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Health Plan Funding Considerations for Small and Mid-Sized Businesses

While the rising cost of health care and a tight labor market put additional pressure on employers when selecting health benefits, there are many funding strategies an employer can choose from, including new options that can save money while maintaining high-quality coverage for employees. Business owners with a clear understanding of their needs and risk appetite may benefit from alternative funding options on the market today.

Health Plan Funding Options

Employee range[1]	Fully Insured	ICHRA[2]	PEO[3]	Captive	Level Funded	Self-Funded
2-50	✓	✓	✓			
50-100	✓	✓		✓		
100-200	✓	✓		✓	✓	
200+	✓	✓		✓	✓	✓

1 A variety of factors contribute to the best funding option for an employer. For example in some cases, smaller employers may choose to be self-funded or level funded.

2 Individual Coverage Health Reimbursement Arrangement

3 Professional Employer Organization

4 Small businesses with 50 or fewer employees can also purchase their benefits directly from a state or federal small business health benefits exchange, known as a Small Business Health Options Program (or SHOP).

Preparing for an upcoming meeting with your broker?
Read our paper: **5 Questions to Ask A Broker and One to Ask Your Company.**

Some health plan funding options are best suited to certain types of employers, and some carry greater risk in the event of unexpected high claims, so doing your research and engaging with your broker if you have one is important before transitioning to a new benefit design. As a first step, consider how various factors will impact your decision-making. These factors include:

Cost

The total annual cost of the benefit plan. Employers usually cover the majority of the cost, but through plan design and employee contribution strategies, employers can determine how much of the total cost for which their employees are responsible.

Financial Risk

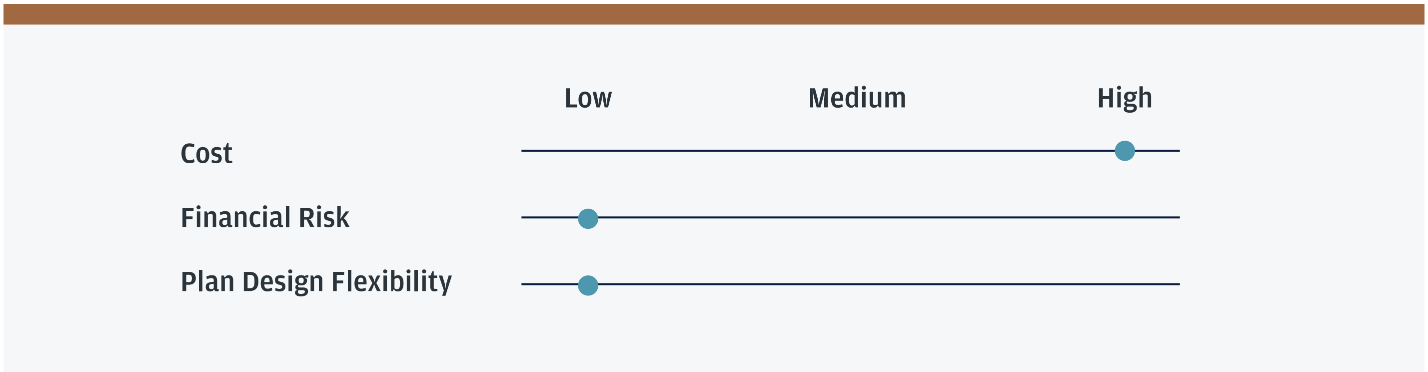
The total exposure of the business for covering unexpected major claims costs. Smaller employers typically outsource this risk to insurers, however large employers often take ownership of this risk because their size mitigates the impact of a few larger claims.

Plan Design Flexibility

Some funding options limit the products and plan design options for employers. If it is important to have benefits customized for your business needs, you may need to consider the plan funding options that allow for this. Doing so may also allow you to deliver a better employee experience, especially if you can tailor benefits to meet their unique needs.

Fully Insured

Fully insured plans offer risk protection for employers because health insurance carriers set annual premiums for employers and manage the total risk for annual health care claims cost on behalf of the company and their employees. These plans typically have the highest premiums for employers but are the predominant funding type for smaller employers.



Advantages:

• Risk mitigation: These plans offer the most protection for employers from the impact of unexpected and high-cost insurance claims. Employers will pay only the set monthly premium.

• Low administrative burden: The insurer manages all aspects of plan administration, including network design, claims administration, and any navigational functions.

Drawbacks:

• Cost: Typically, this is the most expensive funding option due to insurer pricing, mandated benefits, and regulations and taxes.

