MERCER
Human Resource Consulting

Leon County

Funding Alternatives:

Self-Funding vs. Fully Insured Plans

MMC Marsh & McLennan Companies

Mercer HR Consulting
3031 N. Rocky Point Drive
Suite 700
Tampa, FL 33607
Telephone: (813) 207-5100
Fax: (813) 207-5190

Attachment # 12
Page 1 of 5

Executive Summary

Mercer is pleased to present a summary of the funding alternatives for group health plans, including the differences between fully insured and self-funded health plans, as well as some of the advantages and disadvantages of each funding arrangement, for discussion and consideration for the Leon County health plan in future plan years. .

Based on the *2004 Mercer National Survey of Employer Sponsored Health Plans*:

- 18% of all surveyed companies with 500 + employees self-funded their HMO plans;
- 10% of all Government Entities surveyed self-funded their HMOs; and
- 13% of all County Government Entities self-funded their HMOs.

In general, the advantages of self-funding include: a possible reduction in first year costs due to claims lag time, investment earnings generated from holding reserves, greater flexibility in plan design and the potential for reduced fixed costs due to the unbundling of administrative and risk bearing services. The potential disadvantages include an increase in employer liability (both financially and legally), additional administrative responsibility, greater exposure to claims *volatility and the possibility of "run-out" and ongoing claims after contract termination.*

Mercer was asked to take available 2003 and 2004 claims data, as well as average administrative and reinsurance costs for a group of Leon County's size and demographics, and estimate any potential savings or increased cost for a self-funded program vs. the current fully insured program. These assumptions only allow a retrospective analysis of a self-funded program, and would not guarantee similar results in subsequent years due to variances in large claims experience, trend, and other factors. Assuming an average monthly enrollment of 3,774 members throughout the year, Mercer estimates total 2004 self-insured costs would have been $10,839,766. Actual health insurance costs, as reported by Leon County, were $11,817,598. This yields a potential savings of $977,832, or 8.27%, retrospectively for 2004.

Attachment # 12
Page 2 of 5

It should be also be noted that because Leon County's 2006 renewal increase proposed by Capital Health Plan is flat, a self-funded program in 2005 or 2006 would likely not have produced the same level of savings, and may have actually cost the County more than the fully insured program. These expected higher costs for a self-funded program are based on factors such as medical trend, paid claims cost increases, and any migration into a different plan than the 2004 plan split. Finally, a self-funded program would utilize a leased PPO network, which not only impacts the claims costs due to lesser discounts (which have been accounted for), but also would create considerable disruption in the current provider network.

At Leon County's request, *Mercer also examined the issue of increased volatility of health related employer payments in* greater detail. For the time period January 1st, 2003 - December 31st, 2003, Leon County's average paid claims amount was $163.66 per member per month. For the time period January 1st, 2004 - December 31st, 2004, Leon County's average paid claims amount was $193.16 per member per month. Of the 24 months analyzed, there were 10 months in which Leon County's paid claims exceeded these averages, with 5 occurring in each year. The magnitude by which these higher claim months exceeded their respective annual averages ranged from 1.7% to 27.3%. This claims volatility, higher than average claims payments in 41% of the months, and increasing claims costs would have an impact on the rating of Leon County's costs each year at renewal regardless of the funding mechanism used.

In choosing a funding arrangement for your employee health plans, there are generally three alternatives: Fully-Insured (also called conventionally funded), minimum premium, and self-funded/self insured arrangements. Conventionally funded programs can be participating or non-participating. Non-participating arrangements do not have any surplus or deficit at year-end; the insurance company bears the entire risk.

Executive Summary
Continued

Participating arrangements allow the employer to recoup some of the premiums paid if there is a surplus at year-end. However a deficit situation may require additional payments from the employer at some point in the future. Minimum premium plans seek to maximize cash flow by "unbundling" the premium required and giving the employer flexibility on the timing of certain payments to the carrier. Under these types of funding arrangements, the employer's liability is limited to a pre-determined percentage of anticipated monthly or annual claims liability. Self funding or self insurance allows the insurance risk to be fully assumed by the employer. The extent of this risk may be limited by the purchase of stop-loss coverage.

Stop-loss coverage can be purchased at the individual level, in aggregate, or both. Individual stop-loss coverage provides the employer financial protection if any individual claimant exceeds a certain threshold. Aggregate stop-loss protection provides the employer financial protection if, in total, all claims exceed a certain threshold.

Although not a complete profile, below are some characteristics of firms that usually choose to self insure their benefit plans:

- Can accept volatility in claims, has the ability to withstand and fund potentially significant monthly variation in claims levels
- Reasonably smooth claim experience history
- Typically 500 employees or more
- Understands interrelationships and responsibilities among vendor contracts (TPA, Stop Loss Carrier, Case Management, etc.)
- Financial and Human Resources staff understand financial requirements, daily/weekly responsibilities and terminal reserve liabilities
- Higher Risk Tolerance – willing to accept more risk

Attachment # 12
Page 4 of 5

Executive Summary
Continued

Conversely, the characteristics of firms that typically do not find self insurance to be attractive would be an organization that:

- Is shrinking in employee population
- Historically, has experienced a combination of poor or deteriorating claim experience and large claims
- Does not have a firm grasp of historical claims
- Prefers budgeted cost over increased cash flow and employer-held reserves
- Prefers not to take on any additional claims risk
- Has an inability to easily fund significant monthly claim fluctuations
- Does not desire increased Fiduciary Liability
- Prefers not to have additional burden and responsibility of administration, maintenance and evaluation of self-funded plans

28

Attachment # 12
Page 5 of 5