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## Group Health Insurance and Captives

One of the recent trends in the captive industry has been the growth in the use of group captives to fund health insurance. In this article we look at the drivers behind this trend and where this

approach fits. In our second article we look at how health care reform may impact the use of captives for group health.

### Drivers

Healthcare costs have become one of the largest benefit costs facing employers in the US today and they are rising rapidly. As shown in Exhibit A, costs have increased by 149% over the past ten years compared to wage increases of 37%.

### Small - Middle Market Employers

This affordability gap is most pronounced for small to middle market employers who lack the size to consider many options other than conventional first dollar medical insurance. For this group, cost containment measures usually involve pushing more of the cost of health insurance back onto employees with the resultant problems in attracting and retaining employees. They face some unique issues compared to larger employers.

- Smaller and middle market employers are charged industry rates, independent of their experience. They are not individually rated. As a result, improving the health

of the workforce and reducing health claims does not lead to reduced premiums.

- There is a lack of transparency in claims data. While HIPAA considerations can limit the free flow of data, this is most pronounced for smaller employers.
- Smaller employers lack the size to achieve stability in their claims experience. Individual self insurance may be unavailable to an individual employer.

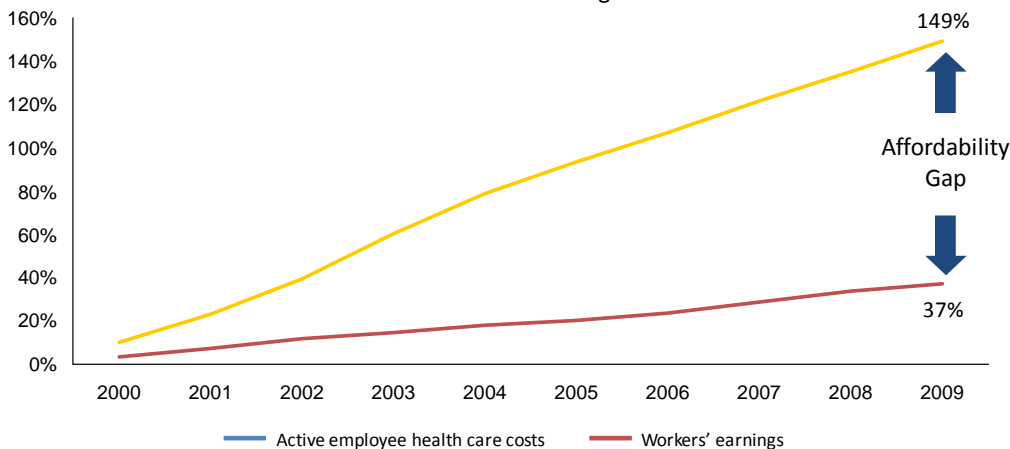
Middle market employers have faced similar issues for property casualty risks. One of the solutions to the problems has been the use of group captives and this approach promises to provide similar benefits in addressing group health insurance.

### Structure

While captives have been used to fund health insurance costs in single parent captives, the most activity is with group captives formed to pool the risks of middle market employers. Group health insurance plans are not new and it is worth distinguishing captives from other plans.

- Multiple Employer Welfare Arrangement (MEWA):** this is a health insurance program where a group of employers form a coalition to offer a health plan to their employees. The MEWA will offer a single insurance plan and a single group insurance rate. It can be fully insured or be self-funded.
- Association Health Insurance Plan (AHIP):** An AHIP is an association of similar businesses purchasing a shared health insurance plan. The intent of these programs is to get group purchasing power by having several employers purchase insurance together.

Exhibit A: Cumulative Active Employee Health Care Costs vs. Wage Increases

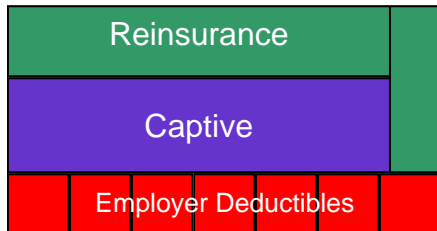


Source: Towers Watson Health Care Cost Survey 2010 (active employee data) and Bureau of Labor Statistics, seasonally adjusted data from the Current Employment Statistics Survey August to August, 2000 – 2009.

The typical structure for a group captive is for each employer to have its own deductible program with the group captive taking a share of the stop-loss insurance

up to an aggregate limit (see Exhibit B).

**Exhibit B: Group Health Captive**



A group captive offers several advantages over the MEWA and AHIP structures.

