Self-Funding and Small Groups

Moderator:
Elaine Corrough, FSA, FCA, MAAA

Presenter:
Joseph P. Slater, FSA, MAAA

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Webcast Overview

- Purpose of the Webcast
- The PACE Act
- Self-Funding Basics
- Self-Funding and Small Groups
- Level Funding Basics
- A Tale of Two Small Groups
- Pricing Comparisons (Illustrative)
- Level Funding Considerations
- Future of Small Groups and Self Funding
- Audience Questions

Purpose of the Webcast

- Discuss a product/funding method that can be used to retain (grow?) small group business starting in 2016
- Discussion focuses on business strategy as well as product specific illustrative pricing comparisons
- Webcast does not delve into all of the regulatory, tax, and legal ramifications of self-funding; therefore please consult with with your company's legal department when considering possible impacts
- The self-funding approach discussed is <u>not</u> new, but may become more popular due to the ACA's community rating rules

The PACE Act

- ***Breaking News***: On October 1st the Senate passed the Protecting Affordable Coverage for Employees or PACE Act
  - House passed it earlier
  - NYT quotes WH SPOX saying Obama will sign it
- The PACE act stops the ACA's Small Group definition expansion from 50 to 100 subscribers that was set to take effect January 1st 2016

The PACE Act

- The self-funding approach discussed in this webcast can be used by small groups under the current definition, i.e. less than 50 subscribers, but level funding may be a harder sell to those groups
- Bottom line: issues and principles discussed in webcast remain unchanged, however the PACE Act shrinks, but doesn't eliminate, the potential market for this type of product
- I will discuss the PACE Act again near the end of the presentation

Self-Funding Basics

- Self-Funding refers to a spectrum of funding methods in which the group bears the financial risk of its members’ health coverage rather than a third party
- Self-Funding can take multiple forms including ASO, ASO with Stop Loss, Minimum Premium Arrangements, etc.

Self-Funding Basics

- Advantages of Self-Funding:
  - Avoidance of Premium Taxes, State Mandates, and certain ACA Fees
  - The group benefits from favorable experience
  - The group avoids paying insurance company risk charges

Self-Funding Basics

- Disadvantages of Self-Funding:
  - Unpredictable (or less predictable) health plan cash flows
  - The group takes responsibility for unfavorable experience
  - The group must have (or hire) knowledgeable professionals to help navigate the legal, marketplace, and regulatory environments
  - Often requires purchase of Stop Loss Insurance

Self-Funding and Small Groups

- Self-Funding has typically been the domain of larger groups
  - Larger number of members mitigates cash flow and risk issues since claims costs are more predictable and consistent
  - Groups can afford to hire internal or external expertise to help manage their plan (economies of scale)
  - Groups can minimize (or even forgo) stop loss coverage

Self-Funding and Small Groups

- Historically, the Small Group Self-Funded market has been very small
  - Unpredictable cash flows and potentially poor experience are serious risks to smaller businesses
  - Small groups lack the expertise to manage a self-funded plan, and often the resources to pay for that expertise
  - Necessary to purchase potentially expensive Stop Loss coverage

Self-Funding and Small Groups

- The ACA makes self-funding attractive to a segment of the small group market
  - The ACA's strict community rating rules will lead to large premium increases for less costly small groups
  - Level Funding is a self-funding approach that could be used by small groups

Level Funding Basics

- Level funding is an ASO product with integrated stop loss
- Level funding payments are designed to be consistent month to month with a potential for a refund (typically a credit for future payments) based on the group’s experience
- For better risk small groups, level funding often produces premium equivalents that are lower than the group’s small group ACA premiums

Level Funding Basics

- Level funding costs are typically made up of three to five components:
  - ASO fees
  - Stop Loss Coverage
    - Specific
    - Aggregate
  - Claims Funds
    - Paid Claims fund
    - Reserve fund

Level Funding Basics

- Projected Claims Cost
  - Very important input into level funding cost projections
  - Used to develop three or four of the actual components (ASL, Paid Claims Fund, Reserve Fund, and sometimes the ASO Fee)
  - Risk rating is the key to successfully offering a level-funding product

