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Committee on Education and the Workforce
Subcommittee on Health, Employment, Labor, and Pensions

“Providing Access to Affordable, Flexible Health Plans Through Self-Insurance”

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Statement of
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Mr. Chairman, Ranking Member, and members of the Committee—thank you for the opportunity to testify today about the impact of the Affordable Care Act on self-insurance options, particularly for smaller businesses, and how the decision to self-insure can affect employees enrolled in those plans, as well as the broader health care market.

My testimony will focus on the following issues:

1. How the Affordable Care Act not only preserves flexibility for businesses that offer their employees health insurance through self-insured, or self-funded, arrangements, but also how the law gives American workers greater flexibility and autonomy over their health care decisions
2. The reasons why self-insurance is not a panacea—there are real risks for both employers who choose to self-insure and their employees
3. How a shift toward self-insurance in the small-group market can create problems for the employers and employees who remain in the fully insured market

Increased flexibility under the Affordable Care Act

The Affordable Care Act reformed much of the private insurance market to guarantee that all Americans have access to high-quality health insurance. But the law has a much smaller impact on employers that choose to self-insure—meaning the employer functions as an insurer and bears the risk of employees’ health care costs—as an alternative to purchasing health insurance coverage for their employees. The law exempts these plans from many of its key reforms.

This approach to the self-insured market took into account differences between the fully insured and self-insured markets prior to the Affordable Care Act. For example, the majority of currently self-funded large employers offer fairly comprehensive benefits, while benefits offered in the fully insured market prior to the Affordable Care Act were far less uniform and some were so minimal that they provided virtually no financial protection to enrollees. The essential health benefits and actuarial-value requirements fixed this problem in the individual and fully insured small-group markets but do not apply to self-insured plans.

This is just one example of how the Affordable Care Act’s treatment of self-insured plans reflects a compromise that largely preserved the self-insured market while making targeted

changes to protect employees, such as banning lifetime and annual limits and requiring dependent coverage and preventive care. As a result, employers wishing to self-fund still have significant flexibility to design their health benefits to fit the needs of their business and employees.

In any discussion of flexibility, affordability, and health care, we should also acknowledge how the Affordable Care Act offers American workers greater flexibility and autonomy over their health care decisions. The Affordable Care Act also provides security even to those people with employer-based insurance who might lose that coverage in the future.

Employees no longer need to be tied to a particular job because it is the only possible source of health insurance. For example, an individual with a pre-existing condition can now find affordable, comprehensive health care options beyond employer-sponsored insurance, which might allow that person to start a new business or return to school.

Self-insurance is not a panacea

Employers that self-insure gain a number of benefits. This approach gives them flexibility to tailor health care benefits to meet their employees' needs. There are also significant financial benefits: These plans can cost less than commercial insurance and give employers more control over health care expenditures. Employers pay for the cost of their employees' care instead of paying a set amount to an insurer, and if health care costs are low in a particular month, the employer—not the insurer—keeps the savings.¹

But in this model, employers assume the risk for employee health care costs that exceed employee contributions. For that reason, self-insured plans are far more common among large employers, especially those with at least 1,000 employees.² Their size gives these employers bargaining power in the health care market and allows them to adequately pool risk across their employees. These businesses also have sufficient financial resources to pay unpredictable, potentially costly claims.

Businesses have several ways to mitigate these risks, making self-insuring even more attractive. Most employers purchase private secondary insurance called stop-loss insurance. Stop-loss insurance protects employers from unpredictable or catastrophic claims by shifting responsibility for those costs from the employer to the stop-loss insurer.

Specific, or individual, stop-loss insurance protects an employer from a single, unusually high claim from any one employee, and aggregate stop-loss insurance limits the total amount the employer must pay each year for all employee health care claims. In both types, the point at which stop-loss coverage begins is called the attachment point. Lower attachment points minimize the employer's financial risk, and if they are particularly low, they start to blur the line between self-insured plans and self-funded plans entirely.³ Stop-loss issuers may also structure stop-loss policies to protect businesses' cash flow in the case of unpredictable claims.

