**Small Business Health Insurance Options: A Guide to the Basics**

As a small-business owner, the decision to provide health insurance for your employees is big one. The value is high. But so is the expense. Making the right decision is critical for your business, but where can you start?

Luckily, there’s a clear path forward. Essentially, you must decide between just two main kinds of insurance coverage: fully-insured health plans and self-insured (or self-funded) plans.

So your first step is learning the basics of how these two forms of insurance work. Then you’ll be well positioned to figure out which is a better fit for your company.

**Fully-insured and Self-funded Coverage: The Basics**

**Fully-insured Health Plan:** With this coverage, you pay a monthly premium to a commercial insurance company. In return, the company covers your employees for a comprehensive group of healthcare services and pays all bills that meet the terms of the plan.

**Self-insured (or Self-funded) Health Plan:** With this coverage, you collect monthly premiums from your employees. Out of those premiums—plus funds your business contributes—you pay your employees’ healthcare bills directly. You choose what your plan covers, free of most legal requirements that apply to fully-insured plans.

**What Are the Biggest Challenges for Providing Healthcare Coverage?**

**High Costs**

There are two major challenges when it comes to paying for healthcare for your workers.

The first is obvious: healthcare is expensive. A national survey by the Kaiser Family Foundation reports that the average annual cost for family coverage at both small and large companies was just over $20,000 in 2019.[[1]](#footnote-1)

**Unpredictable Timing**

The second challenge is something we think about less often. But it’s just as important to business owners hoping to offer coverage. It’s this: healthcare needs don’t happen on a regular or predictable schedule.

It’s hard to predict how high any one person’s healthcare costs will be. And it’s virtually impossible to predict just *when* a person will incur high bills…or whether two or three members of a health plan will have high costs at the same time.

This unpredictability can make providing coverage especially risky, especially for small companies.

What happens when an employer agrees to pay workers’ healthcare bills, but has cash-flow problems or a pressing business need at the same time as a large healthcare bill comes due?

What happens when a small business must pay an especially large healthcare bill — of $100,000 or more — for a sudden aggressive cancer or a severe accident?

For a very large company, that’s not an overwhelming problem.

A big employer collects monthly insurance premiums from tens of thousands of workers, and generally has large cash reserves of its own. So when one employee unexpectedly presents a very large healthcare bill, the company (or its insurer) has a large “risk pool” of funds from which to draw that immediate cash.

A small business has a much smaller “risk pool” to draw from. So a sudden very large bill risks destabilizing it.

Fully-funded and self-insured small-business health plans manage these problems in different ways.

**Costs**

**How Do Fully-insured Health Plans Manage Costs?**

The design of fully-insured plans protects businesses from the unpredictable timing of high healthcare costs.

With a fully insured plan, you pay your health insurer a set premium every month. The premium stays the same for a year, unless the number of your employees changes.

All costs are bundled into your monthly payment. Those include the price or providing the coverage; the price for administering the coverage; the insurer’s profits; and some additional taxes and fees.

Your premiums payments are spread out evenly through the year.

Your insurance company, not you, must pay each claim — including the biggest ones —promptly. Insurance companies are in the business of protecting individuals and organizations from being destabilized by large emergency needs and set aside large reserves so they can do this.

**How Does an Insurance Company Set Rates for My Plan?**

The healthcare-only part of the premium price is based on the kind of plan you choose and some facts about your employees.[[2]](#footnote-2)

**The Kind of Plan You Choose**

Most insurers offer health plans at many price points. They differ in which services they cover, how much of the costs individuals pay out of pocket, and how many providers patients have access to.

**Age and health of your employees**

The Affordable Care Act (ACA, or Obamacare) limits what demographic and health traits insurers can use to set premiums for small-business employees. (For workers in big companies, insurers can use more details, such as gender and medical history, to set rates.) These ACA rules are intended to help small businesses get rates and benefits more like those big businesses get.

For a small business, an insurer may take into account the ages of your employees and their covered dependents, setting premium prices for older adults up to 3 times the price of coverage for a 21-year-old.

Insurers may also raise the premium price up to 50-percent for a person who self-reports tobacco use, in any state that also allows this.

**Your business location**

Healthcare costs vary widely from place to place (even within one state). So insurers may consider your local healthcare-provider prices and the structure of local healthcare systems in setting premiums.