Level Funding Basics

- ASO Fees
  - Covers administrative costs and broker commissions
  - Costs can be percentage of projected incurred claims or total level funding amount, or a flat PCPM or PMPM, or a combination
  - Can be source of profit in level funding premium equivalent

Level Funding Basics

- Specific Stop Loss
  - Covers the cost of individual claimants above a certain deductible (i.e., the SSL deductible or attachment point)
  - Typically priced using a rating manual
  - Specific Stop Loss cost is a function of the following:
    - SSL deductible and coverage period
    - Underlying medical and pharmacy plan design
    - Demographic and/or risk profile of the group
    - Member location
  - Subject to premium tax in many states
  - Can be a source of profit

Level Funding Basics

- Aggregate Stop Loss
  - – Covers the group's excess aggregate claims cost below the SSL deductible
  - – Stop Loss cost is a function of the following:
    - SSL deductible
    - ASL corridor and coverage period
    - Group size
    - Projected claims cost of group
  - – Subject to premium tax in many states
  - – Can be a source of profit

Level Funding Basics

- Paid Claims Fund
  – Product of ASL corridor and projected paid claims below SSL deductible
  – Pre-funds the group's maximum paid liability
    - Claims over this amount are covered by ASL
    - Puts the "Level" in Level Funding
  – Typically the largest component of a level funding premium equivalent payment
  – Portion of paid claims fund surplus typically refunded to group as a credit for following year's costs or settlement at termination (remaining is profit)

Level Funding Basics

- How Paid Claims Fund Surplus Works

	Scenario #1	Scenario #2	Scenario #3
Projected Paid Claims Cost PMPM Below SSL Ded	$136.22	$136.22	$136.22
ASL Corridor	120%	120%	120%
Paid Claims Fund Maximum Liability PMPM	$163.47	$163.47	$163.47
Actual Paid Claims Cost PMPM Below SSL Ded	$136.22	$177.09	$95.36
Actual Paid Claims Cost as a Percentage of Expected	100%	130%	70%
Actual Paid Claims Fund Surplus PMPM	$27.24	$0.00	$68.11

  – Expected surplus is (ASL Corridor – 100%) x paid claims below SSL deductible
  – If actual paid claims is less than 100% of expected, then groups benefits
  – If actual paid claims is more than ASL corridor, group is covered by ASL coverage
  – Carrier can retain some portion of Paid Claims Fund surplus as profit (in my experience 30-50%)

Level Funding Basics

- Reserve Fund
  - Component cost is the annual change in IBNR for the group
  - First year groups will have the largest Reserve Fund costs since no beginning IBNR
  - Carrier can keep fund's surplus at termination as profit, or refund to group
  - Time to refund surplus to group can be upwards of 15 months to allow for claims run-out

Level Funding Basics

- Advantages of Level Funding for Small Groups
  - Predictable (maximum) cash flows
  - Benefit from favorable experience
    - Lower health plan costs than ACA plan for better risk groups
  - Avoid some premium taxes and insurer risk margins, ACA insurer fee, and state mandates (if desired)
- Disadvantages of Level Funding for Small Groups
  - Not a good deal for more costly groups
  - More complex product than FI
  - Realizing full savings will take time

A Tale of Two Small Groups

- Live Well Graphics and Design:
  - Group Size:
    - 45 Subscribers
    - 81 Members
  - Average Age: 23.8 years
  - Industry: Commercial Art and Graphic Design
  - Took advantage of transitional relief and their state allows it until October 2016

A Tale of Two Small Groups

- Classic Cabs:
  - Group Size:
    - 45 Subscribers
    - 81 Members
  - Average Age: 44.6 years
  - Industry: Taxicab Company
  - Took “advantage” of transitional relief and their state allows it until October 2016

Pricing Comparison (Projected Incurred Claims Cost)

Living Well	2015	2016
Base Claims Cost Projection (Med+RX)	$280.00	$308.00
Average Demo Factor	0.824	0.824
Industry Factor	0.900	0.900
Area Factor	1.000	1.000
Risk Adjustment Factor	0.950	0.950
Projected Incurred Claims Cost (Fully Insured)	**$197.37**	**$217.11**
Projected Incurred Claims Cost (Level Funding)	**$193.43**	**$212.77**

