Courting a Captive Audience

Stop-Loss captive programs slowly emerge among mid-market employers, but at least one skeptic questions their effectiveness.
Andrew Cavenagh, president of Pareto Captive Services, LLC, recalls how a midsize-employer client called one day to complain about spending $100,000 on workers’ comp, but as much as $1 million on benefits – wondering if there was a strategy to get the latter to look more like the former. Then he had an epiphany: What if the promising P&C group captives he worked on at the time could be replicated for the employee benefits space?

Welcome to the world of stop-loss captive programs (also known by some as employee benefit group captives), which create a shock absorber of sorts that reduces risk and volatility that a 100 or 200 life group would normally have if they self-insured.

The programs have caught on in recent years because they give members “the ability to have a sense of shared accountability to each other in terms of utilization claims experience that is difficult to get when you’re part of a large, fully insured pool, where you don’t have any credibility,” says Jeff Fitzgerald, VP of employee benefits at Innovative Captive Strategies.

What’s worth noting is that price stability and credibility are in short support for groups of 100 to 400 covered lives that Fitzgerald says are “told they’re not big enough to matter because they’re part of such a large block of a big, fully insured carrier.”

The number of stop-loss captive programs has gone from a handful to nearly 100 arrangements over the past seven years or so, he observes – with anywhere from five to 100 members. He has seen huge growth in the past two or three years, particularly in the “heterogeneous” space involving 100 to 400 covered lives on a plan. “It’s still a very small part of the industry,” he acknowledges, “but if you’re looking at groups of that size throughout the country, that’s an almost uncountable number of employer groups.”

A 2013 Milliman report commissioned by the Self-Insurance Educational Foundation estimated that about one-quarter of the employer medical stop-loss market serves 100 or fewer covered employees as measured by the number of employers. That same segment represents only 2% of the market when measured by covered employees, according to the report, which was based on data provided by eight of the nation’s largest stop-loss carriers serving about 50% of the market.

The Wrong Focus

While these captives may be commanding attention among mid-market employers, there are skeptics who dismiss them as ineffective. The fact is that nearly 98% of the self-funded employer market does not participate in captives, explains Matt Rhenish, president and COO of HM Insurance Group. He says self-funded employers should devote most of their time, energy, resources and dollars to managing claims, which drive at least $85 of every $100 in health care costs. The trouble with captives is that they attempt to reduce only a tiny part of overall cost, which is to get a better handle on stop loss.

“That’s an important thing to do,” he admits, “but it’s significantly less relevant considering it has significantly less impact on a client’s overall financial situation than managing first-dollar claims and claims overall.”

Rhenish is unconvinced that these programs offer a better way for self-insured employers to manage their claims relative to other mechanisms, such as changing deductibles or tightening plan documents, that can be done, irrespective of a captive.

Another issue is the level of complexity associated with these arrangements. “In some cases, you have to put in up-front capital to fund the captives and there are ongoing costs,” he explains. “Those are all costs that don’t really help reduce your overall claims costs. Maybe you can manage the middle layer a little bit better; but that middle layer is going to be what, 5% of your total claims cost? You’re going to manage it 10% better?”

Rhenish points out that banding together will merely extend or share risk across the populations of other captive members rather than actually manage the risk in any meaningful way. “We can’t just make risk disappear,” he says, suggesting that mid-market employers instead “write a straight stop-loss contract that mirrors the underlying plan document.”

Three Programs in One

But others see promise in this approach. Cavenagh was so bullish about captives that he actually quit the large insurance company he’d been working for in 2010 because of a “strong belief that the captive management role should be independent from both the broker and stop-loss carrier.”

Comparing these arrangements to a three-legged stool that’s grounded by the employer, stop-loss company and group captive, a Pareto Captive Services white paper cautions that “if any of these contracts is not negotiated at arm’s length, the structure is weakened. It is difficult to have an arm’s length transaction if the same entity is negotiating two sides of an agreement.”

Cavenagh describes stop-loss captives as essentially three programs wrapped up into one, including a
traditional layer of self-insurance for, say, up to $25,000 per individual and some aggregate stop loss; the captive, or shock-absorbing layer from $25,000 to $250,000; and traditional excess or stop-loss for the portion of claims above $250,000 per individual.

An employer with a $100,000 claim will pay $25,000 and then request $75,000 from the stop-loss captive program, and if there’s any money left over at the end of the year, it’s given back to all the employers that are part of this arrangement. If they run out of money, then the same carrier that has agreed to pay the catastrophic claims agrees to step in and pay claims.

The employer technically isn’t buying a policy from the captive, but rather an “admitted” or “fronting” carrier that will pay all claims in excess of $25,000, according to Cavenagh.

In this example, all of the captive employers will buy a stop-loss policy from a carrier that is going to enter into a reinsurance agreement with a captive that will give a portion of the premiums collected to each employer and the captive is now responsible to pay claims between $25,000 and $250,000.

“That’s a very important twist from a regulatory standpoint, because a captive itself is there for not issuing policies in 50 states around the country, which would be illegal,” he explains.

Key objectives of these programs include a search for greater transparency in claims data as part of a partnership approach that leverages the involvement of many smaller employers, according to Fitzgerald, a member of SIIA’s Alternative Risk Transfer Committee, which he says is always on the lookout for medical stop-loss and enterprise risk captives for small businesses.

The appeal of these programs isn’t confined to a particular employer or industry. While a construction company that offers wellness incentives certainly would fare better than a white-collar group that’s full of smokers, he says “it’s more about having groups of a like mind” that want to share in the risk.

**ACA Program Accelerator**

Fitzgerald predicts that the Affordable Care Act’s (ACA) reporting requirement, which takes effect in 2015, will create the opportunity for an alternative risk vehicle “because the exchanges aren’t interesting for everybody and the traditional insurance market is really having trouble pricing these groups.”

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who have never been offered benefits by appealing largely to entrepreneurial business owners who are seeking more control over the pricing of these benefits, he observes. They may include anyone from franchise owners, staffing agencies and professional employer organizations to construction companies and retail stores that employ many hourly and cyclical workers who may not have qualified as full-timers in the past.

Another key trend that he sees tied to the ACA is that more carriers are prohibited from pricing or banding their rating of groups by age, gender or even claims experience. “Insurance companies are going to basically be underwriting on a platform that makes it difficult to differentiate themselves because of the bands that they’re locked into,” Fitzgerald says.

As a result, he believes better performing groups are going to be subsidizing weaker performing groups without any incentive to do better. The ACA also will continue to drive members who are already serious about wellness and cost-containment strategies “into these sorts of vehicles so that they can be rewarded for the work that they’re putting forward and have some of their own say in the ratings rather than the shrunken rating bands that are going to be allowed by the carriers,” he adds.

Stop-loss captive programs seek a common thread, which Cavenagh describes as “temperament of ownership” – the most important determinant. One such example is a refusal to pay a 15% increase to Blue Cross with no usable claims data and terrible population management.

In spite of what Rhenish says about captives, Cavenagh expects “exponential growth” for these programs as well as his own company, calling the ACA an accelerant if not an actual cause. “It wouldn’t shock me if in the next year it’s a $500 million stop-loss business,” he says.

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