WHITE PAPER

GLOBAL CAPTIVE SOLUTIONS

Evaluating Captive Solutions for Medical Stop Loss Programs

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Employers are turning to captive medical stop loss insurance programs to combat rising healthcare costs. Captives provide a financially sound alternative by allowing companies to self-insure, control their plans, and benefit from underwriting profits. This approach helps employers protect their bottom line while ensuring employees have access to necessary treatments.

Medical researchers continue to develop extraordinary treatments capable of saving the lives of patients. Unfortunately, while these treatments are great for the health of those patients, they can be downright deadly for the health insurance plans offered by their employers. From gene therapy to new medications, the high cost of these innovative therapies are leading employers to look for a cure of their own.

With some of these therapies (especially those involving long-term use of specialty medications), claims amounts can quickly accumulate to six- and even seven-figure levels. At the same time, pharmaceutical costs continue to climb, and inflation and the economy also contribute to uncertainty about future increases.

For employers who self-fund employee benefit plans, one of the best ways to blunt the impact of these higher costs is to establish a captive medical stop loss insurance program. In fact, captive programs are especially well-suited for medical stop loss.

The idea of using medical stop loss coverage to protect plans from extraordinary claims is nothing new. Plan managers have purchased this coverage from the traditional insurance market for some time. Managing claims risk by establishing a captive insurer delivers a more practical and financially sound alternative than crossing one's fingers and hoping for the best.

WHAT IS A CAPTIVE?

In simple terms, a captive is a licensed insurance company owned and operated by those it insures. Organizations can enhance protection, increase their self-insurance opportunities and customize their insurance coverage. In addition, they can benefit from any underwriting profits that would normally go to their insurance carrier, further reducing their overall spend.

If you want to make sure your employees can access the extraordinary care they sometimes need, a captive-based stop loss program could make it happen without sacrificing the health of your bottom line.

BENEFITS OF A CAPTIVE STRUCTURE

Well-managed captives deliver significant financial benefits to their owners. Instead of an expense that grows every year, insuring the risk becomes an investment. As the owners get better at mitigating risk, the captive returns even more on that investment. And because the captive puts them in control of their plan, they can build benefits around their employees' exact needs.

The use of a captive for medical stop loss allows companies that are financially able to retain significant portions of risk to simultaneously reduce their insurance costs while taking greater control of their benefits program. They develop deeper transparency of the nature of their claims, so they can determine the optimal balance of risk retention and risk transfer. They can use a variety of strategies such as case management to mitigate risks and select the coverage options their employees need most. Captives also give them incentives to control costs through wellness programs and other initiatives that will improve their employees' quality of life and lead to long-term reductions in claims. A well-structured and -managed captive may also have the ability to generate dividends that further reduce the overall costs (instead of allowing a traditional carrier to add those amounts to its own profitability).

Another key advantage of establishing a captive for medical stop loss is that it allows companies to ensure that all employees are protected by their plan. Stop loss carriers may exclude individuals with complex health histories or costly diagnoses from coverage, which is often described as "lasering" insureds.

SINGLE-PARENT CAPTIVES

As the name implies, single-parent captives are owned by just one organization and only ensure the risks of that organization. Typically used by employers insuring more than 1,000 employees and dependents -- the vast majority of which are already self-funding at least some of their health benefits -- the single-parent approach is suitable for companies with a solid risk management framework.

Within the single-parent universe, companies have flexibility to match their medical stop loss captive to their appetite risk. Some companies choose to have the captive insurer cover the full amount of potential claims, transferring some of the larger risks to a reinsurance carrier. For example, a company using this structure might cover all claims exceeding $500,000 but use reinsurance to handle amounts over one million dollars.

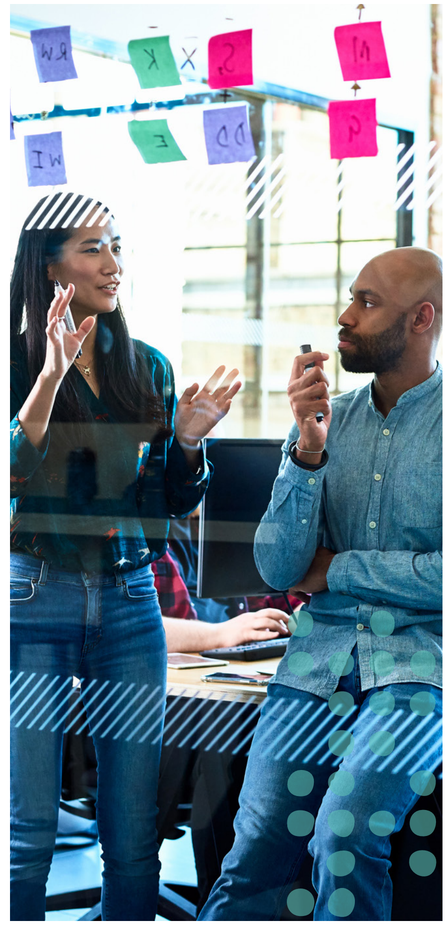
Other companies combine the use of a captive with a traditional medical stop loss policy, creating separate layers for the amount of claims. The captive may cover claims up to $500,000, with the medical stop loss in place for claims in excess of that amount. Finally, a third approach involves buying a traditional fronted policy but carving out a layer of risk to be assumed by the captive. In addition to providing sufficient funding for that layer, the company will also have to pay fronting fees to the carrier.

