CAPTIVE REVIEW

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Exploring what the future holds for captives capitalising on employee benefits growth

THE ESSENTIAL GUIDE TO ALTERNATIVE RISK TRANSFER

UPDATE ON MEDICAL STOP LOSS CAPTIVE TRENDS

Steve McFarland, of QBE, provides an update on the medical stop loss space

Captive Review (CR): Why has medical stop loss become so integral in recent times?

Steve McFarland (SM): Since 2010, the number of US employers that self-insure their employee benefit medical coverage has grown from 48% to a little over 60%. Most of this growth has come from employers having less than 500 employees, particularly employers with between 50 and 250 employees. As you can imagine, the expansion of self-insurance within this market segment has had a tremendous influence in the growth of group MSL captives, which cater primarily to employers of that size. There has not been much new self-funding growth coming from employers with more than 500 employees, as nearly 80% of employers are already self-insured.

There has also been an increased amount of MSL captive activity from employers with more than 1,000 employees. At this level, we begin to see a lot of established single-parent captives expanding to include MSL as an additional line of coverage within the captive. It has been rare for us to see a single-parent formed strictly for MSL as the sole line of coverage. MSL premiums are typically not large enough and therefore economically justifiable as the captive's only coverage line. Most employers that have an established captive for other lines of coverage (such as GL, AL or WC) are invariably self-funding their employee benefit medical plans; and at that stage, it makes a lot of sense to then include the MSL into the captive. MSL, as a short-tail line of business, can provide some beneficial portfolio diversification and serve as an effective risk and financial hedge to counterbalance the more common, longer-tail coverages typically held in a captive.

Steve McFarland

Steve McFarland is vice president – Underwriting, A&H Specialty Markets for QBE North America.

CR: What market factors (and others) has influenced the growth?

SM: The inception of the Affordable Care Act (ACA) in 2010 has had the most direct influence on the expansion of the medical stop loss, and consequentially the MSL captive, market. Prior to ACA the MSL market was estimated to have been a $7 or $8bn market with very little of that premium attributable to MSL captives. As of 2017, the MSL market has grown to more than $18bn and is expected to eclipse $20bn within the next year. The amount of MSL attributable to group captives is now conservatively estimated to be in the neighbourhood of $800m to $1bn, or roughly 10% of the market.

It has been more difficult to estimate the amount of stop loss held within single-parent captives, but we know it is significant. Prior to ACA, many large employers did not need to purchase MSL coverage as the benefit plan itself served to provide a de facto stop loss in the form of lifetime loss limit – typically $1million per employee. At that level, many large employers, knowing that their maximum exposure was capped, would be able to fully self-insure their medical plans without a need for MSL cover. One of the main provisions of ACA is a prohibition of medical benefit plans from defining lifetime coverage limits. Subsequently, even many of the largest employers now need to purchase some level of MSL to cover what is effectively an unlimited exposure for their employee healthcare costs. Although the larger employers were already self-insured, they still needed to adjust the structure of their self-funded plan and how the financial risk associated with the benefit plan was secured. Converting defined segments of existing retained risk into layers of MSL coverage, formalising the funding of through the captive and then purchasing high levels of MSL (re)insurance has significantly influenced the considerable growth of MSL captives and the MSL market itself.

CR: How are medical stop loss captives faring in 2019?

SM: Most, if not all, of the MSL captives that we are familiar with have been delivering exceptional results and we see no reason why they won't continue to outperform more conventionally structured plans in the future.

Employer-provided healthcare plans effectively have an unlimited financial responsibility (or exposure) within an environment where medical costs continually increase. Self-funded employers are uniquely empowered with the ability to design programmes having an increased focus on controlling and reducing risk to generate greater loss-cost savings. Employers' utilising a captive have improved ability to obtain and use data to identify claim trends and isolate specific cost drivers to help an MSL captive to implement targeted cost reduction plans.

Most of our MSL captives implement proven risk and cost reduction initiatives,

such as referenced-based pricing, narrow networks, alternative treatment venues, and direct provider contracting. We have further recommended that some of our captives carve-out pharmaceutical prescriptions to a specialised Prescription Benefit Manager (PBM) partner that provides deeper discounting, is fully transparent and passes through all discounts, coupons and rebates to the client. Pharmaceuticals are among the most significant cost drivers in a benefit plan and this simple plan adjustment has helped deliver highly impactful reductions to further reduce the financial risk to several of our clients.

CR: What does the future of MSL captives look like?

SM: As I mentioned earlier, formalising retained risk as MSL coverage in a captive and funding the captive through regular contributions or monthly premiums paid to the captive provides for the efficient accumulation of surplus. Surplus accumulated through underwriting profit and investment returns can then be effectively deployed in any number of ways to offset future plan costs, enhance benefits, reduce employee contributions, held in reserve or returned to the parent as a dividend.

With the continued regulatory uncertainty and persistently increasing costs associated with health care, the MSL captive market will continue to expand. Innovation in risk control will continue to rapidly evolve and become more assertive. Employers, their covered employees, and even care providers, out of necessity, are likely to become more accepting of emerging cost reduction initiatives. Until there is more clarity – and continuity – in terms of health care regulation, employers will need to do explore any viable options for reducing the overall costs associated with delivering healthcare benefits to employees. A properly structured captive amplifies an employer's ability to deliver more sustainable, long-term cost reductions.

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Even with some of the recent publicity challenges, we have been seeing increased opportunities for properly structured Enterprise Risk Captives (ERC) beginning to emerge, especially since the IRS increased the 831(b) limit to \$2.2m in premium. Regardless of whether these captives take an 831(b) election, they can be an efficient platform for assuming MSL risk for some employers. Because of their smaller size, our approach is to simply provide our traditional MSL coverage (excess insurance) to these captives rather than an assumed reinsurance structure that is more prevalent with the larger single parents. We are also exploring the structuring ERC Risk pools with some select captive managers to facilitate a more traditional single-parent, assumed reinsurance structure for small captives. Each ERC captive, as a separate single-parent, can direct-issue its own MSL policy and then purchase reinsurance from a properly structured MSL risk pool. The risk pool is essentially structured as a more traditional MSL group reinsurance captive to provide appropriate risk assumption, distribution and diversification. QBE will provide reinsurance to the risk pool. This is a more efficient structure than more traditional group captives as fronting and collateralisation are not applicable to the participating single-parents.

QBE was one of the earliest pioneers in the MSL captive space, having written our first captive programme in 2003. We continue to innovate within this segment and look for continued market expansion.