Three Methods to Place Medical Stop Loss Insurance in a Captive Solution

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Many large organizations and associations of affiliated midsize and smaller employers have developed captive insurance solutions to manage or share their respective property and liability risks, a number that continues to grow yearly.

At the March 2024 meeting of the Captive Insurance Companies Association (CICA, 560 new members were announced, representing a 20 percent increase in CICA's membership.[1] At this pace, the captive industry is on track to reach $250 billion in global market value by 2028.[2]

By melding medical stop loss risks into an existing captive, owners and managers have the opportunity to fuel further growth and profitability. The challenge for many captive professionals is the need to learn the language of employee benefits and feel confident with healthcare financing stakeholders. Although skilled in managing property and liability exposures, risk managers have limited experience supporting employee benefits. While interested in placing medical stop loss inside a captive, a road map guiding the way has been elusive.

Help is now at hand: Here are three methods to place medical stop loss risks in an existing captive, beginning with the most straightforward and followed by the rationale for making the journey. Each approach has its advantages and disadvantages, but in all cases, they reach the desired destination.

METHOD #1: Journey with a Fronting Insurer

Approximately 90 percent of Fortune 500 companies own a captive,[3] suggesting a higher level of comfort among such large organizations to assume medical stop loss risks without a fronting insurer or reinsurance partner. In certain cases, these captives have more capital at hand than many insurance companies. Assuming suitable cash flow and profits, regulators can be expected to approve the capitalization requirements.

On the other hand, many smaller organizations and associations may lack the internal support to assume medical stop loss risks in their captive. One way to ease this process is fronting—the use of a licensed, admitted insurer to issue an insurance policy on behalf of a self-insured organization.

In the context of medical stop loss insurance, an AM Best-rated commercial insurer provides the policy to the captive insurance solution, which retains the risk of loss through a reinsurance agreement or an indemnity. The fronting insurer's underwriting, claims processing, and policy issuance teams handle the transaction, hence the ease of this approach for risk management professionals.

Fees paid to fronting insurers typically represent a percentage of the written premium and generally range from 8 percent to 15 percent, if not higher. The fee factors into many of the administrative obligations handled by the fronting insurer and the responsibility that the insurer bears to honor the policy obligations if the captive fails to indemnify the loss.

The fronting method offers the opportunity for risk management professionals to feel comfortable in knowing that a reputable insurance company that understands the nuances of employee benefit exposures is partnering with the captive in its decision to assume medical stop loss risks.

METHOD #2: Assume a Calculated Amount of Risk

A more involved alternative to a fronting arrangement with an insurer is to partner with a reinsurer to cover the exposure at a higher limit and directly write an appropriate amount of medical stop loss risk within a captive. The captive owner, often with the support of the captive manager, secures an agreement with a reinsurer to not only be a partner on the risk but also service the underwriting of the policy as well as provide insight into the risks and notice to pay on reported claims. The services can be comprehensive.

With a quality reinsurance partner, a team of clinicians will review the risk of the medical stoploss policy with an eye toward future claims frequency and severity. From a claims management standpoint, a third-party administrator (TPA), often in collaboration with the clinician team, will examine each claim to determine if the "usual and customary" services for insurance reimbursable purposes were performed by the healthcare provider. If this is not the case, the claim will be contested.

From a cost-containment standpoint, the reinsurance partner can help identify if claims below the policy deductible are resulting in higher loss costs borne by the captive and put forth ways to mitigate the impact.

By capping the maximum losses of assumed medical stop loss risks, the capitalization requirements are often lowered. Other benefits to this method include removing the upfront costs associated with a fronting insurer, controlling of the underwriting margin, and attaining a higher level of focus on claims adjudication. A reinsurance partner can provide a significant level of comfort for risk management professionals taking this approach.

However, there are things to consider in this arrangement: Removing the fronting insurer requires more capitalization by the regulator and a higher level of oversight by the captive owner, officers, and captive manager. While the reinsurer can be relied upon to review claims and prepare loss runs, the captive owner must ensure the availability of services from TPAs, pharmacy benefit managers, and other costcontainment partners to support the determination and investigation of potentially egregious claims. These are reasons why

[1] Rachel Moir, "*CICA 2024 Conference: Record Growth Signals Industry Boom*," captive.com, March 12, 2024.
[2] Barry Leigh Weissman, "*The Outlook for Insurance Captives in 2024*," Carlton Fields, November 18, 2023.
[3] "*Captive Insurance Companies*," National Association of Insurance Commissioners, accessed on November 19, 2024.

many captives assuming medical stop loss risk will lean into their reinsurance partner for support.

METHOD #3: Assume Risk with Support

The third approach is a further advancement in integrating medical stop loss risk into the captive strategy. Here, the captive owner decides to assume all medical stop loss risk in their captive without a risk partner. This is often undertaken to reduce frictional costs and enhance the opportunity to build profit into the captive.

In this approach, all the actuarial, underwriting tools, clinical support, and claims services relied upon by the reinsurance partner in the second method are managed by the captive insurance entity and their captive manager. This proposition can be daunting for many captive owners, as it puts significant pressure on their captive manager to perform the necessary insurance management services. Even the most seasoned employee-benefit-focused captive manager may be overwhelmed by the responsibilities.

Consequently, many owners and captive managers will look toward insurers, given their breadth of experience and operational support, to provide a range of value-added claims management services, cost-containment solutions, and oversight of the insurance operations. The most crucial task performed by the insurer is the proper adjudication of claims and confirmation that claimants are eligible for payment.

The potential downside of this option is that it requires the captive owner and captive manager to invest their own capital and resources and assume all of the risk, including any high-cost claims that arise. With proper risk management policies in place, this liability can be mitigated.

A Worthwhile Journey

Certainly, many employers with self-funded health plans will be intrigued by at least one of these three methods, due to fast-rising medical stop loss premiums. Past is often prologue, and this has been the status quo with healthcare costs, which are projected to increase between 7 percent[4] and 8.9 percent[5] in 2024, up from the 5.5 percent and 6.0 percent increases in 2022 and 2023, respectively.

To contain these costs, the momentum toward self-funded healthcare plans continues to rise, as does the demand for medical stop loss insurance to cover catastrophic risks. The next step in this costoptimization journey is to place medical stop loss risks in a captive program, thereby maximizing the overall business value as often happens when leveraging existing property and casualty risk.

By pursuing one of the three methods, risk management professionals achieve benefits beyond cost optimization; one example is captive risk diversification. Medical stop loss insurance is a short-tail business, with claims generally made during the policy term and quickly settled.

Unlike long-tail liability lines with long settlement periods, medical stop loss programs derive surplus only a few months after the close of the policy year. Regulators will be well-received by a well-managed medical stop loss program that develops surplus faster to support the other risks in a captive for both this diversification effect and cost-containment feature.

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Mr. Sagen specializes in medical stop loss captive solutions that are designed for employers and their advisers. He believes the key to sustainable healthcare costs in America is to bring together best-in-class risk management procedures that control catastrophic risk that in turn diminish the ever-rising cost of corporate benefits.

In addition to earning the Associate in Captive Insurance designation, Mr. Sagen is a Distinguished Toastmaster and enjoys coaching his children's soccer teams. He lives near Cleveland, Ohio and is a graduate of the University of Toledo.

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[4] "*Medical Cost Trend: Behind the Numbers 2024*," PWC, accessed on November 19, 2024.
[5] Kathryn Mayer, "*Insurers Say Health Care Costs Will Jump in 2024*," SHRM, January 2, 2024.