Self-insurance and Small Business

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Some small businesses find it advantageous to provide health insurance coverage via self-insured plans rather than through the fully-insured market. Now, some state and federal policy-makers are moving to deny small businesses the self-insurance option by limiting the stop-loss insurance policies that make self-insured plans safe and viable.

A business that self-insures makes a conscious choice – to accept more risk in exchange for higher return. Businesses face tradeoffs between risk and return every day; that is the essence of owning a business. Government should not arbitrarily deny small business the right to self-insure while allowing big business to do so.

The proposed limits are motivated in part by a desire to ramp up usage of the insurance exchanges established under the Patient Protection and Affordable Care Act (PPACA). This effectively requires small business to serve PPACA, rather than the other way around.

According to a recent RAND study of businesses that offer insurance coverage, 8% of those with 3-49 employees self-insure, as do 20% of those with 50-199 employees. In 2010, PPACA's framers promised, "If you like the insurance you have, you can keep it." For that 8% and 20% representing hundreds of thousands of businesses and millions of employees, limits on self-insurance could break that promise.

SELF-INSURANCE DEFINED: With a self-insured plan (before adding in a stop-loss policy), the employer bears the financial risk of employees' healthcare. If employees collectively spend a great deal on healthcare, the business loses money – paying the bills out of its profits or savings. In the fully-insured market, a business purchases a policy from an insurance carrier (Blue Cross, Aetna, etc.), for a fixed premium. If some employee suffers, say, a $150,000 illness, the carrier, not the employer, foots the bill.

Few self-insured employers, however, can or wish to bear all of the financial risk from employees' healthcare. One or two catastrophically ill employees could potentially wipe out the health plan or even the business. That's where stop-loss insurance comes in.

STOP-LOSS INSURANCE DEFINED: Stop-loss insurance allows self-insured employers to modulate their risk; by using the policies intelligently, they can bear more risk than with a fully-insured policy, but less than with a purely self-insured plan. In this way, a stop-loss policy protects both the employer and the employees.

A stop-loss policy might, for example, limit the employer's liability to $20,000 for any individual employee and $100,000 for all of the business's employees combined; here, $20,000 is the policy's "attachment point" and $100,000 is the "aggregate attachment point." If an employee suffers a $500,000 illness, the employer only loses $20,000. If six employees suffer $500,000 illnesses, the employer only loses $100,000.

ADVANTAGES OF SELF-INSURANCE: With self-insurance, certain businesses save money in most years, losing money in the scattered years when some employees suffer major illnesses. For these businesses, self-insurance costs less over the long-run than do fully-insured products. So some, but not all, businesses will find it advantageous to self-insure.

Self-insurance also offers employers wider latitude in designing coverage. Under the federal law known as ERISA, self-insured plans are immune from costly state benefit mandates. Importantly, the option to self-insure offers employers an emergency exit in case the fully-insured market becomes problematic. Given the uncertainties surrounding PPACA, that is an important option.

PROPOSED RESTRICTIONS: Some state policymakers would like to prohibit small businesses from self-insuring. Oregon and New York already prohibit self-insurance outright for businesses with fewer than 50 employees.

In California, Amended Senate Bill 1431 would limit the sale of stop-loss insurance to businesses with fewer than 50 employees. Specifically, small employers could not purchase a stop-loss policy with an attachment point of less than $95,000 per individual and an aggregate attachment point of less than the greatest of (a) $19,000 x the number of covered employees and family members, (b) 125% of expected claims, or (c) $95,000. For some employers, this would effectively eliminate the self-insurance option; others might continue to self-insure, but also to carry considerably more risk than they currently have.

In Washington, D.C., it appears that the Administration is considering regulations that would similarly restrict the ability of small businesses across the nation to self-insure and to safeguard their plans by using stop-loss insurance.

QUESTIONABLE MOTIVATIONS: The policymakers seeking to limit stop-loss insurance and self-insured small-group plans worry that self-insurance will lead to segmented markets, higher rates of claims denials, and lighter benefit packages, but the evidence supporting these fears is weak. They worry, too, that self-insurance will weaken the SHOP exchanges, but this argument, once again, is speculative.. The federal government understands that these worries are overblown.

Proponents' fears about self-insurance do not hold up to scrutiny. The RAND study cited above challenges concerns that businesses with healthy employees will tend to self-insure, leaving a sicker, more expensive-to-treat employee base in the fully-insured market and, in particular, in the Small Business Health Options Program (SHOP) exchanges set to open in 2014. "Our results do not point to major differences in benefit generosity between self-insured and fully-insured plans or to a major threat of adverse selection in the small-group market after [PPACA] is fully implemented."

The RAND reports also dispute concerns that employees in self-insured plans may experience higher rates of claim denials or skimpier benefit packages: "Although data are limited, we found no evidence that claims denial rates are higher for self-insured firms." And even if one believed those charges, it raises the question of why self-insurance is fine for employees of large entities, but not of small businesses.

The federal government bulletin cited above includes wording that suggests how weak the argument against self-insurance is: "The Departments have little data on the incidence or terms of stop loss insurance among self-insured employers' group health plans." … "The limited available information suggests that stop loss insurance is perhaps becoming more common among smaller self-insured plans but information is not available on the type of stop loss coverage purchased by plans of various sizes." … etc. etc.

SUMMARY: The drive to limit small-group self-insurance is one of many examples of PPACA-inspired micromanagement of healthcare. This means more time and effort devoted to paper-shuffling and less time devoted to developing and growing businesses. A better solution in this case is for states and the federal government to allow markets to function properly. Let employers and employees determine what is too risky and what is not. If the government wishes employers to insure their employees through the SHOP exchanges, then make the SHOP exchanges attractive places to do business. That means well-functioning services, simple forms, competent administrators, well-designed websites, and telephones that don't go straight into voicemail; it also means adding attractive and innovative features like defined-contribution capabilities.