HPM INSTITUTE
HEALTHCARE PERFORMANCE MANAGEMENT

New Healthcare Realities for Small Employers:

Self-Insurance, HPM and ACA:

The Small Employer Challenge

August 2012

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Special Report

As if small employers don't have enough to worry about, soaring healthcare costs are an added burden to operating a small business.

"Across the country, small businesses are struggling in today's difficult economy as the cost of healthcare continues to skyrocket and millions of small employers see health insurance costs consume a greater share of their payroll," according to a new Health and Human Services (HHS) government report.[1]

The report states that a large fraction of small businesses are made up of an uninsured workforce. "Nearly one-third of the uninsured—13 million people—are employees of firms with less than 100 employees."[2] A separate government survey cited in the HHS report states that about a third of uninsured workers in firms with fewer than 50 employees obtain health insurance through a spouse.[3]

Cost Is the Problem

The erosion of health coverage among small businesses is largely driven by cost. One national survey cited in the HHS report, notes that nearly three-quarters of small businesses that did not offer health benefits named high premiums as the reason.[4]

Despite the new health reform law, higher health premiums will impact small employers more significantly than large employers. Studies show that small employers pay 18 percent more for health insurance coverage than larger firms, curbing a small firm's ability to invest and grow.[5] Pricewaterhouse Coopers reports that the cost of U.S. healthcare services is expected to rise 7.5 percent in 2013, more than three times the expected rate of inflation and economic growth.[6] Exacerbating the cost issue, a recent Congressional Budget Office (CBO) study found that small businesses pay significantly more on average for insurance administrative services such as marketing, enrollment and premium collection.[7]

In the past two years, more than half of small businesses with health coverage reported switching to insurance plans with higher out-of-pocket employee costs in response to higher premiums. Another third switched to a plan that covered fewer services and 12 percent dropped coverage entirely, according to the Main Street Alliance, an association of small employers.[8]

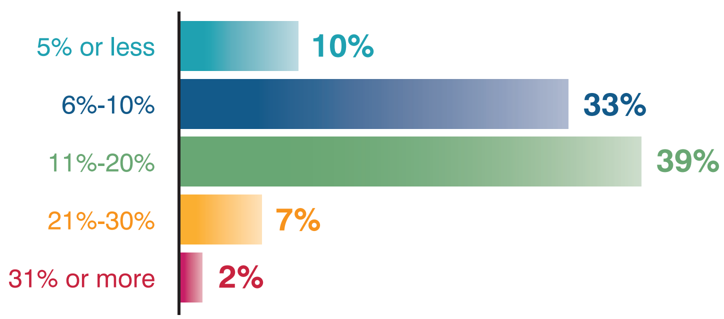
"Nevertheless, many small employers increasingly believe that offering health benefits helps with employee recruitment and retention, increases productivity and is 'the right thing to do,'" according to the Employee Benefit Research Institute (EBRI), a non-partisan research organization.[9]

In the search for solutions, small employers increasingly have been attracted to data-driven technology to control health costs and more effectively manage their health plans. Referred to as Healthcare Performance Management (HPM), this technology is helping employers of all sizes—even small employers—to control health costs.

This Special Report examines new trends in the healthcare marketplace and the factors prompting small employers to employ tested software programs to establish and manage their health plans. With help from brokers and providers, even

Four in Ten Agents Expect Premium Increases Between 11% and 20% in 2012

Based on what you've heard from carriers in the [individual/small group] market, what do you expect the typical percentage point premium increase for health insurance to be in 2012?



Source: Kaiser Family Foundation *Survey of Health Insurance Agents* (conducted February 15-March 8, 2012)

1 Health Reform and Small Business, July 2012. http://www.Healthcare.gov

2 Current U.S. Population Survey, March 2008.

3 Center for Financing, Access and Cost Trends, Agency for Healthcare Research and Quality, Medical Expenditure Panel Survey 2006.

4 Holve E, Brodie M, Levitt L. Small business executives and health insurance: Findings from a national survey of very small firms. Managed Care Interface 2003; 16 (9): 19-24.