• Limited customization: Employers have limited opportunity to customize benefits as insurers offer standardized plan design.

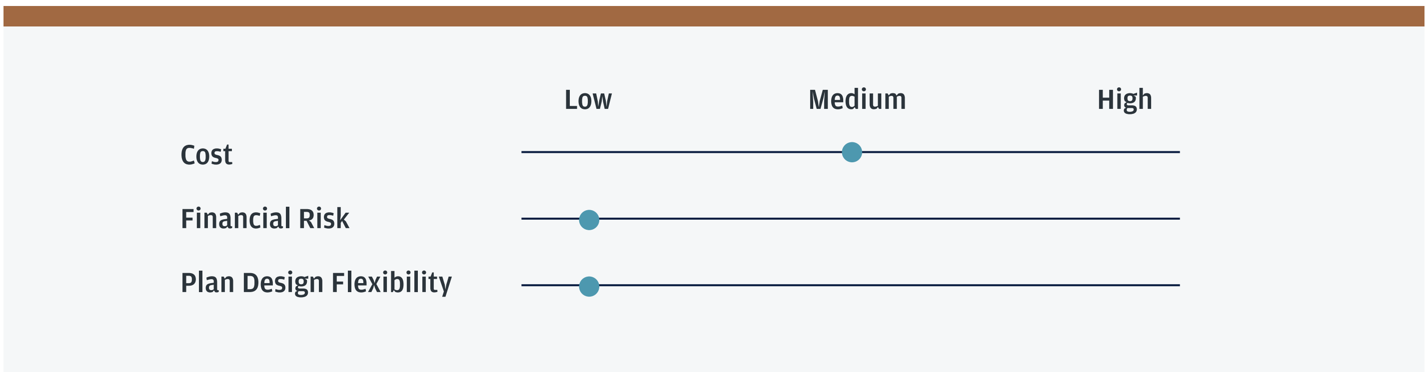
Considerations:

• Premiums factor in group demographics and health care claims experience for larger employers, however small employers are often priced using community rating, which incorporates the expected costs of all small employer groups in a region without considering the employers' specific health care cost experience.

• Best for: Employers between 2-500 employees, with a low risk appetite or cash flow challenges.

Professional Employer Organization (PEO)

A PEO acts as a "co-employer," outsourcing critical human resource (HR) functions such as payroll and benefits. PEOs work specifically with small employers, acting as a third party on their behalf. In these arrangements, the PEO will process payrolls, administer employee benefits and provide support for other HR functions such as compliance, talent management, and workers' compensation. By outsourcing these functions, small employers can focus on running their business.



Advantages:

• Administrative efficiency: PEOs offload the administrative burden of benefits administration, allowing small businesses to focus on core business functions.

• Cost savings: PEOs co-employ multiple businesses and use their scale to unlock more affordable benefits than small businesses would be likely to procure on their own.

Drawbacks:

• Less decision-making authority: The PEO makes decisions about benefit plan design on behalf of their member employers.

Considerations:

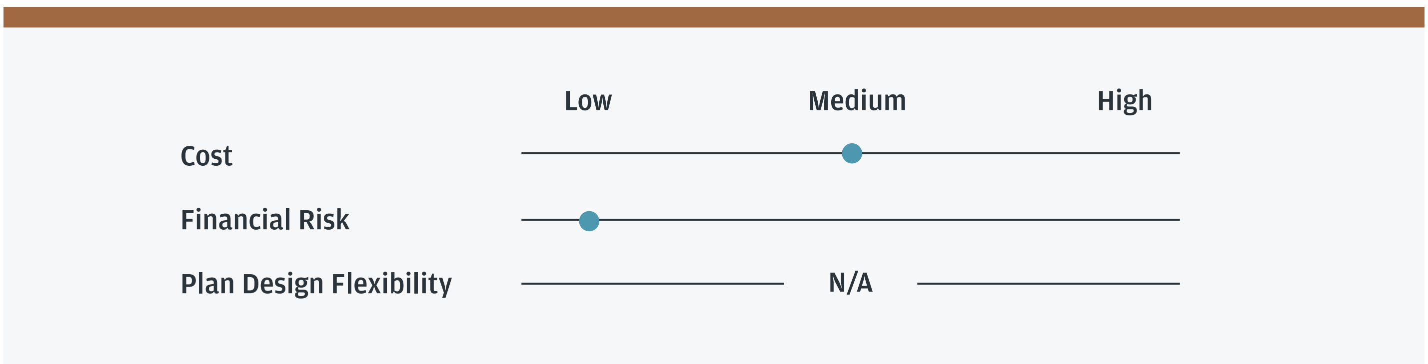
• Employees will see the name of the PEO, not their employer, on their paycheck.