- Carrier utilizes a rating manual to develop claims projections
- Risk adjustment factor developed using in-house proprietary risk scoring tool
- Living Well's projected claims cost reflects its favorable demographics, industry, and risk profile

Pricing Comparison (Projected Incurred Claims Cost)

Classic Cabs	2015	2016
Base Claims Cost Projection (Med+RX)	$280.00	$308.00
Average Demo Factor	1.893	1.893
Industry Factor	1.100	1.100
Area Factor	1.000	1.000
Risk Adjustment Factor	1.100	1.100
Projected Incurred Claims Cost (Fully Insured)	**$641.33**	**$705.47**
Projected Incurred Claims Cost (Level Funding)	**$628.51**	**$691.36**

- Carrier utilizes a rating manual to develop claims projections
- Risk adjustment factor developed using in-house proprietary risk scoring tool
- Classic Cab's projected claims cost reflects its unfavorable demographics, industry, and risk profile

Pricing Comparison (2016 SG ACA Premium)

	Live Well	Classic Cabs
Base Premium Rate (Med+RX)	$386.54	$386.54
Average Age Factor	0.955	1.652
Industry Factor	1.000	1.000
Area Factor	1.000	1.000
Risk Adjustment Factor	1.000	1.000
2016 SG ACA Premium	**$368.98**	**$638.55**

- SG ACA Rating Rules
  - Three-to-one age rating and area rating are the only allowable rating factors
  - No industry rating
  - No risk (i.e., UW judgment) adjustment
  - No experience rating

Pricing Comparison (Level Funding)

LF Component	Living Well	Classic Cabs	Difference
Projected Inc Clms	*$212.77*	*$691.36*	*$478.59*
ASO Fee	$44.38	$44.38	$0.00
Specific Stop Loss	$86.25	$163.28	$77.03
Aggregate Stop Loss	$14.63	$60.88	$46.26
Paid Claims Fund	$124.47	$528.89	$404.42
Reserve Fund	$19.15	$62.22	$43.07
ACA Fees	$2.45	$2.45	$0.00
2016 Total LF Amount	**$291.32**	**$862.10**	**$570.78**

- Level Funding amount based on risk-rated claims projection
- ACA Fees include Reinsurance and PCORI Fees
- Total level funding amount represents the ***maximum*** the group will pay on a PMPM basis
  - Excess actual claims are covered by Stop Loss coverage
  - Paid Claims Fund has a built-in expected surplus

Pricing Comparison (Living Well 2016)

	FI or LF Rate PMPM	2016 Rate Increase	2016 Rate Rank (Smallest to Largest)
2015 SG Pre-ACA FI	$262.10		
2016 SG Pre-ACA FI	$284.49	8.5%	1
2016 SG ACA FI	$368.98	40.8%	3
2016 Level Funding	$291.32	11.1%	2

- Since Living Well is a January 1st renewal in 2016, it is able to renew in 2016 as a Small Group under pre-ACA rating rules (i.e., transitional relief)
- If transitional relief not available (e.g., at the time of LW's 2017 renewal), Level Funding will probably offer the group the lowest monthly cost

Pricing Comparison (Classic Cabs 2016)

	FI or LF Rate PMPM	2016 Rate Increase	2016 Rate Rank (Smallest to Largest)
2015 SG Pre-ACA FI	$749.53		
2016 SG Pre-ACA FI	$821.05	9.5%	2
2016 SG ACA FI	$638.55	-14.8%	1
2016 Level Funding	$862.10	15.0%	3

- SG ACA premium rate is the lowest available to Classic Cabs (i.e., group benefits from ACA's community rating rules)

Carrier Level Funding Considerations

- Cannibalization of SG ACA Block
  - Carriers want better risk groups to be part of their SG ACA blocks
    - Better risk groups are very profitable to insurers under the ACA's rating rules (low Loss Ratios)
    - Moving better risk groups to a level funding product could lead to large increases in SG ACA rates for remaining groups
    - Insurance carriers will not want to offer level-funding to good risk groups that would choose an ACA product otherwise