5 Gabel J, McDevitt R.et al. The Commonwealth Fund, Benefits and premiums in job based insurance, May 2006.

6 Pricewaterhouse Coopers. Medical Cost Trends, Behind the Numbers 2013. May 2012. http://www.pwc.com/us/MedicalCostTrends

7 Congressional Budget Office. CBO's Health Insurance Simulation Model: A Technical Description, Oct. 2007. http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/87xx/doc8712/10-31-healthinsurmodel.pdf

8 The Main Street Alliance. Taking the Pulse of Main Street: Small Business, Health Insurance and Priorities for Reform. January 2005. http://www.mainstreetalliance.org/wp.content/uploads/2009_01_15—Taking the Pulse of Main.street.pdf

9 Fronstin P, Helman R, Greenwald M. Small employers and health benefits survey: Findings from the 2002 small employer health benefits survey. EBRI Issue Brief. Jan. 2003; 253:1-21

small employers can utilize cost-efficient cloud-based technology and Web-based software tools, including analytics, predictive modeling and computer dashboards to identify what is driving their costs and how to better manage their plans.

Also discussed is how self-insurance, combined with HPM, can work to make a difference in more effective plan management.

The Report also describes how the four pillars of HPM described below, combined with self-insurance, empower organizations not only to more efficiently manage their risk and compliance exposures, but also to deliver bottom-line business value to a company. By applying the HPM business discipline, employers of all sizes—including small employers—can improve plan performance and reduce healthcare costs while improving employee health outcomes.

Small Employers and Self-Insurance

Since the advent of self-insurance in 1974, today more than 77 million of workers and their dependents receive their health benefits through a self-insured plan.[10]

These figures are heavily skewed towards larger employers, with only 16 percent of workers in small firms (3 to 199 employees) covered by self-insured plans in 2010. Despite the low penetration, small firms represent the fastest growing segment of self-funded plans (up from 10 percent of workers in self-funded plans in 2003) as they choose self-insurance as a cost-effective alternative to ever-rising commercial health insurance premiums.[11]

As more Affordable Care Act (ACA) provisions become effective, a growing number of small employers are expected to find it advantageous to choose self-insurance due to substantial changes in the small group market. Small employers looking ahead to 2014—when the state insurance exchanges will be in place—need to decide whether to continue health coverage or scrap their plans and pay the $2,000 per employee penalty. They will need to weigh not only the impact on their bottom line, but also determine "what is the right thing to do for employees." There is no clear answer as this will be a business-by-business decision.

Employers in this smaller size range, who choose to continue health plan coverage, will need to select the funding method—insurance or self-insurance—that does the most to lower their health costs and improve employee healthcare quality. The other option—coverage in state health insurance exchanges—is expected to benefit from negotiated prices with insurers, but will be subject to costly new HHS-regulated "essential benefits" mandates and other requirements.

Some insurers have announced they will not participate in the exchanges but will offer their products only outside the exchanges. Many employers not eligible for coverage in exchanges, mainly due to size, can be expected to continue funding health benefits outside the exchanges through commercially insured plans. However, these plans will be subject to the same mandated state benefits, premium taxes, rating restrictions and other costly requirements that have resulted in soaring premiums.

"With the help of qualified professional service providers such as underwriters, accountants or TPAs, employers can be evaluated objectively to determine whether they are viable candidates for self-insurance. The most important consideration is whether employers have sufficient positive cash flow in order to pay incurred claims," said Michael Ferguson, chief operating officer of the Self Insurance Institute of America (SIIA). Employers should also recognize that self-insurance is a long-term risk management strategy that requires ongoing proactive involvement by plan sponsors to consistently achieve the twin objectives of controlling costs while providing quality benefits.

10 KFF/HRET. Employer Health Benefits: 2010 Annual Survey. http://ahbs.kff.org/pdf/2010/8085.pdf

11 KFF/HRET 2011, Survey of Employer Sponsored Health Benefits 1999-2011.

While commentators have stated that small employers who self-insure do so to avoid state regulation, according to a new RAND report, overall the literature does not show a strong correlation between state regulatory requirements and self-insurance, suggesting that adverse selection due to a self-insured firm's ability to avoid state regulation may be of limited concern.[12]

The Self-Insurance Advantage

In the post-ACA world, small employers who choose to self-insure health benefits for their employees will do so for the same reasons larger employers self-insure. According to SIIA, the key reasons employers choose this approach are:

