Product Illustration

The attached sample document is designed to help illustrate how ERISA product design might be presented to an employer who is seeking to understand the difference between a Fully-Insured, State Regulated product and an ERISA plan with Stop-Loss reinsurance.

Reading across the top rows on the page you will see four different plan design options along with their annual expense allocations in the different columns. This scenario illustrates the State Regulated product on the top-row and three ERISA plan designs below.

The pie charts at the bottom of the page illustrate how the funding for the program is allocated on a monthly basis. For the State-Regulated product on the left (Fully-Insured), 100% of the resources are allocated as premium which will be given to the carrier. The pie chart on the right illustrates how cash is deposited into an Employee Benefit Plan Trust (special bank account) and for what purposes the employer will deposit the money. Notice, in the pie chart on the right, the monthly premium expense is significantly lower than in the Fully Insured plan on the left. Even though the premium amount is lower in the ERISA plan, it still serves exactly the same function as in the pie on the left. That function is to make sure that the account doesn't run out of money if actual costs exceed the allocations.

To the left and center of the page, there is an Expense Analysis of the previous 12 months claims experience as reported by the incumbent vendor. Historical utilization can be relied upon to predict future behavior. In this illustration, for the total 2006/2007 period, all claims have been divided into two categories, small dollar claims and large dollar claimants costs. Small dollar claims are those routine expenses which can be expected to maintain the health of any population. Small Dollar expenses vary based on the plan design (how the cost for medical services are avoided and or shifted to participants). Large Dollar claimant costs are less stable because it is difficult to predict what very expensive conditions will pop up within this population. As with any plan, expenses need to be allocated to cover the costs of both routine and non-routine large dollar claims costs.

The financial model in the center and to the right assumes that premium is a fixed cost, Plan management fees are a fixed cost and small dollar claims are a predictable and slightly variable cost (depending on how the plan design affects behavior). The premium paid in the ERISA plan covers two unexpected scenarios. It represents the cost of any claimant over the specific individual attachment point (specific deductible) of $45,000 in this scenario and it represents the unlikely event that all claims expense funding (both large dollar and small) are inadequate to cover the cost of the plan in any given month. In which case, premium is simply exchanged for a monetary advance to the account to cover expenses. In this financial model, if the group does not experience a large claimant in the upcoming year, assuming that small dollar claims costs are predictable, the group will save approximately $180k. If the group experiences multiple large claimants then an additional $50,000 (the responsibility of the plan) is added for each large claimant, until the worst case cost of the plan is met.

Conclusion

Health plan financing is not rocket science. It simply asks the question: “What is predictable and what is unpredictable?” Just like in Fully-Insured environments, unpredictable events are covered by premium. But in ERISA plans, predictable events should be budgeted for by the employer in the Employee Benefit Plan Trust and managed by a professional Third Party Administrator instead of simply given to the insurance company. Ultimately the term “Self-Funded” implies financial risk. However, the implied risk related to the term “Self-Funded” is not necessarily part of the equation because an employer can always exchange more premiums for a lower stop-loss deductible.

Under ERISA, an employer retains control over information, plan design ideas and suggestions. Ultimately a high value benefit plan design can be achieved at any price point.

Another important note is that in the fully-insured model the carrier earns profits basically by “buying medical services at a low price” from healthcare providers and “selling them for a high price to employers” and keeping the spread for its own profit. The States endorse this action because they collect more premium taxes on a larger premium pie and the vendors that they regulate are more stable if they are profitable. In the ERISA plan model the claims administrator does not get to keep any of the claims allocation and instead is incentivized with a flat per person per month Plan Management fee and the employer gets to keep any money saved in trust to offset future expense increases.