**How Can I Know Insurers’ Rates Are Reasonable?**

Insurers must submit their proposed rates for small-group policies, along with justification for the rates, to either state or federal regulators for scrutiny, depending on the state.

The ACA also requires insurers to spend from 80 to 85 percent of premium dollars on medical care and health-care quality, not administrative costs. If they spend less on care, they must issue rebates.

This is called the “medical loss ratio” rule, and it doesn’t apply to businesses who self-fund health plans.

**Fully-insured Plans: Potential Upsides**

• **Predictability.** If one of your employees has an especially high bill, you won’t need to pay it on the spot. Your insurance company, not you, must pay the claim promptly.

• **Administrative Costs.** Your monthly premiums cover the costs of administering your plan, so you don’t need to hire anyone else to do it.

**Fully-insured Plans: Potential Downsides**

• **High Cost.** Paying an insurer to cover healthcare costs and administer your plan is expensive.

It’s hard to generalize how the cost compares to that of self-funded coverage because self-funded plans vary widely. But since self-insured businesses design their own plans with few restrictions, many such plans are cheaper.

• **Avoidable Costs?** Your premium covers insurer profits and state taxes, which average between 2 and 3 percent of the premium’s dollar value. Self-funded plans don’t pay either of these.

• **No Refunds.** If your employees’ healthcare costs over the course of a year are lower than what your insurer charged for them, the insurance company keeps the money at year’s end.

**How Do Self-insured Health Plans Manage Costs?**

With self-funded plans — also called self-insured plans — business owners are on the hook to pay bills promptly. This makes unpredictability an inescapable feature of self-funded coverage.

However, to help businesses keep their overall costs down, self-funded small-business plans are free from most coverage requirements that fully-insured plans must abide by.

**The Payment Structure of Your Self-Funded Plan**

Self-insured plans are mainly regulated by ERISA, the Employee Retirement Income Security Act. ERISA requires employers to put plan participants’ contributions (usually monthly premiums) into a trust reserved for paying healthcare bills.[[3]](#footnote-3)

Your second primary obligation will be to pay promptly whenever a plan member submits a bill for covered services.[[4]](#footnote-4)

Besides paying bills for covered healthcare when they arrive, most self-funding small businesses pay two fixed-cost bills each month. Most hire a contractor at a monthly rate to do some or all administrative tasks for their health plan. Most also pay a monthly premium for “stop-loss” insurance to pick up the most expensive claims.

**What Fixed Costs Will I Pay in a Self-funded Plan?**

**Who Will Administer My Self-insured Plan?**

Self-funding businesses usually hire specialists to do some or all administrative tasks. Third-party administrators, or TPAs, are companies specializing in this. Some insurance companies also offer “administrative services only” contracts, or ASOs. Both kinds of business generally bill a fixed monthly fee.

TPAs and ASOs do these jobs, among others:

• Process and pay claims.

• Review claims to ensure they’re payable under the terms of your health plan.

• Answer customer-service inquiries and complaints.

• Contract with healthcare providers, like hospitals.

• Prepare reports and analyses to help you design your plan.

**What Is Stop-loss Insurance Coverage?**

Some diseases and accidents come with six-figure price tags, or more. To protect against such high losses, most self-funded employers buy stop-loss insurance. It reimburses the employer for claims that exceed some predetermined dollar amount that the employer and insurer agree on.

There are two kinds of stop-loss coverage. Many employers buy both.

*Individual — or specific — stop-loss insurance* covers catastrophic claims for individual employees. The insurer pays all bills for any individual plan member whose costs exceed the agreed-upon amount.

An *aggregate stop-loss policy* kicks in when annual spending for your entire group exceeds a certain dollar amount. After that point, the insurer pays all costs of care for the rest of the year.

**Self-insured Plans: Potential Upsides**

• **Earning Interest.** You may have low or no spending in some months. As reserves accumulate, you can grow the trust by putting some funds into an interest-bearing account.

• **Year-to-Year Rollover.** If your trust has reserves at year’s end, you can roll them over to help pay next year’s costs.

**Self-insured Plans: Potential Downsides**

• **Prompt Payment.** You must pay even large bills promptly, no matter what else is going on in your business.

