(from McEvilly Group seminar)

LEVEL FUNDING TO TRADITIONAL SELF FUNDING?

The concept of level funding as an alternative to fully insured group health insurance plans just makes perfect sense for employer plan sponsors to consider.

Rather than continuing to pay fully grossed up retail premiums for group health insurance a level funding approach allows a plan sponsor to participate in their own favorable claims experience, should that occur, while still having strong protection against adverse claims experience.

If level funding seems to be working well for a plan sponsor why would any consideration be given to adopting a traditional self funding arrangement with specific and aggregate stop loss? Actually there are several very good reasons.

1- **After one or two renewal cycles it usually becomes apparent to a plan sponsor that the fixed cost ingredient of their program is really quite expensive when compared with the fixed costs associated with a traditional self funded plan. This difference averages 15% to 20% and higher in many cases.**

2- **One of the main attractions of level funding to begin with is that a typical proposal usually reflects a maximum annual liability level which often compares reasonably well (the same or only slightly higher) with the fully insured renewal terms for that case yet still allowing an employer to participate in favorable claims experience should that occur. What could be better you might ask?**

3- **The answer is the fixed cost piece of that level funding proposal is seriously loaded up with a combination of internal pooling charges plus a substantial load to bring the maximum annual liability number down to where it might compare favorably with the fully insured renewal terms.**

4- **When a plan sponsor is presented with a traditional self funding quote they see fixed costs including claims admin fees; network fees; managed care vendor fees; possible pepm consulting fees and premium for specific and aggregate stop loss all broken out in detail. It is the sum of these costs that usually total 15% to 20% less than the fixed cost piece of a level funding quote which also includes all of the above referenced costs; looks a lot simpler but just more expensive.**

5- **The maximum annual liability number associated with a level funding proposal is often quite a bit lower than the sum of the fixed costs associated with traditional self**

funding plus the annual aggregate attachment point associated with that proposal. In the absence of further explanation and education the plan sponsor may reasonably try to decide if the lower MAXIMUM LIABILITY associated with level funding is more attractive than the lower FIXED COSTS associated with traditional self funding. This is a MISLEADING CHOICE for the following reasons.

a. **Without really understanding how traditional self funding and stop loss actually works the plan sponsor has NO IDEA that only the amount of any claim UP TO THE GROUP'S SPECIFIC DEDUCTIBLE can even count toward the aggregate attachment point for that group. As an example, a plan sponsor has a specific deductible of $40,000; if there were 3 claims totaling $200,000 each for a total of $600,000 only $120,000 (3X $40,000) would even count toward the annual aggregate attachment point. There would be 3 specific claims of $160,000 each, ($200,000 minus $40,000); the plan sponsor would fund a total of $120,000 for all 3 claims (not $600,000).**

b. **The above example reflects the justification for aggregate stop loss premium being so low. Underwriters usually set an attachment point based upon expected claims (only up to specific deductible amount) plus a corridor of 20% to 30%; the number of cases where aggregate claims actually reach or breach an aggregate attachment point is extremely low. Many groups which have been self funded for more than a few years will actually stop purchasing aggregate stop loss coverage.**

c. **This reasoning is why a plan sponsor, during the decision making process, should not focus heavily on maximum liability when evaluating a proposal for traditional self funding with stop loss.**

d. **THE PRIMARY FOCUS INSTEAD SHOULD BE ON SETTING A REASONABLE SPECIFIC DEDUCTIBLE for their risk and PUTTING THE PRIORITY ON COMPARING FIXED COSTS.**

In summary the concepts of both level funding and traditional self funding with stop loss are not exact sciences. Making the best decisions possible as to which concept and which proposals within those concepts are best suited for any one plan sponsor presupposes a real and thorough grasp of what they are and how they work by both the plan sponsors and their benefit advisors.