• Best for: Employers with under 50 employees that are comfortable outsourcing HR functions in return for administrative efficiency and lower costs.

Individual Coverage Health Reimbursement Arrangement (ICHRA) & Qualified Small Employer Health Reimbursement Arrangement (QSEHRA)

ICHRAs were introduced in 2020 to allow employers to contribute tax-free dollars to their employees to purchase health benefits on the Individual Marketplace. Unlike traditional group insurance, where employers select health plans on behalf of their employees, ICHRAs function as a defined contribution from employer to employee, enabling employees to select from a choice of plans and benefit designs that meet their individual needs.

Employers with fewer than 50 full-time employees can offer a QSEHRA, which functions like an ICHRA but with greater restrictions on eligibility and contribution limits.



Advantages:

• Predictable costs: Employers can set a contribution limit for their employees, removing their role in purchasing and renewing benefits, subject to cost swings and annual increases.

• Employee choice: Unlike traditional benefits, employees decide which health plan they want to select from dozens of options.

Drawbacks:

• Learning curve: Employees who are used to employers selecting benefits on their behalf may be overwhelmed and confused by the number of options available through an ICHRA or QSEHRA.

• Cost to employees: Since their employer sets a defined contribution amount, employees may be left with picking up more of the cost for the benefit plan that they prefer most.

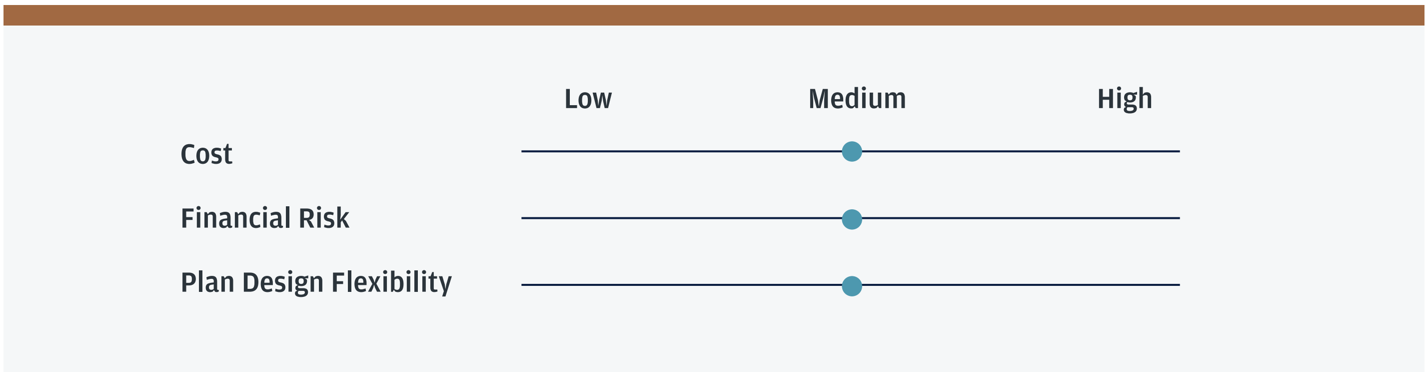
Considerations:

• In some states, benefits purchased on the individual marketplace may be more expensive than what employers can purchase via the small group market, so employers should be sure to ask and understand which states are the best for ICHRA and QSEHRA.

• Best for: Employers of all sizes with employees residing in multiple markets, employers with high employee turnover, and/or employers wanting to give their employees maximum choice.

Level Funded

Level funded plans give employers the benefits of self-funding without the immediate cash flow risk. These plans offer a set monthly premium and allow employers to keep a portion of cost savings if annual claims are lower than expected.



Advantages:

• Cost savings: Level funded plans are generally cheaper than fully insured plans.

• Cash flow certainty: Unlike self-funded plans, employers are shielded from the immediate impacts of high health care claims by paying a set monthly premium throughout the year.

Drawbacks:

• Payback requirements: Similar to fully insured plans, carriers underwrite level funded plans and set a consistent monthly premium. While employers can retain savings if annual costs are below expectation, they can anticipate increased premiums in future years or be required to pay back losses if switching carriers in some cases.

