The Captive Business Strategy: Employee Medical and Other Heath Care Risks

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Medical systems have historically been the quickest to adopt captives to control their employee healthcare costs. From regional hospitals with a single plan, to large hospital systems with multiple plans, the systems have found that a captive-based structure used at the parent level enables a more efficient purchase with uniform protection across plans. Instead of numerous affiliates within each human resources (HR) department buying their own stop-loss coverage, the parent can aggregate risk across their locations, giving them better efficiency, consistency and cost savings — as much as 20 percent on a stop-loss purchase.

Many other types of industries are now following suit. Virtually any large employer with a self-funded medical plan is a candidate for a captive stop-loss strategy, whether they are in manufacturing, foodservice, retail, higher education or any other for-profit or not-for-profit space. This strategy is helping employers continue to provide competitive benefits to employees, while managing costs as medical costs rise. This can even be seen with multinational employers. According to Marsh's "The 2019 Captive Landscape" report, 53 percent of Marsh-managed captives are already writing, considering writing, or likely to consider writing benefits such as group life, multinational health and disability benefits, and voluntary benefits.

Large Claims – Now More Than Ever

With the end to annual and lifetime caps brought on by the Affordable Care Act, and significant increase in specialty drugs and other costly treatments, organizations are starting to see that a single claimant in the millions of dollars is not necessarily a question of "what if," but of "when." Industry data suggests that for every 1,000 members in plan, there is a 5 to 10 percent chance of a claim of at least USD 1 millon, a 1 to 2 percent chance of a claim of at least USD 2 million, and a ~0.20 percent chance of a claim greater than USD 5 million. In fact, Truven's Marketscan report shows an increase of 87 percent between 2013 and 2017 in members with claims over USD 1 million.

While large, self-insured employers may have been big enough to withstand a large loss in another era, this is no longer the case. Medical stop loss coverage is more of a necessity than ever. Now, companies are realizing that buying through their captive instead of the commercial market can be a more efficient mean of obtaining this coverage.

Claim Size	2013	2014	2015	2016	2017
$1M - $2M	276	296	371	460	516
$2M - $3M	32	28	41	48	59
$3M - $5M	8	12	11	13	12
Over $5M	1	4	5	6	6
Total:	**317**	**340**	**428**	**527**	**593**

Source: Truven MARKETSCAN Research Database. © Copyright 2019 Truven Health Analytics Inc. [2]

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Stop-Loss Landscape – Reinsurance Through Captive is Growing

The market has responded to the growing needs of self-insured medical plans to obtain stop-loss coverage and reinsurance through their captive. Commercial stop-loss continues to grow as more (and smaller) groups shift to self-funding; however, that growth shifts the employee stop loss (ESL) market away from a focus on larger employers and opens the door to a captive-based reinsurance program.

In 2015, most reinsurers were not familiar enough with the strategy to quote on an employee plan through a captive: Guy Carpenter's first program had six markets quoting, with just one or two that were coherent. At 2019 renewals, in contrast, we saw up to 10 markets sharing compelling quotes across each of our 20+ cases. Market conditions have also contributed to the uptick in quotes: there is always appetite in the market for new sources of reinsurance premium, which these programs represent.

For clients, this means more competitive quotes. We typically see lower prices of 5 to 25 percent in total costs for exactly the same coverage as a traditional ESL program through the reinsurance market. Note that this is only the immediate savings, and does not factor in the potential for additional savings after the year is complete.

What to Know Before You Purchase Reinsurance via Your Captive

A captive is an effective vehicle for building capital to guard against volatility in future years, withstanding a loss event or a change in pricing in the commercial market, in exchange for retaining a layer of risk. You may already own a captive and use it to support your other lines of business: according to a recent survey from our colleagues at Marsh, 78 percent of companies that engage in some form of alternative risk transfer use captives.[1]

Buying stop-loss reinsurance through your captive has several advantages. The reinsurance market tends to be more nimble than the commercial insurance product as it's not a filed insurance product. This can allow greater flexibility in customizing terms: the reinsurance pricing can be more reactive to the results of the plan itself, rather than defaulting to a filed rate or manual rate. By structuring your reinsurance with a captive and retaining layer of risk, you're also able to soften the impact of price increases in subsequent years, allocating more of the spend to the captive retained layer as opposed to paying it to an external party.

By maintaining control of your capital through a retained layer, a captive strategy also allows you to participate in a favorable loss year outcome. For example, if you have USD 1 million funded in your captive, you get to keep what you didn't spend at the end of the year — usually a much higher amount than what is offered in commercial market profit share options.

Through pricing, efficient structure and ability to be more agile at renewal, along with the greater participation in favorable results, a captive stop-loss strategy may be the best solution.

However, there are certain nuances that buyers need to be aware of, such as data requirements, issues of timing, regulation and internal alignment. All data elements of the employee plan need to be on hand to design and market a medical captive strategy. Fortunately, they are not very different from a commercial placement and your HR team, third-party administrator, or benefits broker should already have them available. Then, there is timing. When first considering the switch, quotes need to be coordinated between the captive vehicle and the commercial market, to make sure these quotes are coming in and are actionable within the same timeline. From a regulatory standpoint, the captive domicile will also have some questions about adding a new line of business — usually not onerous, but necessary. Finally, there is the internal friction that can arise when any large process changes. Guy Carpenter has experience in mitigating the respective teams and addressing concerns ahead of the switch.

A captive-based structure is not a traditional placement, but it can offer many positive steps towards a more efficient risk program. But the more complex structure, the greater the hurdles that come with it, an expert's help is needed to help the process go smoothly.

At Guy Carpenter, our experienced team can help you analyze your current captive strategy to make sure that writing medical stop-loss within your captive won't threaten the other lines of business it covers, get the new line of business approved, and help you find the best reinsurance partner for your needs.

[1] Marsh, "The 2019 Captive Landscape: Securing Your Future With a Captive," June 2019

[2] Derived from Swiss Re presentation at 2019 SOA Health Meeting and Sun Life 2019 High Cost Trends report