Captives Take the BURN out of Lasers

Written By Mike Madden

There comes a time in nearly every self-funded employer's experience when a single catastrophic claim threatens to bankrupt its health benefit plan. Whether it be the rare $1 million premature baby or organ transplant or a cancer requiring expensive chemotherapy, it can happen.

Specialty drugs, extended hospital stays and complex treatments are major cost drivers in million-dollar-plus claims, according to a claims analysis published in June 2019 by Sun Life Financial, a leading medical stop-loss underwriter with approximately 2,300 U.S. employer clients that cover more than 4.7 million people.

The number of patients with more than $1.5 million in claims surged 54 percent between 2015 and 2018, Sun Life reported. Meanwhile, the number of patients with more than $3 million in claims rose 140 percent, according to Sun Life, which analyzed nearly 37,000 high-dollar medical claims in its database.

Berkley Accident and Health, a Member of W.R. Berkley Corporation that specializes in accident and health products, recently reported similar experience, with the incidence of stop-loss claims exceeding $1 million more than doubling between 2014 and 2017 from 49 per 100,000 employees in 2014 to 109 per 100,000 in 2017.

Pharmaceutical costs are major contributors to the costs of $1M claims, as new and more expensive drugs enter the pipeline. According to the National Institutes of Health, 38,175 registered clinical studies with posted results were being conducted as of August 11, 2019, 28,166 of which involved drugs or biologics.

Moreover, that number will continue to grow as improvements are made in detecting disease, understanding the root causes of acute and chronic illnesses, and in discovering new medical interventions.

More U.S. employers than ever before are feeling the brunt of these catastrophic claims since more of them are self-insuring. The proportion of self-funded employers has swelled to more than 60% today from just 48% in 2010, according to the annual Kaiser Employer Health Benefits Survey.

Typically, smaller and midsize employers that self-insure their health plans purchase medical stop-loss coverage to protect against high-dollar claims. However, since the passage of the Affordable Care Act in 2010, even the large Fortune 500 companies now buy it. This is because the ACA prohibited health plans from setting lifetime limits on benefits beginning in 2011.

Annual caps also were eliminated for plan years beginning after Jan. 1, 2014. As a result, self-funded employers now face unlimited plan exposure unless, of course, they purchase medical stop-loss coverage.

In fact, because so many more self-funded employers are purchasing medical stop-loss coverage, the market has exploded, growing from $7 billion before the ACA's passage to more than $18 million today. It is expected to eclipse $22 billion within the next few years.

Additionally, with the advent of new and more expensive treatments for conditions like cancer, the incidence of self-insured employers filing stop-loss claims also is growing. Sun Life's research found that 85 percent of self-funded employers experienced a medical stop-loss claim in any given policy year, while 22 percent had at least one member with a claim of more than $1 million over a four-year period.

When a self-funded group files a stop-loss claim in connection with one or more of these high-dollar claims with a potential to be on-going, that is it costs will continue into the next policy year, its medical stop-loss carrier will mostly likely require that a laser be placed on those individuals at renewal time, so that it can limit its exposure.

With a laser, the carrier either totally excludes certain individuals from stop-loss coverage or raises the deductibles for those individuals.

Medical stop loss is a form of excess-of-loss coverage to protect against larger, more unpredictable risks, but when a known condition can be identified;

YOUR BEST PARTNER
LEADS THE WAY

For more than 35 years, self-funded employers have trusted Sun Life to deliver flexible stop-loss solutions and seamless claim reimbursement. And now, with our new Clinical 360 program, our clinical experts will review your claims data to identify cost savings and care optimization. With high-cost medical and pharmacy claims growing every year, you need your best partner with you every step of the way. **Ask your Sun Life Stop-Loss specialist about our latest innovations.**

STOP-LOSS | DISABILITY | ABSENCE | DENTAL/VISION | VOLUNTARY | LIFE

For current financial ratings of underwriting companies by independent rating agencies, visit our corporate website at www.sunlife.com. For more information about Sun Life products, visit www.sunlife.com/us. Stop-Loss policies are underwritten by Sun Life Assurance Company of Canada (Wellesley Hills, MA) in all states except New York, under Policy Form Series 07-SL REV 7-12. In New York, Stop-Loss policies are underwritten by Sun Life and Health Insurance Company (U.S.) (Lansing, MI) under Policy Form Series 07-NYSL REV 7-12. Product offerings may not be available in all states and may vary depending on state laws and regulations.

BRAD-6503k

SLPC 29427 02/19 (exp. 02/21)

it becomes an expected or predictable risk. The practice of lasering supports the self-funding principal of retaining known, or predictable, risk and only purchasing insurance for unknown, or unpredictable, risk.

So, for example, if the employer's specific stop-loss deductible is $50,000, an individual with a serious ongoing claim may have his or her own separate deductible of $150,000. The self-funded employer would then be responsible for paying the difference between the $50,000 specific deductible and the $150,000 laser deductible.

In recent years, due to the increasing prevalence of high-dollar claims, more stop-loss insurers are imposing lasers. Moreover, insurers that previously did not institute lasers have begun doing so.

Alternatively, the stop-loss carrier may offer a "no-laser" policy at renewal, which often comes with a hefty price tag. The no-laser renewal contract also typically has a rate cap that specifies the maximum premium increase that can be charged at renewal.

So, for example, the policy may have an initial 10% premium bump over the prior year with a renewal rate cap of 40%. However, rate caps are on the rise and what was a 40% rate cap two years ago is now 55% or more.

However, there is an alternative to self-funded employers paying for an expensive no-laser renewal or exposing themselves to picking up 100% of the tab for lasered individuals' medical expenses.