• Limited customization: Employers are often limited in how much they can customize benefit and plan design under level funded plans, unlike self-funding.

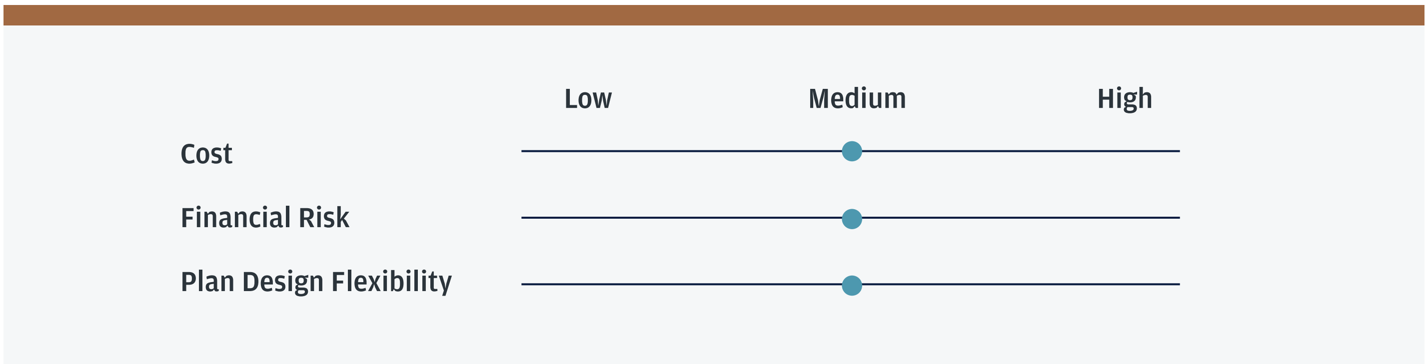
Considerations:

• Level funding is often a stepping stone to self-funding for employers. However, carriers are selective in which groups they will quote for these plans and may decline some groups with more health risks and poorer claims experience.

• Best for: Employers with 100-500 employees with a good health care risk profile and higher financial risk tolerance.

Group Captive

Group Benefit Captives allow multiple employers to pool funding and leverage economies of scale to jointly manage risk through self-funded benefits. Each employer manages their own self-funded plan; however, the captive combines funding from each employer to cover unplanned health expenses and allows groups to benefit from savings in good years.



Advantages:

• Cost and risk mitigation: Captives allow small and mid-sized employers to self-fund benefits.

• Benefit control and customization: Unlike other alternative funding options, captives typically allow employers to select their own health plan and customize benefits to meet their unique needs.

Drawbacks:

• Upfront costs: Captives typically offer long-term savings for most employers; however, employers may have higher near-term expenses including legal fees, administrative costs and capitalization requirements.

• Shared risk with other employers: Since this plan pools risk from multiple employers, any individual employer can affect the health outcomes of the whole group. Even if one employer has a good year, they are still dependent on another employer's experience to save money.

Considerations:

• Good option for small and mid-sized employers that want to self-fund and have moderate risk tolerance. Must be open to partnering with other employers.

• Captives are subject to their own regulations, and employers must be careful to work with trusted experts and advisors when entering into a captive.

• Best for: Employers with 50-500 employees, with moderate risk tolerance and willingness to partner with other employers.

Self-Funded

Employers who self-fund their benefits take on the financial risk for the plan and are responsible for all health care costs throughout the year. Employers will work with health plans and Third-Party Administrators (TPAs) to manage key functions such as claims payment, customer service and network management, among others.

Advantages:

• Cost savings: In many cases, self-funded plans are the most cost-effective solution for employers with different tax requirements and reduced insurance overhead costs, as well as the ability to customize benefits for the employee population and maintain reserves.

• Customization: Employers have control over plan design, including employee cost sharing and which benefits to cover.

• Access to data: Employers have unlimited access to all of their health plan data, which can be used to identify cost drivers and develop strategies to improve plan performance.

Drawbacks:

• Risk: Employers must cover all claims costs and are subject to irregular monthly expenses depending on group health care claims experience.

• Additional protections: To mitigate the impact of unexpected high-cost claims, employers typically must purchase Stop Loss coverage.

• Administrative burden: Self-funded employers are responsible for designing and managing many aspects of their plan.

Considerations:

• Many self-funded employers work with employee benefit consultants and actuaries to design their annual benefit plan.

• Best for: Employers with over 200 employees with a healthier employee population and higher risk tolerance.