- The ability to customize health plan benefits to the specific needs of the workforce
- Employer control over the health plan and its reserves
- Better cash flow because coverage does not have to be prepaid
- Exemption from often conflicting and costly state benefit mandates
- Exemption from state insurance premium taxes (usually 2 or 3 percent of premium dollar value)
- Freedom to contract with any provider or provider network
- Option to administer claims in-house or contract with a TPA
- Purchasing stop-loss insurance to protect the plan sponsor from catastrophic claims

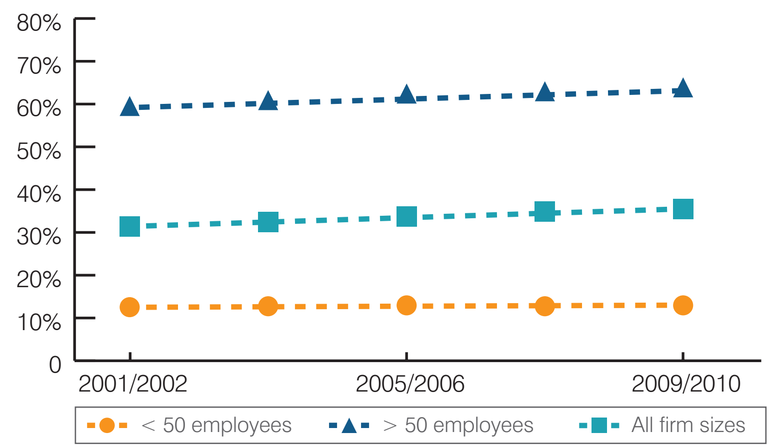
"While self-insurance may not be a viable option for many smaller employers because their balance sheets are not strong enough or due to workforce instability, an increasing number of smaller employers are operating successful self-insured group health plans," said SIIA's Michael Ferguson in recent testimony before the California legislature. "These plans provide cost containment advantages, and they are often customized to meet the specific needs of plan participants."

Because self-insurance is regulated under the federal Employee Retirement Income Security Act (ERISA), self-insuring firms with employees in multiple states can offer uniform benefits to workers across state lines. Furthermore, costs are based on the employer's own claims experience and are not pooled with others, as they might be for smaller firms purchasing fully insured plans in the commercial market. While smaller firms with a younger workforce may find self-insurance advantageous, national studies report that the demographics of self-insured plans mirror the composition of larger firms.

"Increasing medical costs and willingness to assume more risk are driving many employers, including small employers, to shift to self-insured health plans," according to Sheri Sellmeyer,

Trends in Self-Insurance, by Firm Size in U.S.

Among employers that offer health insurance, percentage with a self-insured plan:



Source: Agency for Healthcare Research and Quality, Medical Expenditure Panel Survey-Insurance Component tables, as analyzed by SHADAC

[12] RAND Technical Report. Employer Self Insurance Decisions and the Implications of the PPACA. p.46, 2011 Report to U.S. Department of Labor. http://www.rand.org/health

vice president of analysis for HealthLeaders InterStudy, a leading provider of healthcare market intelligence.

"We've just finished our first year on a self-funded plan backed by stop-loss insurance, and we've saved over $600,000 in the first year by being self-funded," said Tad Roane, chief financial officer of Crescent Directional Drilling, a small employer in Houston, Texas.

ACA sets forth new federal standards and mandates applicable to fully insured as well as self-insured plans. However, self-insured plans are exempted from some ACA reforms that apply specifically to insurers such as medical loss ratio (MLR) standards, rating restriction rules and insurer fees.

HPM and Small Employers

The four pillars of HPM combined with self-insurance that empower small employers to take control of their plans and reduce costs include: Measure, Manage, Engage and Automate.