- Cost savings through individualized risk retention: each employer group uses its own deductible program, which allows that employer to benefit from favorable loss experience and wellness programs. This advantage tends to be most pronounced for mid-sized employers with 50-250 employees. These employers have typically come from a fully funded program and the captive is the first time that they have been able to benefit from savings through risk retention.
- Multi-state: the captive can operate in multiple states compared to a MEWA which can be limited to a single state.
- Individualized plans and rates: different employers can have different plans and attract different rates. This gives the employers greater individual control.
- Re-capture stop loss premiums: for larger employers, who may have already benefited from cost savings through self-insurance, a group captive provides a means to recapture stop-loss premiums, without taking on catastrophic risk.

## Challenges and Risks

Group captives are not without their own risks and challenges. Any vehicle that involves retaining risk is subject to loss as well as potential savings. Like other captives, a group health captive will require adequate funding and capital supported by appropriate levels of specific and aggregate stop-loss protection. Group health captives also face some unique challenges:

- Lack of data: it is difficult for a middle market employer to obtain claims information from health insurers, particularly under fully insured programs. Without the data, actuarial estimates are based on industry data and do not reflect the true risk to the captive. The captive owners then need to take a “leap of faith” regarding

the expected claims experience. This lack of transparency can be a motivation to move to a captive, gaining access to claims data and starting to control healthcare costs.

- A national healthcare provider network: networks are a key piece of the health insurance puzzle. They determine the cost that the health provider will charge you and your employees for claims. To be effective the captive program must access a network that has a strong presence in the employers’ states. It also needs to have sufficient leverage to make the cost of claims competitive with commercial insurers.
- An integrated risk management and benefits approach: captives have traditionally been used as a property & casualty risk financing technique. Applying this approach to group health requires expertise from both sides of the house. Employers and advisers need to build an integrated team and approach and avoid any internal conflicts over a captive solution.
- An immature captive reinsurance and stop-loss market: For health insurance, captives are new and are looking to reduce the amount of premium flowing to stop-loss insurers. However, like other captive programs, they cannot operate without the support of the stop-loss market. Available options may be limited until the captive market for health insurance matures.

Despite the challenges, more and more employers are participating in group captives programs for health insurance. One of the principle reasons is control. Captives offer middle market employers a means to take control of healthcare costs. Control of significant and increasing costs is a primary motivator behind the use of captives. We do not anticipate health care costs reducing in the short term and consequently we expect more employers, particularly middle market employers, to look to captives as a means of controlling their health care costs.

## The Impact of Health Care Reform

In our lead article we discussed the growing trend of using group captives to fund health insurance. This trend is taking hold just as health care reform is passed. How will health care reform affect the use of captives for health insurance?

The passage of the health care reform legislation in March 2010 signals the start of a transition to a public health care system. The transition is due to be complete by 2018 with public health exchanges operational by 2014. The implications for individuals and employers are far-reaching and in the immediate aftermath of the legislation’s passing it is difficult to assess with

certainty how it will change health care costs for employers. There is nothing specifically in the legislation that address captives. However, there are components of the legislation that will likely impact the drivers behind the use of captives.

## Employer – Pay or Play

By 2014, employers will have the option of paying the government to cover its employees in public health exchanges (pay option) rather than continuing to provide private health insurance (play option). There would be no need for group health captives under the pay option. It remains to be seen how many employers will “pay”. This option represents a major change from the current practice. We believe that most employers will continue to “play” and provide health insurance plans to employees, due to competitive pressures to attract and retain employees and cultural pressures to maintain the status quo.

## Key Provisions

- **Elimination of Life-Time Maximums:** current health plans often include lifetime maximums. These will be removed with health care reform and replaced with annual limits. The result is that there will be additional catastrophic risk picked up by health insurers. This will result in some additional cost as well as stop-loss insurers raising attachment points to push more of the risk into the primary layer.
- **Dependent coverage:** children up to the age of 26 will be eligible to be covered under family plans. This compares to current age limits of 19 -23. The additional dependents coverage will result in some costs increases.
- **No pre-existing conditions:** insurers will no longer be able to impose a waiting period on new insureds for pre-existing conditions. This will also result in additional costs for health insurers.

## Impact on Captives

- **Risk selection:** with additional risk being passed into primary and self-funded plans, there may be a tendency for employers with higher risk profiles to “pay”. The exchanges could face an adverse risk selection problem and become the equivalent of the workers compensation assigned risk pools. How premiums will be rated in the exchanges and what incentives will be provided to control costs are unknown. For employers with good risk profiles who have invested in wellness and cost control measures, using self funded plans and captives may be a much more attractive option to the exchanges.
- **Increased costs:** The additional costs imposed on health insurers will be passed on to insureds in higher premi-

ums. Any time there is a perception, real or not, that premiums are increasing and are not being utilized the alternative market will enter.

- **Ratio of claims to expenses:** the regulation includes a requirement that a health insurer’s expenses can not be more than 20% of the overall premium. The definition of what is included in expenses is unknown, but we believe self-insured groups will be exempt from this provision as they are paying their own claims. This provides these groups and captive programs more flexibility in pricing.
- **Control:** there is considerable uncertainty surrounding the cost and regulation of health care going forward. Government regulation is unlikely to increase the transparency of the system and lead to more available claims data. Captives offer employers a means of controlling costs and could be a valuable option to have available as health care reform is implemented.

