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RISK BITES

Self-Funding Your Insurance Plan: Sounds Great — But Danger Lurks Beneath

By Rhonda D. Orin

Offering health insurance for employees used to be simple. Corporations would receive proposals from a number of insurance companies. They would pick the best deal.

Those days are over. Now, when a corporation decides to offer health insurance to its employees, it is presented with a bewildering array of alternatives. It can be difficult even to decide among them, as the comparison usually is not apples to apples.

One of the most attractive options today, at least for large corporations, is self-funding. In a self-funded plan, a corporation essentially insures its employees itself. Typically, the corporation purchases reinsurance to cover the losses that exceed an agreed-upon amount. It also enters into a contractual relationship with an administrator — typically an insurance company — to perform the functions that insurance companies used to do.

On paper, there are clear financial advantages to self-funding. The principal one is the lack of insurance premiums. Especially now, with premiums skyrocketing, this option is extremely attractive.

But corporations should not jump too fast. There are many disadvantages to self-funding. Many of them are not obvious, and unfortunately are not appreciated by corporations until after they get into trouble.

The principal disadvantage is, essentially, the principal advantage: the corporation becomes the insurance company. This means that, if there is a wrongful coverage denial, the corporation can be held responsible. The corporation essentially is in the front lines on all coverage decisions. The corporation, through its self-funded plan, is the entity that gets sued.

Certainly, corporations can turn for relief to the companies that it hired to administer the plan, and that told them to deny the coverage. But those companies, typically known as third-party administrators or TPAs, are not liable to the employees. TPAs have contractual relationships only with the corporations and, at most, are liable to the corporations for indemnification or contribution.

It goes without saying that an opportunity to have a third-party to sue probably was not what the corporation had in mind when it opted for self-funding. In fact, the corporation may not have had anything in mind. Many corporations may enter into self-funded plans without understanding that they will be in the front lines of any coverage lawsuits.

Another disadvantage to self-funding is that it makes corporations liable for decisions that they do not understand. The insurance industry is a mosh pit. It is not a good place for amateurs to dabble. Yet as a practical matter, that is exactly what corporations are doing — at least to a certain extent — when they enter into self-funded plans.

For all of these reasons, there has been a noticeable rise in lawsuits between self-funded plans, their brokers, their reinsurers and their TPAs.

Yet the solution is not necessarily to avoid self-funding. Self-funding, or some creative mutation, appears to be here to stay.

Instead, corporations that opt for self-funding should prepare themselves fully for the risks. Among other things, the initial decision of whether to self-fund should be made by corporation counsel, not by risk management alone. All TPA contracts and reinsurance policies should be reviewed carefully by counsel, and thoroughly understood, before they are deemed acceptable. Before entering into particular contracts, corporations should find out related information as well, such as whether their brokers are independent or are agents of the insurance companies with whom the corporations are considering.

Finally, if problems arise, and corporations are told by the brokers, TPAs and reinsurers that they just happen to be the responsible party, the corporations should make sure that this information is correct before they accept the blame. And, if there is any chance at all that this information is wrong, they should defend themselves to the fullest.

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