Carrier Level Funding Considerations

- Cannibalization of SG ACA Block
  - So why sell Level Funding?
    - Groups will (eventually) make choices in their best interest
      - Better risk groups may leave ACA block for a competitor's LF or SG ACA product
    - What if other carriers sell a level-funding product and others do not?
      - Both sets of carriers will probably have worse performing (and potentially unprofitable) ACA blocks
      - Carriers that offer level-funding products should be able to be profitable with them

Carrier Level Funding Considerations

- Risk Rating Smaller Groups
  - Need to utilize small group Underwriting techniques
    - Medical Apps/UW
    - Risk Assessment tools
      - Predict future high claimants (prospective risk scores)
      - Research experience high claimants to determine "ongoing" large claims
  - Insurance carriers may need to invest in additional UW resources
  - Better risk groups may be more likely to share information if it will save them money
    - E.g., automatic "discounts" for groups that submit medical applications for all members

Carrier Level Funding Considerations

- Stop Loss Insurance
  - Choice of Specific SL deductibles and ASL corridors affects pricing and risk levels assumed by the carrier
  - A lower SSL deductible increases price of SSL, but also lowers the cost of ASL coverage and Paid Claims fund
  - Consider at what point is the group no longer really self-funded?
    - Need to model expected % of risk assumed by group and carrier.
    - Need to keep group's expected % of risk > 50%
  - NAIC model Stop Loss law, which has been adopted in many states, requires minimum SSL deductibles (e.g., $30,000 or $40,000) and ASL corridors (typically 120%).
    - ASL restrictions can be more nuanced, so talk to legal!

Carrier Level Funding Considerations

- Plan Designs Offered
  - Groups used to having a large range of plan design options will not be happy with narrow standard plan design portfolio
  - Excessive customization may lead to adverse selection (still an issue with maximum paid claims liability)
- Profit considerations
  - How much and in which components?
  - Profitability can be similar to pre-ACA Fully-Insured

Carrier Level Funding Considerations

- Target Group List
  - Rank groups by average “risk”
  - Develop LF and ACA premium comparison for each group
  - Offer LF quote to target groups alongside their ACA quote when TR ends
    - “Here’s your 50% rate increase”
    - “And here’s your Level Funding quote. What is Level Funding you say?”

Carrier Level Funding Considerations

- Need to market Self-Funding to groups that probably don’t understand it (yet)
  – Use target group list
  – Price comparisons will help, but product is much more complicated than being Fully Insured
  – Important to develop specific marketing approach and to train sales staff on the details of product
  – Develop self-funding and level funding FAQs to answer expected questions, i.e. be prepared!

Carrier Level Funding Considerations

- Making a group's transition from fully insured to self-funded as easy as possible
  - Interested groups would probably rather be fully-insured under pre-ACA rules
  - Develop reporting packages to keep groups up-to-date on their paid claims fund status
  - Plan designs offered should be consistent with pre-ACA offerings to the group
  - May want to include state assessments and relevant ACA fees in total Level Funding amount
    - Might be against company policy and/or state regulations
  - Prudent to design the groups' LF products as similar to their current FI product as possible

Future of Small Groups and Self Funding

- Real possibility that a significant percentage of small groups will be in a level funding product after 2016
  - Transitional relief is a better option for groups while available
  - Better risk groups in SG transitional block most likely to be interested
  - PACE Act removes a good number of potential groups
- How will regulators react?
  - Expand Stop Loss laws to make self-funding more risky for small groups?
  - Level funding defies the spirit of the ACA
  - Level funding could drive SG ACA premium increases upward
    - Remaining small groups in ACA pool more likely to be the riskier ones

Future of Small Groups and Self Funding

- How will the market react?
  - A large number of carriers either have a level funding product or are developing one
  - Anecdotal evidence shows level funding not popular yet, but in most states it is too early to tell
- Carriers should probably be prepared
  - Probably less important with passage of PACE Act, but incentives remain for better risk small groups to consider level funding

Questions?

Please remember to complete the webcast evaluation: