Multiemployer Review

Originally published in the July 2018 issue of Milliman's Employer Health & Group Benefits Update. JULY 2018

Health and welfare trusts seek increased guidance regarding continuation value

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One of the primary purposes of a health and welfare trust is to develop strategies to share risk and leverage group purchasing power for the provision of health and welfare benefits to its participants. Examples of health and welfare trusts are multiple employer trusts (METs) and Taft-Hartley multiemployer trusts.

In most instances, benefits provided under health and welfare trusts usually include medical and prescription drug coverage to participants. They also frequently include other ancillary benefits such as dental, vision, life, accidental death and dismemberment, disability, and other welfare-related options. Dependent upon the size and structure of the trust, benefits are typically provided on a fully insured basis, a self-insured basis, or a combination of both.

Due to the continued rise of healthcare costs and uncertainties about the future landscape of healthcare, plan sponsors and fiduciaries are keeping a close eye and seeking increased guidance regarding the financial status of their trusts. A variety of methods can be utilized to assess the financial status of a health and welfare trust. One of the most common methods is to estimate continuation value, or the amount of time that the trust can continue to cover the cost of benefits to its participants and pay for associated administrative, operating, and professional expenses, assuming no future income.

Continuation value can be expressed in many different ways, one of the most common being reserve months. But what level of continuation value should a health and welfare trust target? While the question is common, the answer is complex and requires assessment and understanding of a variety of factors:

- How might deviations from projected experience impact actual results? Estimated months of reserves are developed from financial projections of future experience, which are based on a set of assumptions. It is important to have a full understanding of the assumptions used and how the reserve estimates would be impacted if actual experience differs from projected experience. Sensitivity analyses can help illustrate the impact of changes to assumptions.
- Months of reserves can be expressed on a gross or net basis. Gross reserves are based on total trust assets, while net reserves are based on total trust assets net of liabilities. Trust liabilities can include amounts for premium payments, incurred but not reported (IBNR) claims, accumulated eligibility credits, and hour bank or dollar bank benefits, among others. It is important to understand the basis for which reserves are reported, as well as the impact of trust liabilities on total reserves and how that may change over time.
- How is the future number of participants expected to change? Months of reserves are impacted by participant growth or reduction. For example, a trust with declining participation will experience trust assets being spread over fewer people, thus increasing the months of reserves. Conversely, a trust with increasing participation will experience trust assets being spread over more people, thus reducing the months of reserves.
- Are benefits provided on a fully insured or a self-insured basis? Fully insured trusts tend to have more predictable expenses, and are typically more comfortable holding fewer months of reserves, all else being equal. For self-insured trusts, the level of susceptibility to large fluctuations in claims experience is dependent upon participant size. Because of this, self-insured trusts tend to target a higher level of reserve months than fully insured trusts. Some self-insured trusts may have stop-loss coverage in place to protect against unexpected spikes in claims experience, especially for catastrophic claims.

- How is the trust funded? The primary source of funding is typically through employer contributions, for which the structure can vary among a flat monthly contribution rate per participant, hourly contribution rates, percentage of participant earnings, etc. It is important to understand the structure under which employer contributions are paid, and how economic changes such as variations to employment levels might impact future employer contributions. Other sources of trust income may include participant contributions, investment income, and rebates and subsidies.
- How frequently are employer contribution rates updated? Some trusts update employer contribution rates annually, while other trusts may set employer contribution rates in advance for several years due to multiyear agreements. Trusts for which employer contribution rates are static for numerous reasons (unfavorable economic conditions or political sensitivities for collectively bargained trusts) may wish to retain higher numbers of reserve months to protect against adverse experience.

When determining the optimum number of months of reserves to hold in a health and welfare trust, it is important to speak with your consultant and other trust professionals to address the considerations described above and their respective implications.

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