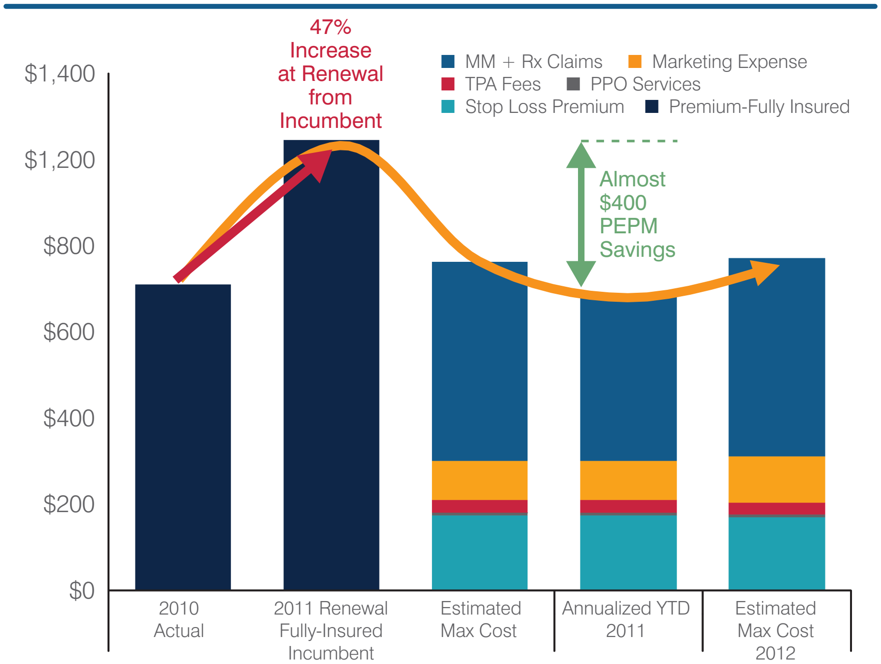
Measure—*Data driven analytics and predictive modeling allow organizations to measure risk and assess the health profile of a plan population and better understand the key risk and cost drivers.*

Under ACA, a small employer who self-funds is able to quickly gain more control over costs associated with employee health benefits. Working with their professional advisors, employers who don't know much about the health of their workforce—and what is driving costs—now can utilize innovative technology, including analytics, metrics and predictive modeling, to help employees make healthy lifestyle choices and reduce healthcare costs.

Self-funded employers can access their own plan's clinical and prescription claims data without an insurance company standing in the way. Working with professional advisors, employers can leverage HIPAA-compliant claims data that unveils a real-time snapshot of plan health risk. They are able to gain insight into potential costly catastrophic conditions in the workforce before high-cost claims are filed. With this information, employers can adopt actionable plan design changes and employee outreach prevention campaigns to mitigate risk.

"As a leader in data-driven health management solutions for small and mid-size plans, New York-based WellNet Health Plans (WHP) has been instrumental in helping my small employer clients better manage and control health costs," said Jerel Levenson, a broker at CG Benefits Group in Manalpan, New Jersey. "Utilizing a unique cloud-based technology, a firm such as WellNet Health Plans works closely with small firms to identify potential expensive health trends in advance and implement tailored care management campaigns that are working with my clients to control costs."

Sample Self-Funded Group PEPM Cost Analysis



The sample case in the figure above shows how small employers can break free from the double-digit price increases of the fully insured market to implement more cost effective, transparent and flexible self-funded plans.

Based on advanced technology and data analytics, many of the high-cost, high-risk chronic conditions of an employee population are predictable and preventable, regardless of employer size. Software can be applied to analyze plan claims data, including Rx, medical claims and lab data, to proactively identify chronic conditions such as diabetes, cardiovascular risks and other health risks before they occur. Self-reported health assessment and biometric screening data are additional sources of information that assist in identifying population risk.

Relying on high-speed tools, plan sponsors can use a desktop computer dashboard to unveil a real-time snapshot of workforce demographics and the population health risk profile. By gaining an overview of healthcare trends and utilization patterns, plan sponsors are better able to adopt proactive strategies that can improve plan performance.

Manage—*Powerful analytics technology provides guidance for designing and managing actionable health and wellness strategies and campaigns that improve employee health outcomes, enhance their quality of life and reduce costs.*

A significant aspect of HPM is the integration of data, workflow and best practices to target care, lifestyle and disease management issues in advance. In a 2012 survey sponsored by Pitney Bowes and conducted by IDC Health Insights, health plans reported investing in technologies and practices to create actionable campaigns that focus on opportunities for improved outcomes, health and costs. This approach can uncover the real drivers of high health costs and the beneficial opportunities for integrated care management.