Other common practices further ease the financial and administrative burdens on employers wishing to self-insure. Employers frequently contract with insurers that serve as third-party administrators, processing claims and handling other administrative services on behalf of self-insured employers. And self-funding arrangements between employers and third-party administrators also commonly include access to the insurer's provider network.⁴

Even with these mitigation strategies, self-funding can still be a risky option for smaller businesses that choose this approach.⁵ Because self-funding requires a number of complex components—often including complicated contracts, provider networks, benefit administrators, and management of financial reserves—even firms with stop-loss insurance must have significant resources and expertise to understand and manage the financial and legal complexities of the plan.

And when discussing the affordability of group health plans, we must consider not just the employers' costs but also the cost to employees.

If smaller businesses choose to self-insure to avoid complying with changes made by the Affordable Care Act, employees in these plans may find their coverage to be limited. Some employers—especially those with healthier employees—may choose to cut costs by offering fewer categories of benefits or structuring their benefits to pass along certain costs to their employees.

Sicker employees in self-funded plans may also face higher out-of-pocket costs and possibly employment discrimination because of a process known as *lasering*. *Lasering* allows stop-loss insurers to set higher attachment points for employees with costly pre-existing conditions or other health risks, which shifts liability for these employees' costs back to the employer and potentially to the employee.⁶ The Affordable Care Act explicitly prohibits such targeted discriminatory behavior, but that protection does not apply to this practice.

Problems for businesses and their employees that remain in the fully insured market

For many small businesses, the Affordable Care Act helps make coverage affordable. Millions of small-business employees have historically been uninsured, and those with coverage have often paid more out-of-pocket for their coverage.⁷ Unlike their larger counterparts, small businesses may not have enough employees to spread risk if the group includes sicker or older individuals. Small businesses that have a disproportionately older and less healthy workforce face even higher costs.⁸

The Affordable Care Act tackles these problems in different ways. First, the law prohibits many formerly common practices that priced older and sicker groups out of the health care market. Second, the law spreads risk among all small employers. Third, the law created small-business marketplaces.⁹

But if businesses with healthier employees decide to leave the fully ensured market en masse, these changes will not help businesses that remain in that market. And without a stronger regulatory framework for the self-insured market or limits on stop-loss insurance, this is a significant risk.

As long as a group of employees remains young and healthy, there are few incentives for employers to join the fully insured risk pool that includes older, less healthy individuals who increase the price of insurance premiums.

Once the group's health status declines, self-funding becomes far more risky and expensive. Stop-loss plans, for example, can raise premiums or refuse to renew coverage once a group

becomes less healthy or more expensive to cover. In this case, small employers could either drop coverage or return to the fully insured small-group market, adding its less healthy employees to that risk pool.

For small businesses, a single unexpected injury or illness can raise costs sharply for the employer and trigger the above response. But if that employee leaves or resolves the health issue, the firm may opt to self-fund again. Churning between the self- and fully funded markets would allow small businesses to capitalize on the fully funded and regulated market only when employer risk is high without otherwise participating in the risk pool. This adverse selection could, in turn, raise premiums in the fully funded small-group market.

One study has found that without further regulation of stop-loss policies, up to 60 percent of small businesses could self-fund, leaving mainly older, more costly employees in the fully funded small-group market. This could increase premiums in the small group market by up to 25 percent.¹⁰ These substantial premium increases could, in turn, deter other small businesses from offering health insurance or encourage them to drop the coverage they now offer, further driving up costs in the fully insured market. Anecdotal evidence from various news articles suggests that this shift toward self-insurance is already occurring.¹¹ A brief review of stop-loss policies that are marketed to small firms also indicated this shift.¹²

Ultimately, self-funding will likely lower costs for some employers who choose this path. But this trend will dramatically increase costs for other employers and their employees who remain in the insured market because self-funding is not a viable alternative. We must acknowledge this and other trade-offs as part of the discussion about self-funding and affordability. Oversight and regulation of stop-loss insurance, which is extremely limited today, will help stabilize the small-group market and protect both employers and employees.