GROUP CAPTIVES

A group captive is owned by multiple companies who share uncontrolled risks such as medical stop loss, and also share in the liabilities and profits associated with insuring or reinsuring the group. While each member's premiums are based upon its own loss experience, all members benefit by spreading administrative and underwriting costs across all the members. In addition, they get to participate in decision-making about coverage, vendors and consultants. Groups can either be homogeneous, in which all members are from the same industry, or heterogeneous, in which members are from different industries.

When using the captive approach for medical stop loss coverage, the group members agree to work with a single medical stop loss insurer, which provides separate medical stop loss policies to each of the members. That allows each company to determine the level of coverage based upon its own ability to assume risk and comfort with doing so. The members continue to fund and operate their own healthcare plans with carriers and vendors they trust. Typically, the medical stop loss carrier will transfer part of the risk to a reinsurance captive owned and operated by the group members.

Group captives tend to be most suitable for plans with fewer than 500 covered employees, which lack the premium dollars and financial strength to make a single-parent medical stop loss captive viable. The group approach allows them to take advantage of the flexibility and other benefits of captives, while sharing the risk with other members of the group.



WHY USE A CAPTIVE FOR MEDICAL STOP LOSS INSURANCE?

Companies can benefit from using a captive for medical stop loss insurance by generating dividends that reduce overall costs and ensuring comprehensive employee coverage without exclusions for high-risk individuals. Single-parent captives offer flexibility for larger organizations to manage risk and potentially transfer larger risks to reinsurance carriers. Group captives enable smaller companies to share risks and benefits, providing access to tailored coverage and cost efficiencies typically unattainable through traditional insurance alone.

CELL CAPTIVES

A newer approach that is especially suitable for smaller companies that want to keep their operating costs lower is what's known as a cell captive. Like a multi-tenant office building, a third party sponsor creates the overall structure and rents individual cells to a variety of companies. While each cell owner is required to capitalize its cell, this approach generally carries lower startup and frictional costs than single-parent captives.

TYPICAL MEDICAL STOP LOSS STRUCTURE

When using a captive to cover medical stop loss, organizations will typically establish tiers. The bottom tier represents the company's direct retention of medical expenses. For example, the organization may choose to retain the risk for claims up to a maximum of $350,000. The next tier is the captive, which covers claims expenses above that amount and up to $750,000. Claim costs above that level will be covered by the medical stop loss carrier. (The actual amounts will vary by captive.) This approach pushes the reinsurer's role higher, so its primary function becomes covering only the most catastrophic claims and its premiums decrease accordingly.

RISK REDUCTION AND DATA

Most successful captives put an emphasis on mitigating risk to reduce the number of claims. Federal requirements for pricing transparency have been a boon for captives, as they've provided access to an amazingly deep well of benefit-related data. That data has been readily available, but until recently, it's been incomprehensible. Not only does the data improve companies' ability to quantify the risk, but they can use money from the captive to fund programs to reduce those risks.

Developments in data analysis and artificial intelligence are giving plan managers new insight into old questions. How exactly are employees using benefits? Are there more efficient ways to spend benefit dollars? What would our spend become if we moved to a different pharmacy benefit manager? The more you know about your data, the better you'll be at making key decisions about the plan. These tools allow closer examinations of factors such as:

- **Medical spend by diagnosis**, looking across the 21 major diagnosis chapters and comparing that to benchmarks to determine what's contributing the most to claims.
- **Pharmacy categories by paid amount** offer insight into higher-cost specialty medications.
- **Pharmacy categories by volume** call attention to increasingly frequent diagnoses.
- **Adherence metrics** explain whether members use preventive care and medications effectively.
- **Chronic condition prevalence** highlights treatments that might suggest underlying issues, such as a high musculoskeletal spend for employees handling specific tasks.

These data analysis tools let you spot patterns your eyes would miss, allowing you to shape your plan to meet your employees exactly where they are. For example, you may discover your plan has an unusually high rate of preventable musculoskeletal claims. You mandate training on stretching and proper lifting and fund that training through the captive. Your employee doesn't get hurt, so your company doesn't pay a hefty claim.

Cell captives offer a cost-effective solution for smaller companies, allowing them to manage medical stop loss insurance with lower startup costs. This approach leverages data analysis to optimize benefit spending and mitigate risks, providing deeper insights into claims and employee health patterns. By tailoring their plans based on detailed data, companies can reduce preventable claims and improve overall cost efficiency.

USING EXISTING CAPTIVES

Companies that have already established captives to address other areas such as automotive or general liability may be able to establish a medical stop loss program within those captives. That can simplify the process of using a captive while adding diversification, non-correlation and more premium income.

REALISTIC EXPECTATIONS

It's not unusual for an organization facing steep premiums to hear about the captive strategy and assume it's the right answer for them. Moving to a captive isn't like simply flipping a switch. The process isn't focused on the amount of premium. Instead, it's all about the organization's overall business strategy, financial strength and leadership's appetite for risk.

That's because an organization moving to a captive will be assuming a significantly larger share of financial risk. If a $50,000 deductible terrifies a company's CFO, will they be able to handle a captive in which the company becomes directly liable for half a million dollars or more?

TRUSTED ADVICE IS CRITICAL

Medical stop loss coverage is a time-proven concept. Combining it with the many advantages of a captive insurance program and today's extraordinary access to data lets you take control of healthcare costs and rewards you for making smart choices.

Captives are intricate structures, requiring professional planning, forecasting, and advice to achieve long-term success. Choosing an experienced captive advisor or manager gives you access to knowledge about captive types, ownership and program structure, service provider guidance and more. Your future captive will also benefit from their working relationships with carriers and other key players, which helps them make the right recommendations.

Hylant, for example, fields a globally respected captive team with access to brokerage partners and carrier staff. Together, they implement innovative strategies to help organizations design and manage affordable employee benefits programs.