SAMPLE ERISA PLAN FINANCIALS

12 MONTH PLAN MODELING & COST COMPONENT COMPARISON WORKSHEET

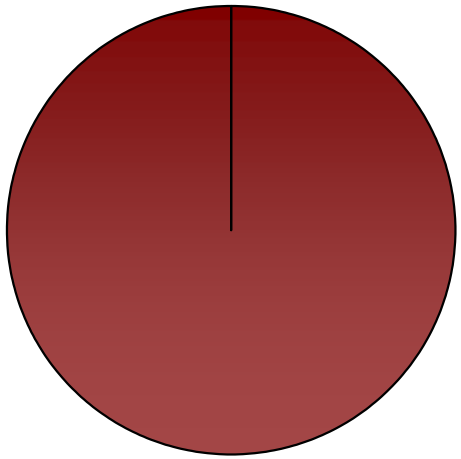
Plan Design Option	Plan Design	Premium	Plan Management	*Small Dollar Claims	Large Dollar Claim Funding	Cost with 1 large claimants	AnnualWorst Case Cost	12/15 Specific Contract
Fully Insured	Current Plan	$949,347	N/A	$405,615	$543,732	$949,347	$949,347	N/A
ERISA Plan Option 1	Current Plan	$171,170	$92,929	$405,615	$359,941	$719,714	$1,029,654	$29,099
ERISA Plan Option 2	$500 FMD 100/60	$171,170	$92,929	$377,222	$353,391	$691,321	$994,712	$29,099
ERISA Plan Option 3	$1,000 FMD 100/60	$171,170	$92,929	$356,941	$336,741	$671,040	$957,781	$29,099

Expense Analysis	
Plan Year	**2006/2007**
Total Claims in Previous Reporting Period	$552,516.00
Large Claimant Cost	$146,901.00
*Small Dollar Claims	$405,615.00
Total Medical & Rx Claims	**$405,615.00**

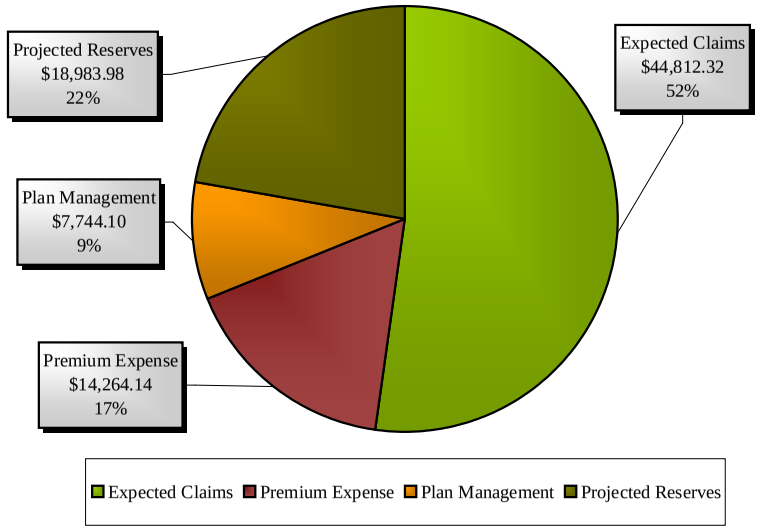
*Small Dollar claims are calculated using the total reported annual claims cost for a full 12 month period minus the total cost of the 3 large claimants who exceeded $20,000 in paid claims ($146,901).

Financial Model				
Plan Option	**Fully Insured**	**Current Plan**	**$500 FMD 100/60**	**$1,000 FMD 100/60**
Spec Level	N/A	$50,000	$50,000	$50,000
Premium	$949,347	$171,170	$171,170	$171,170
Plan Management	N/A	$92,929	$92,929	$92,929
*Small Dollar Claims	$405,615	$405,615	$377,222	$356,941
w/ no large claimants	$949,347	$669,714	$641,321	$621,040
w/ 1 large claimant	$949,347	$719,714	$691,321	$671,040
w/ 2 large claimants	$949,347	$769,714	$741,321	$721,040
w/ 3 large claimants	$949,347	$819,714	$791,321	$771,040
w/ 4 large claimants	$949,347	$869,714	$841,321	$821,040
w/ 5 large claimants	$949,347	$919,714	$891,321	$871,040
w/ 6 large claimants	$949,347	$969,714	$941,321	$921,040
w/ 7 large claimants	$949,347	$1,019,714	$991,321	$957,781
w/ 8 large claimants	$949,347	$1,029,654	$994,712	
w/ 9 large claimants	$949,347			
w/ 10 large claimants	$949,347			

Fully Insured - 100% Fixed Cost
$79,112 Monthly



Self-Funded - 26% Fixed Costs
Monthly Expected - $66,820
Monthly Worst Case - $85,804



This Illustration is for Comparison Purposes Only. The Data provided by the Current Carrier May or May Not be Accurate!