Mr. Chairman, this concludes my testimony, and I am happy to answer any questions that members of the committee may have.

Endnotes

- ¹ Deborah Chollet, “Self-Insurance and Stop Loss for Small Employers” (Washington: Mathematica Policy Research, 2012), available at http://www.naic.org/documents/committees_b_erisa_120626_chollet_self_insurance.pdf; Self-Insurance Institute of America, Inc. “Self-Insured Group Health Plans,” available at <http://www.siaa.org/i4a/pages/Index.cfm?pageID=4546> (last accessed June 2013).
- ² The Kaiser Family, “Employer Health Benefits: 2012 Annual Survey” (2012), available at <http://ehbs.kff.org/pdf/2012/8345.pdf>.
- ³ Timothy Stoltzfus Jost and Mark A. Hall, “Self Insurance for Small Employers Under the Affordable Care Act: Federal and State Regulatory Options” (New York: NYU Annual Survey of American Law, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2070883.
- ⁴ Kevin Lucia, Christine Monahan, and Sabrina Corlette, “Cross-Cutting Issues: Factors Affecting Self-Funding by Small Employers: Views from the Market” (Washington: Urban Institute, 2013), available at <http://www.urban.org/UploadedPDF/412799-Factors-Affecting-Self-FundingbySmall-Employers.pdf>.
- ⁵ Ibid.; Mark A. Hall, “Regulating Stop-Loss Coverage May Be Needed To Deter Self-Insuring Small Employers From Undermining Market Reforms,” *Health Affairs* 31 (2) (2012): 316–323.
- ⁶ Dean M. Hoffman, “How Health Reform Could Change the Self-Funded Marketplace” (Washington: National Association of Health Underwriters, 2009), available at <http://www.nahu.org/meetings/capitol/2010/SelfFunding101%20the%20BasicsCapCon2010.pdf>; Lucia, Monahan, and Corlette, “Factors Affecting Self-Funding.”
- ⁷ The Kaiser Family, “Employer Health Benefits: 2011 Survey” (2011), available at <http://kff.org/health-costs/report/employer-health-benefits-annual-survey-archives/>.
- ⁸ Jost and Hall, “Self Insurance for Small Employers.”
- ⁹ *The Patient Protection and Affordable Care Act*, Public Law 111-148, 111th Cong., 2nd sess. (March 23, 2010).
- ¹⁰ Matthew Buettgens and Linda J. Blumberg, “Small Firm Self-Insurance Under the Affordable Care Act” (Washington: The Commonwealth Fund, 2012), available at http://www.commonwealthfund.org/~media/Files/Publications/Issue%20Brief/2012/Nov/1647_Buettgens_small_firm_self_insurance_under_ACA_ib.pdf.
- ¹¹ Christopher Weaver and Anna Wilde Mathews, “One Strategy for Health-Law Costs: Self Insure,” *Wall Street Journal*, May 28, 2013, available at <http://online.wsj.com/article/SB10001424127887323336104578503130037072460.html>; Sally Pipes, “U.S. Companies Engage in Financial Jiu-Jitsu To Get Around Obamacare,” *Forbes*, May 13, 2013, available at <http://www.forbes.com/sites/sallypipes/2013/05/13/u-s-companies-engage-in-financial-jiu-jitsu-to-get-around-obamacare/>; Robert Pear, “Some Employers Could Opt Out of Insurance Market, Raising Others’ Costs,” *The New York Times*, February 17, 2013, available at <http://www.nytimes.com/2013/02/18/us/allure-of-self-insurance-draws-concern-over-costs.html?pagewanted=all& r=0>.
- ¹² Mark A. Hall, “Stop-Loss Insurance with Low Attachment Points Marketed to Small Firms” (Winston-Salem, NC: Wake Forest University, 2012), available at <http://www.dol.gov/ebsa/pdf/StopLoss0032.pdf>.