Captive Solutions for Medical Stop Loss: Take Your Self-Insurance Program to the Next Level by Allison Repke

As the costs associated with providing healthcare coverage continue to rise, companies are looking to improve risk management and reduce expenses. It may seem like the only alternative is to increase employee contributions or cut benefits. However, it is possible to utilize customized risk transfer methods to improve the financial management of an employer-sponsored health plan.

If you are already self-insured, then you know that it is the most widely used alternative method for managing an employee medical benefit plan. This is an alternative way to finance the plan, where the employer takes responsibility for some or all of the risk. Claims are settled on a pay-as-you-go basis or out of a pre-funded fiduciary account. The employer can buy stop loss coverage, which insures against bad experience. Self-insurance is a financial management tool that allows for greater control over the plan and improved cash flow.

For many years, employers have used captives to insure a broad spectrum of employee benefit risks, including life, disability, workers’ compensation and retiree benefits. Although the captive insurance company is a well-known risk management tool, it is not commonly utilized for employee medical benefits. Over the past several years, more employers have been implementing captive programs for medical stop loss. This article will examine the structure of a medical benefit captive, how it is analyzed and implemented and define the best candidate for this type of program.

The function of a captive insurance company is to underwrite and insure the risks of its owners and affiliates. Like self-insurance, a captive is an alternative risk management tool that provides greater control over how the risk portfolio is managed, which can lead to reduced insurance expenses, improved cash flow, more efficient capital utilization and possible tax benefits. With few exceptions, companies that have multiple lines of insurance coverage and the financial ability to retain risk can benefit from a captive.
Captive programs are designed to maximize financial leverage through pooled and shared risk. Just as a commercial insurer improves loss experience and makes profit by covering a larger, more diverse group, a business owner can employ this risk management strategy and receive the same benefits. Risk can be diversified by combining across different groups, geographical areas, lines of coverage, units of business and even time periods. For example, like-minded employers can form a group captive to share their health plan liability. Or, a single employer can pool their medical benefit risk with lines of coverage for property, casualty and worker’s compensation.

Purchasing stop loss from a captive insurer is functionally the same as from a commercial insurance carrier and has no impact on plan participants. If you are already familiar with the methods of self-insurance, then you will understand how the deductible is established and the premium rates are set. The difference is that the captive owner(s) will also have responsibility for the risk within the captive layer. The following diagram shows the progression of risk retention from a fully insured plan, to a standard self-insurance program, to a captive insurance program. This is just an example; the attachment points will vary based on your chosen primary deductible, actuarial and reinsurance market analysis and the financial goals of your captive program.

Instead of a single medical stop loss contract, there will be two: one between the employer group and the captive insurer and one between the captive and the reinsurance carrier. One of the many benefits of a captive program is the ability to purchase coverage for the excess layer from the commercial reinsurance market, which typically has better rates than the retail insurance market. The above diagram illustrates the flow of premium and claims between the parties.

There are multiple types of medical benefit captives. An employer can choose which program structure best suits their size and risk appetite.

- Single parent captive owners have complete control over the program. This structure is recommended to those with a large number of plan participants, because the captive requires a broad population to achieve proper risk distribution and adequate premium to cover operational costs.
- Employers with smaller populations can participate in a group captive. Member-owners increase financial leverage by retaining a higher level of risk than would be possible as an individual entity. The owners also have increased buying power, which can lead to savings through lower reinsurance premiums. By spreading losses across a larger group, there is a higher probability of a favorable loss ratio, which means gains from captive dividends.
• A protected cell captive program is beneficial for groups who want to share risk, but prefer to use an existing captive facility rather than form their own. An employer is able to retain a limited amount of additional risk and benefit from positive experience within the captive layer. Some programs also offer indemnity against bad experience, so that the group does not suffer financially during policy periods with heavy losses.

In all cases, the captive will accrue retained earnings and establish a smoother loss cycle, making the financial liability more affordable and predictable.

The first step in implementing a captive program is to identify the short-term needs and long-term goals of your risk strategy. You will need to understand the size and nature of the risk by collecting information on the current benefit program and past plan experience. Many companies that provide captive consulting offer feasibility studies, which includes actuarial analysis to establish premium and capitalization amounts and financial pro forma to determine the proper risk retention levels. The data analysis provides key metrics to inform and support the optimal structure. Below is a simplified outline of how a captive program is implemented.

There are various expenses incurred when starting or running a captive, which should be taken into consideration during the cost benefit analysis of the program.

Just like any business, a captive program will need to employ an accountant to ensure financial health and to maintain the necessary records for submission to state regulators. And just like any insurance company, the program will need the services of an actuary or underwriter to review and rate the risks. The program will also need to establish a method for administering claims. There are several ways to source these services: hiring a complete captive manager, contracting with a Managing General Underwriter, or partnering with a fronting carrier.

The ideal employer for a captive program will share the risks and rewards of benefit plan liability and actively manage plan expenses for the best experience. When you take a portion of the risk of a health plan, the issues of loss prevention and loss control are all the more important. As with traditional self-insurance, a benefit of captive participation is improved access to claim data. Analyzing plan experience to understand cost drivers helps to lower these factors and increase efficiencies. The captive program is the financial component of a proactive risk management strategy.

If you are interested in more information on captive solutions for medical stop loss, speak with a
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resource to guide your understanding of this emerging risk management tool. This may be a company that provides captive consulting services, the owner or administrator of a group captive program, or a representative from a carrier that reinsures these programs. A captive is more flexible and accessible than you may think; it can be designed around your company’s needs and goals. By improving the financial management of your medical risk, you can prepare for negative outcomes and gain from positive results.

Allison Repke is a client services specialist with the Willis Global Captive Practice, focused on captive solutions for medical stop loss. Her background is in product development for the self-insured market, including international medical travel benefits.