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GROUP MEDICAL CAPTIVES – Get by With a Little Help from Your Friends

By Paul Hyl, Esq., ACL, General Counsel

- According to data from the Kaiser Family Foundation, since 2010, the premiums for family health insurance coverage has risen 55%, significantly more than wages.
- In the last decade, deductibles have risen 111%!
- In 2018, the average annual family premium crossed $20,000 for the first time.

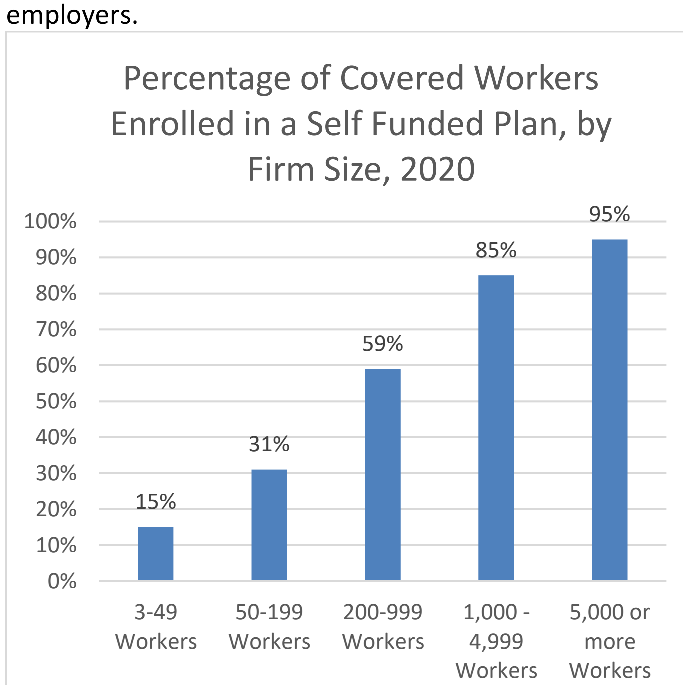
For many companies, health insurance premiums represent their second largest expense after employee salaries. Employer health care costs rose 7% in 2021 and are projected to rise 6.5% in 2022.

Such constant increases are pushing more and more employers to consider self-funded health insurance plans. With a self-funded insurance plan, instead of paying premiums to a commercial insurance company, the employer takes the financial risk of paying for its employee's medical costs.

SELF-FUNDED PLANS

To lessen the risk of the employee's health costs being too catastrophic, self-funded employers will often purchase medical stop-loss insurance to cover large claims that exceed a certain threshold. Stop-loss insurance can be on a per claim basis, kicking in when a particular claim exceeds a certain amount, or on an aggregate basis, when the total claims for a particular employee or the group exceed a certain dollar amount. The dollar amount at which the stop-loss coverage kicks in is referred to as the attachment point.

In 2020, 67% of all covered workers were in a plan that was self-funded. Statistically, larger employers were far more likely to have a self-funded plan than smaller employers.



SOURCE: KFF Employer Health Benefits Survey, 2020

LAW OF LARGE NUMBERS

One of the reasons self-funded plans are so prevalent in larger Employers is because of the Law of Large Numbers. The Law of Large Numbers is not a law in the legal sense, but a probability theorem. It stands for the proposition that the more often an action is carried out, the closer the total outcome will be to the expected result. Put another way, the more often something happens, the closer to average the results become. Let's look at a coin flip as an example. We all know that when you flip a coin, there is a 50% chance that it will land on heads. However, anyone who has lost an initial coin flip and protests "2 out of 3" knows that if you flip a coin 3 times, it can very easily land on heads 3 times in a row. However, flip that same coin 3,000 times and the results will be very close to 50% heads. That is the law of large numbers at work.

Using the Law of Large Numbers, an actuary looking at the likely claims of an employer with more than 1,000 employees can more accurately predict the expected dollar value of claims each year. As such, large employers have no problem maintaining a self-funded insurance program and have an easier time obtaining medical stop-loss coverage should they choose to. For small and mid-size employers with fewer than 1,000 employees, an actuary is less confident in the accuracy of claims predictions. The risks are greater for these employers since a disproportionate number of employees could have a "bad year." In those cases, there is a greater need for a stop-loss policy. However, purchasing a stop loss policy from a commercial insurer puts the employer back at the mercy of the commercial marketplace. Enter the group medical captive.

GROUP CAPTIVE SOLUTION

A group captive is a private (captive) insurance company that insures a number of unrelated entities. These unrelated entities are the owners of the captive. To the uninitiated, a group captive may seem like a mutual insurance company, and while both entities are owned by the policyholders, there are significant differences that we will have to save for another newsletter.

The members of a homogeneous group captive are all from the same or a similar industry, whereas heterogeneous captives have members from a variety of different industries. With a group captive, there are far more risks and exposure units than there would be with a single parent captive. Thus, the impact of an unintended loss can be spread out among all of the members of the group, since not every group member will have a bad year in the same year. Once again, the Law of Large Numbers.

In a group medical captive, a number of small to mid-size companies purchase their stop-loss policy from the group captive. The companies have greater control over the structure of the policies including premiums, plan details, coverages, and third-party administrators. It allows companies to capture the underwriting profit that would otherwise be lost to the commercial insurance carrier. In addition, it provides greater purchasing power and access to PPO networks. If a company happens to have a bad year, it will not have a negative impact on their premiums the following year a would happen on the commercial market.

For companies that are already self-funded, a group medical captive can help then lessen the cost of their stop-loss coverage. For companies that have contemplated self-funding but have been reluctant to pull the trigger because of the uncertainly over catastrophic claims and stop-loss coverage, the group medical captive should help to alleviate these fears.

Ultimately, joining a group medical captive is not only about whether the group captive is right for your company, but also about whether your company is a good fit for the group captive.

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