The goal is to manage employee health through prevention-focused health coaching. Population healthcare management including highly interactive, risk-specific health improvement programs, including preventative care, health coaching, wellness and disease management, are critical components of this HPM pillar.

Concierge-like member relationship campaigns include mobile, text, e-mail, member engagement and decision support software tools. "Availability of medical and Rx drug claims data provides information that helps customize care management and wellness programs to specific conditions," says Gary Baker, a broker at Gary Baker Group working with small groups in southeastern Pennsylvania.

Plan data translated into targeted wellness initiatives can help manage employee health risk, particularly when combined with incentives that encourage employee engagement in their own health. According to national consulting firm Milliman Inc., new lifestyle-based data sets and predictive modeling techniques are proving highly effective while lifestyle analytics speed up the identification and reliability of disease prediction.[13] Through current disease and care management techniques, earlier detection and action results in significant savings.

Engage—*Backed with corporate endorsement, targeted risk-specific personalized outreach and healthcare management campaigns can be introduced within a health plan to foster employee engagement and emphasize healthy lifestyles.*

HPM tools enable plan sponsors to intervene with employees before major health events occur. Campaigns featuring incentives and tested risk-specific engagement programs that manage health and lifestyle conditions are offered to employees on a voluntary basis. For example, if heart-related medical and Rx claims are a growing expense item, wellness programs could include blood pressure and cholesterol screenings as well as educational activities aimed at lowering blood pressure and total cholesterol.

With direction by health coaches who engage employees in "high touch" wellness programs and activities, the HPM discipline produces above average participation and results in healthier employees as well as reductions in healthcare costs. "One small employer client previously experiencing annual increases of 15 to 20 percent, after more than a year, was able not only to hold the line on costs, but also showed a substantial surplus," said Baker.

[13] Milliman, Inc. "Lifestyle-Based Analytics Effective in Risk Selection, Feb.11, 2008.

In one study, the use of a $100 financial incentive for health assessment completion achieved an 86 percent response rate. In contrast, within the same group, the request to complete a health assessment without an incentive produced a 10 percent response rate. In another example, the use of a $50 incentive for completion of an online health coaching program produced a 30 percent response, while response rates without the incentives produced a response of less than 3 percent, thus showing that incentives can drive high-level employee engagement in wellness and lifestyle behavior change programs.

Automate—*A cloud-based healthcare technology infrastructure and applications platform allows for unified data integration and management across disparate data silos that foster the institutionalizing of care management and healthy corporate lifestyle strategies.*

While health plan data is sent across corporate data silos—unmanaged, unfocused and frequently uncoordinated—this pillar facilitates an operational dashboard that connects all internal functions and teams on a single, secure HIPAA-compliant platform.

Cloud-based computing allows on-demand network access to a shared pool of technology resources such as networks, servers and storage, as well as a suite of applications and services developed for the healthcare industry. With cloud computing, these resources can be accessed by small employer plans with minimal management effort and can help reduce the health cost curve while improving health outcomes.

Conclusion

In the post-ACA world, escalating costs will represent one of the most predictable outcomes of health reform for small employers. As small firms face higher costs and expanded legal requirements, many will turn to alternative risk transfer funding methods such as self-insurance to better manage their health plans and control costs.

While embraced by larger firms for years, self-insurance is becoming an increasingly popular option for many mid-sized and small employers as well. In the new healthcare marketplace, these employers can be expected to adopt technology such as HPM that empowers them to take greater control of their plans and reduce costs.

Whether for financially qualified small employers considering self-funding as an alternative to fully insured coverage—or for employers with self-funded plans already in place—self-insurance is emerging as a viable solution to rising healthcare costs.

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About the HPM Institute

The Healthcare Performance Management Institute (HPM Institute) is a research and education organization dedicated to promoting the use of business technology and management principles that deliver better and more cost-effective healthcare benefits for employers who cover their employees.

The Institute's mission is to introduce and develop a new corporate discipline called Healthcare Performance Management (HPM)—a technology-enabled business strategy that tackles the challenge of controlling healthcare cost and quality in much the same way that enterprises have optimized customer relations, supply chain management and enterprise resource management. Supported by its four key pillars—Measure, Manage, Engage and Automate—HPM provides organizations with visibility and control over their healthcare benefits spending trends and risk management postures, while protecting individual employee privacy.

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