It’s important to consider in advance how you’ll do that, especially when your plan is new with low premium reserves or if your company is very small or in a field where cash flow is irregular.

• **Lead Time.** It will take longer to get a self-funded plan up and running than a fully-insured plan. Self-funded plans face few restrictions on their design, so there are many choices to make.

**Coverage**

**What Coverage Does a Fully-Insured Plan Provide?**

**Essential Benefits**

The ACA’s essential health benefits (EHBs) include ten broad categories of healthcare services. All fully-insured small-group policies must cover these categories to the same extent that the average large-employer plan does.

Insurers may impose no lifetime or annual limits on the dollar amount of coverage an individual may receive in an EHB category.

These are the ten EHBs:

• Outpatient care.

• Emergency services.

• Hospitalization.

• Pregnancy, maternity, and newborn care.

• Mental health and substance use disorder services.

• Prescription drugs.

• Rehabilitative and habilitative services and devices.

• Laboratory services.

• Preventive care, wellness services, and chronic disease management.

• Pediatric services, including oral and vision care.

**Preventive Benefits**

Fully-insured small-business policies must cover ACA-specified preventive services with no patient cost sharing. The services include certain immunizations, wellness visits, and some women’s health services.

**State Regulations**

Fully-insured plans for small business are regulated by both states and the federal government. A fully-insured policy will include benefits mandated by your state, such as contraception or access to certain providers like chiropractors.

**Pre-packaged Plans.**

Most insurers have many plan packages for fully-insured small businesses to choose from. They range from high-deductible coverage and HMOs to plans that offer access to very broad provider networks and add-on coverage like dental care or vision care.

Small businesses don’t have leverage to negotiate plan details with insurance companies so they use prepackaged plans as is

**What Coverage Does a Self-funded Plan Provide?**

To help them keep costs down, businesses with self-insured health plans have wide latitude in plan design, subject to few legal requirements related to coverage.

**ACA Requirements**

These ACA provisions apply to self-funded small-business plans:

• **Dependent Coverage.** Must provide dependent coverage for adult children up to age 26.

• **Preventive Services.** Must provide ACA-specified preventive services with no cost sharing. Services including certain immunizations, annual wellness visits and some women’s health services.

• **EHBs and Coverage Limits.** Other than preventive services, self-funded small-business plans aren’t required to cover any of the ACA’s essential benefits. (see above for list)

However, for any EHB category your plan does cover, such as hospitalization or emergency services, no annual or lifetime limits may be imposed on the dollar amount of coverage an individual may receive.

**Opportunities to Cut Costs, Customize Coverage**

As a self-funded plan sponsor you have nearly unlimited freedom to choose the benefits, level of provider access and payment requirements your plan will include.

Most rules that apply to fully-insured small-business plans don’t apply to self-insured plans. For example, self-funded plans may set premium prices at any level they choose, while fully-insured small-business plans may not charge older adults more than 3 times the rate they charge a 21-year-old.

You will also have full access to your employees’ healthcare claims, with information including providers they see, services they use and costs. In succeeding years, analyzing this data can help you tweak your plan to lower costs and better meet your workers’ needs.

Every business is different. And insurance decisions are always a matter of balancing benefits, costs and risk.

But now that you know how fully-insured and self-funded plans work, you’re a big step closer to finding healthcare coverage that works for your employees and for your business, too.

1. [“2019 Employer Health Benefits Survey,”](https://www.kff.org/health-costs/report/2019-employer-health-benefits-survey/) Kaiser Family Foundation, September 25, 2019 (accessed July 2020). [↑](#footnote-ref-1)
2. [“Consumer Guide to Group Health Insurance](http://nahu.org/looking-for-an-agent/helpful-guides/consumer-guide-to-group-health-insurance),” National Association of Health Underwriters (NAHU), September 1, 2017 (accessed July 2020). [↑](#footnote-ref-2)
3. [“Understanding Your Fiduciary Responsibilities Under a Group Health Plan,”](https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/publications/understanding-your-fiduciary-responsibilities-under-a-group-health-plan.pdf) U.S. Department of Labor Employment Benefits Security Administration, September 2019 (accessed July 2020) [↑](#footnote-ref-3)
4. [“What Is Self Funding?’](https://www.hcaa.org/page/selffunding) Health Care Administrators Association (accessed July 2020). [↑](#footnote-ref-4)