## Conclusion

There is a lot of uncertainty at the moment, but we do not see anything around health care reform that will reduce the attractiveness of group captives for health insurance. There is increasing sophistication among small to middle market employers. These employers are unbundling their health programs and increasing their risk tolerance. As health care reform is rolled out, we expect there to be an increase in groups that are self funding and using captives as an option to the exchanges and private insurance.

## Domicile News

### Regulatory Changes in Vermont

The Vermont Department of Banking, Insurance, Securities and Health Care Administration (BISHCA) has recently announced two changes to its senior regulatory staff.

**Commissioner of Insurance**—In June, Commissioner Paulette Thabault left the Department to take a position with CVS Caremark MinuteClinic. Her replacement is Michael Bertrand who was the Deputy Commissioner of BISHCA, responsible for overseeing the Insurance Division. Michael has been a supporter of the captive industry for years and has a long history with state government in Vermont. Prior to his role as Deputy Commissioner of Insurance, he served as Deputy Secretary of Administration, Commissioner of the Department of Labor and Industry and as deputy legal counsel and special assistant to Governor Douglas.

**Director of Captive Insurance** — Sandy Bigglestone will be replacing Peter Raymond as Director of Captive Insurance. Sandy was formerly the Director of Financial Examina-

tions and brings 13 years of captive experience. As the Director of Captive Insurance, she will be responsible for organizing and directing the operations of the examination and analysis section of the Captive Insurance Division, which is led by Deputy Commissioner for Captive Insurance David Provost.

Peter will be leaving the department on July 16th to become a contract examiner and consultant for the Florida Hurricane Catastrophe Fund. He has spent 22 years in the captive insurance industry in Vermont. We wish him well in his new endeavors.

As the leading onshore domicile, Vermont has consistently shown a commitment to the captive insurance industry at a senior level within state government. The appointment of Michael Bertrand and Sandy Bigglestone, both experienced regulators in Vermont, provides continuity in regulation. We do believe that either of these changes will impact the regulatory environment for captives in Vermont.

## SRS News

### SRS Receives United Way President's Award

SRS Vermont has been presented with the United Way's President's Award in recognition of the company's commitment to the United Way. The President's Award is an additional recognition from the Gold award received by the office in previous years.

Our Vermont office has had a 100% participation in the United Way during the year.

## Staff News

**Jenni Bradwell** has joined SRS as a client accountant in our Cayman office. Jenni was previously a Senior Client Accountant at Rawlinson & Hunter (Cayman), where she managed a diverse client portfolio, including trusts, partnerships and private equity clients. Prior to that, she worked with Evans Property Group in the UK as an accountant. Jenni is a qualified Chartered Accountant.

## Industry Events

SRS will be participating in the following upcoming industry events. Please contact us at [info@strategicrisks.com](mailto:info@strategicrisks.com) to arrange meetings with our team at any of these industry events.

**June 27-30, 2010, Bermuda Captive Conference:** Brady Young, Andrew Human and Richard Winchell will be attending this conference at the Fairmont Southampton Princess.

**August 1-4, 2010 Society of Financial Examiners:** Derick White will be speaking and Judy Nako will be attending the Career Development Seminar in Providence, RI.

**August 10-12, 2010, 25th Annual VCIA Conference** SRS will be exhibiting at the conference. Derick White, and Jeff Fitzgerald will be speaking at the conference and senior members of our Vermont management team and consulting team will be attending

**September 13-15, 2010, 26th Annual SCCIA Conference** Laura Roemer, Brady Young and Derick White will be attending the conference to be held at the Charleston Place Hotel in Charleston, SC.

## SRS Webinar Series

SRS hosts monthly webinars on topical issues affecting the captive insurance industry. Upcoming webinars include:

- **Basics of Captives:** Thursday, July 1, 1pm EDT
- **Enterprise Risk Management and Captives:** Wednesday, July 28, 1pm EDT.

**Recordings** - Recordings of prior webinars may be viewed at any time. A full listing of webinars is on our web-site at [www.strategicrisks.com/webinars](http://www.strategicrisks.com/webinars).

To receive invitations to our webinars, please email us at [info@strategicrisks.com](mailto:info@strategicrisks.com).

Strategic Risk Solutions (SRS) is an independently owned captive management and consulting firm. The company is an approved manager of captive insurance companies in most leading onshore and offshore domiciles. SRS is committed to being the premier provider of captive management and advisory services in the territories in which we operate.

For more information on SRS, visit us at [www.strategicrisks.com](http://www.strategicrisks.com).

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