With the Affordable Care Act still having an impact on self-funding and the use of medical stop-loss captives, Phillip Giles of QBE North America explores where this area will go next

For what reasons are companies that self-fund their employee health insurance plans increasingly using medical stop-loss captives?

I should first point out that the medical stop-loss market has been very competitive for a number of years. I hesitate to describe it as 'soft' as, after this point of sustained longevity, the prevailing rate environment actually becomes the new level of market pricing reality. Whether a single-parent or a properly structured group arrangement, stop-loss captives are not just about saving money on medical stop-loss itself, but rather incorporating medical stop-loss as a contributing component within a larger holistic risk strategy for reducing the overall cost of providing healthcare insurance to employees.

Many larger employers can also realise enterprise level risk-cost reductions by adding medical stop-loss to existing captives. As the majority of existing single-parent captives provide long-tail coverage, stop-loss can serve as a complementary short-term profitability hedge for the captive.

Has the Affordable Care Act had an impact on the number of medical stop loss captives?

The Affordable Care Act (ACA) has contributed to the growth in self-funding and consequently to an expansion in the use of captives. As a carrier that can uniquely write medical stop-loss coverage as either insurance or reinsurance, we have experienced a significant upsurge in the number of employers exploring single parent or group captive options.

Prior to the ACA and its mandate for unlimited lifetime benefit liability, most employers that had a single-parent captive were also large enough to completely self-fund employee healthcare without purchasing medical stop-loss coverage. The growth within this demographic segment was not in the actual number of self-funded employers, but rather in the number of self-funded employers now needing to purchase medical stop-loss coverage. Many of these larger employers are now formalising their retained healthcare benefit risk by converting it into medical stop-loss coverage within the captive and then purchasing reinsurance for the higher layers of risk that need to be transferred.

Most of the market growth in the number of new self-insurers is actually coming from employers having fewer than 500 lives. With this, the number of group captives catering to smaller and mid-sized employers has increased substantially. Some of these are very large 'open-market' captives formed by programme administrators that explicitly target fully insured employers and use the captive as a conduit to facilitate a transition to self-funding.

There has also been a notable increase in the number of existing mid-sized (250 to 1,000 lives) self-insurers forming group captives. Within this segment, the groups tend to be more industry-specific, have tightly controlled membership entry and higher levels of active management engagement by members. We have seen a great deal of performance success within this group captive segment as the typical membership composition has greater underwriting credibility, which fosters increased predictability and decreased loss volatility. The increased member engagement also serves to improve proactive risk control initiatives. We expect to see continued growth in this particular segment.

What are the key advantages for large companies with their own captives?

Stop-loss coverage by itself would not typically generate enough premiums to justify formation of a captive solely for that purpose, however, it can be used to effectively expand the utility and enhance the efficiency of an existing captive. Funding layers of medical stop-loss coverage through a single-parent captive, as opposed to simply paying claims within the same layers from general assets or through a formal trust, allows the employer to more easily recognise and deploy underwriting profit and investment returns attributable to these layers. Surplus derived from the underwriting and investment return from the captive can be returned to the employer more efficiently in the form of dividend distributions or strategically deployed to offset future plan costs, expand benefits to employees, or retained within the captive to smooth financial volatility associated with other lines of coverage.

Adding stop-loss to a captive will enhance the financial performance of the captive, especially one that that primarily writes 'long-tail' coverage, such as workers' compensation or liability, and can provide a protective 'short-tail' stability hedge by diversifying the captive's risk portfolio.

Why are small- and medium-sized entities considering group structures?

With self-funded plans having the ability to preempt state and some ACA benefit and rating mandates, the opportunity to more appropriately tailor coverage, reduce coverage costs and related expenses, such as premium tax, exists. These employers are not large enough to support their own single-parent captive but do have the ability to participate in group captive arrangements that can, through collective size leveraging, provide many of the same advantages traditionally enjoyed by single-parent captives.

What would happen in this space if ACA was repealed?

I don't believe that a full repeal will happen, but rather significant amounts of evolutionary reform are a more realistic scenario. ACA is a massive and excessively magnanimous legislation. It's well-meaning but misguided in terms of how to appropriately and equitably satisfy the objective of affordable healthcare. ACA is still quite raw and I expect that it will continue to evolve through continuous legislative refinement.

The stop-loss market itself will also undergo some gradual change. We currently see plan sponsors and brokers continuously pushing for very aggressive pricing and expanded contract terms, while costs within an ACA-influenced healthcare environment push in an incompatible direction. The cost of claims, especially large claims over $1 million, has increased dramatically with the mandate to abolish lifetime benefit limits.

Over the next few years, I expect the larger stop-loss writers to increase their market share while many of the smaller writers, especially managing general underwriters, will struggle. Medical stop-loss will need to be written primarily by carriers with the financial strength and stop-loss portfolios large enough to absorb losses, especially the increased instances of large, multi-million dollar claims.

Medical stop-loss will continue to respond to the evolving dynamics as reflected by underlying benefit plans of the self-insured employers that we insure. With that, more employers will utilise captives as a tactical resource to support a larger strategy for lowering the ultimate cost of providing healthcare benefits to employees. **CIT**

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