That employer could join together with other employers and form a group captive to fund the difference between the plan's medical stop-loss deductible and the laser level, spreading this cost among other captive members.

A "captive insurer" is generally defined as an insurance company that is wholly owned and controlled by its insureds; its primary purpose is to insure the risks of its owners, and its insureds benefit from the captive insurer's underwriting profits.

By grouping together and forming a captive, midsize employers also have greater leverage in negotiating more attractive long-term contracts with stop loss carriers. They can collectively purchase stop-loss coverage with a higher deductible, which costs significantly less than such coverage with lower deductibles and the higher deductible will take you most typical lasered claims.

Additionally, pooling several midsized employers' health benefit risks in a captive creates greater underwriting credibility, or predictability, for the stop-loss carrier. The larger the group, the more predictable the claims experience. Larger participation numbers also help to stabilize the loss volatility within the layer of risk that is retained by the captive.

Taking the Burn Out of Lasers

Then when a captive member is faced with lasers on certain plan members, they can spread this risk among the other captive participants on a quota-share basis, as determined by their prior claims experience.

For example, an employer with greater exposure to such catastrophic claims would be put in the highest tier, paying a greater percentage of the claims, while an employer with the least exposure would pay the smallest percentage of claims. The remaining employers would fall in the middle tier.

If the average group captive member has 100 employees, a typical medical stop-loss captive with 30 members/owners and 3,000 employees would have the following proportional breakdown of laser costs:

Tier	# of	# of Employers	Average Stop Loss Premium	Initial Stop Loss Premium by Tier	Additional Costs for Known Claimants	Final Premium by Tier	Final Premium By Employer
Low	1,500	15	300,000	4,500,000	-	4,770,000	318,000
Mid	1,200	12	300,000	3,600,000	77,500	3,924,000	327,000
Hi	300	3	300,000	900,000	732,500	1,116,000	372,000
Total	**3,000**	30		**9,000,000**	**810,000**	**9,810,000**	

Average

Tier	Increase
Low	6%
Mid	9%
Hi	24%
Target	9.00%

0

Claim #	Amount	Likelihood	Discounted Amount	Related Employer
1	50,000	95%	47,500	Mid
2	40,000	75%	30,000	Mid
3	30,000	50%	15,000	Hi
4	200,000	25%	50,000	Hi
5	225,000	75%	168,750	Hi
6	125,000	60%	75,000	Hi
7	70,000	40%	28,000	Hi
8	175,000	75%	131,250	Hi
9	150,000	75%	112,500	Hi
10	160,000	95%	152,000	Hi
Total	**1,225,000**		**810,000**	

Row Labels	Sum of Discounted Amount
Mid	77500
Hi	732500
Grand Total	810000

Note that a prudent practice of the captive will be to laser on the way into the captive offering the protection of the group for on-going claimants at renewal. The captive is protective when employers join, but then extends the benefit at subsequent renewals. Think of this as 'saving for a rainy day'.

The captive also uses a team-based approach to managing lasered individuals' claims to ensure they don't get out of hand. The team, consisting of the captive program manager, third-party administrator, stop-loss carrier, benefit consultant, and employer, has broader access to cost containment and case management services including dialysis vendors, transplant and specialty pharmaceutical networks, and Centers of Excellence.

By collaborating with other like-minded employers on risk management initiatives, costs associated with catastrophic claims can be better managed and mitigated.

Additionally, by leveraging the larger population of a group captive, some initiatives such as data analytics and predictive modeling can produce a better return on investment. Other initiatives such as sharing and establishing best practices among the employers can ensure cost containment measures are established within the plan documents to hopefully get out in front of the next claimant of concern.

While some of the captive members in the low tier might object to paying even a fraction of the lasered claims, it would be worth noting that eventually what goes around comes around. Based on the statistics shared earlier from SunLife, there is a 22% likelihood that even these low-tier employers will experience a claim exceeding $1 million in any given year. By pooling this risk in a captive, it removes the peaks and valleys that might otherwise occur.

Large self-funded employers with single-parent captives also can benefit from this risk-sharing technique by placing a portion of its medical stop-loss risk in its property/casualty captive spreading the risk of an ongoing claimant across other lines of business instead of across disparate employers thereby dampening down volatility.

For example, if the benefit plan retains the first $250,000 of claims, the employer could purchase specific stop-loss coverage with a specific deductible of $1 million per-employee but use the captive to pay claims between $250,000 and $1 million. Over time, as the captive builds loss reserves, those reserves can be used to pay the medical claims that might be lasered by the stop-loss carrier.

In conclusion, funding lasers via captives can serve as a viable alternative to paying higher premiums for no-new-laser-renewal stop-loss contracts while also providing a collective approach to risk management for self-funded employers. ■

Mike Madden

Michael P. Madden is the Senior Vice President – Benefits, North America at Artex Risk Solutions, Inc., a wholly-owned subsidiary of Arthur J. Gallagher (NYSE: AJG), focused on alternative risk solutions. In this role, Mike leads the Benefit Captive strategy, which provides employers with the opportunity to better manage health plan risk and costs through the development and management of captive insurance programs.

Mike has over 20 years of experience structuring single-parent and group captive insurance programs for both employee benefit and property casualty coverages. Mike is one of the early innovators in the Benefit Captive space developing stop-loss group captive programs while working for both stop-loss carriers and captive management firms.

Mike is the immediate past Chairperson for the Self-Insurance Institute of America (www.siia.org) Captive Committee which, among other initiatives, promotes industry education and advancement of stop-loss captive programs, enterprise risk captives and group captive programs furthering the interests of captive owners, service providers and insurance industry professionals.