

Self-Funding and Business Virtue



By Carlton Harker, FSA, MAAA

Introduction

In this brief critique, I draw attention to three problem areas, which affect self-funding either directly or indirectly. With each such problem area, we find this common theme:

“white collar misdeeds are profitable.”

It is the writer's view that the *Enron* tragedy, the Spitzer Commission investigation and those of a similar nature are symptomatic of deeper mischief. The so-called business modeling often has built-in and anticipated misdeeds; some litigation is expected and occurs as the model performs its functions. These business models are taught in our business schools as being good for the bottom-line, necessary to survive in a global economy and with as much virtue as growth/profits will allow. That is, statistical quality control as with *making widgets* is now found with business *errors*. Thus, we find law schools becoming one of our nation's big growth industries.

These three problem areas are briefly discussed and then followed by a conclusion which hopefully will be useful to self-funders:

- Changing Face of Insurance
- Conflicted Interest
- Unfair Practices.

Changing Face of Insurance

Assault on The Actuary

The actuary is a proponent of sound rates, well-defined risks and disciplined underwriting. Its recommendations are usually contrary to those of marketing. Over the years, this *balance in power* has shifted to marketing.

Demutualizations

It is not necessary for me to list all of the demutualizations, which have occurred in recent years. Suffice it to say that for each such reorganization, the insured was taken from (a) a risk pool managed by fiduciaries to (b) a risk pool managed by non-fiduciaries.

Bad Faith Denials

The practice of bad faith denials is on the increase because it is part of the new insurance business model to *sell and deny*. Bad faith denials in some insurance lines is endemic.

Accounting Practices

With generally accepted accounting practices, insurers enjoy a big spike in earnings when business is placed. This delights the marketers and stockholders to such an extent that it is factored into the business model of the insurer. It has the direct result of (a) favoring the marketer over the actuary and (b) making the practice of sell and deny good business sense.

Financing and Banking

In the marriage of insurance and banking/finance (usually but not necessarily with an affiliate bank) recently permitted by federal law it will be the banking/finance, which will emerge dominant. As a result, new operating paradigms are being seen. Such new paradigms will favor the marketer over the actuary with predictable consequences. Further, as far back as Venice following the Renaissance and old London Lloyds, banks and insurers were not permitted to mix. The good reasons for this are and will continue to be seen.

Dominance of Insurance Departments

The traditional role of state insurance regulations grows less tenable as banking (and financial services) and insurance merge. However, should such regulation diminish in power, the autocratic tactics of many insurers and the general political environment with state-elected commissioners will be contributing factors. For most insurance traditionalists, 50 Herods are preferable to one Caesar. Two of the more common temptations which the insurance departments must resist are these: (a) political pressure to go along with insurance practices, etc. which foster the states' economy and (b) future plans of the insurance department personnel to look to their future as potential candidates for insurance company employment opportunities.

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Conflicted Interest

Background

One has a conflicted interest if it is financially advantageous to make Decision A as opposed to Decision B given that the decider has the full option to either A or B. Conflicted interest is not *per se* improper but it is suspect. At the very best, a conflicted interest will put the decider at a significant disadvantage if the matter is ever litigated.

Examples of Conflicted Interest

- Insurers offering both claims administration services (so-called ASO arrangement) and also stop-loss whether by a single company or by an affiliate.
- Actuaries who do health care plan work as employees of accounting firms which also do the audit work for the same plan.
- Plan vendors (e.g., claims audit firms) the compensation of which is a function of claims recovered, reduced or denied.
- State insurance departments and their inherent bias for fully insured (conventional, Blues or HMOs) and against self-funding. Discriminatory tax assessments for uninsured risk pools would be an example.
- Claims gaming by, or against, the stop-loss carrier.
- Plan supervisor's ability to help the stop-loss carriers and hurt the employer, or vice versa, by cooperating with the provider network.
- Non-disclosed vendor compensation or significant *perks*.

Unfair Practices

Such practices are of three types:

- Claims
- Fair Trade
- Anti-Trust.

Infractions may be state or federal in nature.

Examples of such infractions are as follows:

1. Claims

A bad faith claim denial is one that violates any of the generally accepted rules of practice (at least 50 in number found in laws, regulations and court decisions).

2. Fair Trade

Examples of violations of fair trade practices are:

- Rebates, advantages and inducements
- Contingent commissions
- Minimum premium disguised as a self-funded plan
- Secrecy or non-disclosure conditions made part of agreements.

3. Restraint of Trade

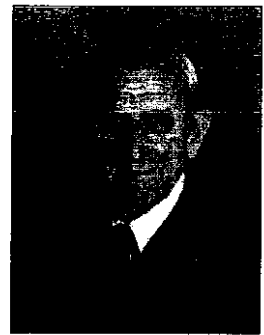
- Predatory pricing
- Collusive actions
- Tying agreements.

Litigations numbering in the thousands (which are reported) and in the tens-of-thousands (which are settled or not reported) nearly all revolve around one or more of these unfair practices.

Conclusions

Given the present *back-slidden* condition of our national business ethics, the employer seeking virtue (or at least prudence) will find more comfort with self-funding than the funding alternatives. This is because the self-funder becomes a miniature insurer and it is able to control, directly or otherwise, all of the plan-related functions. The self-funded plan will be as virtuous as the employer wishes; this is not true with any of the other funding options.

Carlton Harker, FSA, MAAA is a well known and respected member of the self-funding community and has been an active participant in the Self-Insurance



Institute of America's educational programs for many years. In addition to authoring numerous books on a diversity of subjects related to self-funded health care, Carlton has appeared as a speaker and panel member at various industry educational functions. Harker has appeared as an expert witness in many hearings and trials. Mr. Harker is the Principal of Self-Funding Actuarial Services, 8025 North Point Blvd., Suite 207 W., Winston-Salem, NC 27106. (tel) 336-759-2035, (fax) (336)892-0392, or via e-mail at harker2@earthlink.net He maintains a web site at www.self-fundhealth.com

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