Safety in numbers

Pioneer's group captive programme is providing employee benefits coverage to healthcare employer groups. Mark Troutman of Summit Reinsurance Services and Chris Payne of Alternative Risk Underwriting present a case study of the programme to *Cayman Captive*.

In an increasingly volatile healthcare market, how an employer manages the risk associated with its employee benefits can have a significant impact on its bottom line. A captive arrangement allows an employer to provide comprehensive healthcare coverage to its employees while maintaining primary responsibility for controlling healthcare costs.

It also provides an intermediate choice between the extremes of purchasing a fully insured product (more expensive, less volatile) and becoming fully self-insured with traditional employer stop loss protection (less expensive, more volatile.)

Even if an employer or employer group is not large enough to form its own captive, this type of arrangement can still be utilised. The Pioneer group captive programme enables an organisation to insure its employee benefits plan risks into a captive owned by an unrelated entity. An employer can use this arrangement to accomplish its financial objectives while segregating the captive programme risk from other captive liabilities.

To better understand the difference in control between conventional and captive insurance, see Figure 1.

First things first

By definition, a captive is a vehicle which allows like-minded employer groups to pool risk. Controlling healthcare costs still depends upon sound plan design, efficient administration, and medical management services and provider networks which focus on high quality, cost-effective care, but captives can provide more flexible, cost-effective coverage when commercial insurance markets do not provide the desired insurance benefits or charge unreasonably high premiums. Although a captive has more flexibility in the types of coverages it provides, it still needs to focus on a manageable set of alternatives for its employer groups.

In one such arrangement, Pioneer contracted with its third-party administrator (TPA) in utilising national networks. The TPA provides access to multiple prescription drug managers, provider networks, precertification, large case management, disease management, and modelling software covering predictive claims and plan design. The underlying benefits in the employer stop loss programme are customised to the greatest extent possible while maintaining administrative ease.

Pioneer has a menu of health plans that it can administer with its TPA; initially there were seven plan designs focused around provider network, prescription drugs, and wellness programmes. Each employer that joins the captive must commit to implementing these programmes. Because the TPA's comprehensive reporting package shows results for each employer as well as the captive in total, the visibility fosters accountability within the group.

Promoting wellness services to the greatest extent possible is a critical component of buying into the Pioneer arrangement, which

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follows the principle that "an ounce of prevention is worth a pound of cure." Pioneer's wellness services include the following:

- Biometric screening services
- Health risk analysis tool
- HIPAA-compliant individual and employer group biometric screening reports
- Wellness education/engagement rewards programme
- Health coaching services for smoking cessation, diabetes, weight loss, nutrition and stress

Service providers

Since the captive itself is not licensed to issue employer stop loss insurance policies in the US, the Pioneer programme engages Companion Life Insurance Company as the issuing carrier. To provide financial security and reserve credit for Companion for its statutory and GAAP financial statements, the captive either allows for certain funds to be withheld by the issuing carrier and/or provides a letter of credit as allowed by NAIC credit for reinsurance regulations.

The following entities are the resources that manage the captive programme responsibilities:

- Captive consultant: Alternative Risk Underwriting
- Captive manager: Strategic Risk Solutions (SRS)
- Issuing carrier: Companion Life Insurance Company
- Managing underwriter: Summit Reinsurance Services
- Wellness: MedWatch
- Reinsurer of Companion Life Insurance Company: AXIS Insurance Company

In addition, Pioneer solicits additional services from accountants and auditors via Strategic Risk Solutions to meet its Grand Cayman regulatory requirements.

Reinsurance

As reinsurer of Companion Life Insurance Company, AXIS is responsible for providing aggregate protection on the premiums and risks assumed by the captive so participants know they have some maximum exposure. The current risk structure allows for writing employer stop loss policies with deductibles from $25,000 to $150,000. The captive retains a layer of specific stop loss risk between the self-insured retention and $400,000 from the ground up.

In addition, the risk retained by the captive for claims experience below $400,000 is limited to 125 percent of premium. In this way, even the potential losses retained by the captive for specific stop loss coverage have a maximum limit. Figure 2 documents the risk structure for the Pioneer programme.

The captive consultant monitors actual versus expected loss emergence for both the primary and captive layers. Although there is no guarantee this will occur on an ongoing basis, the Pioneer programme has performed very close to target since its inception. Although most entities establishing a captive expect their claims experience to be better than average, there is always a possibility that losses will exceed their expected value, requiring additional employer funding and establishment of loss reserves. In that situation, additional capital is required to strengthen the captive's balance sheet and/or to provide funding for losses.

Summit Re and Pioneer assist each client in determining the appropriate level of risk for their captive participation and secure excess of loss and/or quota share reinsurance to limit each participant's exposure.

Governance

The employer's sense of ownership comes through the committee structure as well as the allocation of gains and losses in the overall financial experience of the captive. A variety of committees were established to handle different business matters (see Figure 3).

Figure 1: Conventional vs group captive cost elements

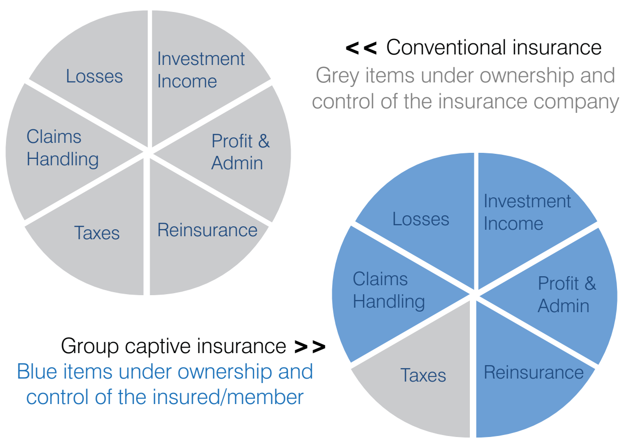
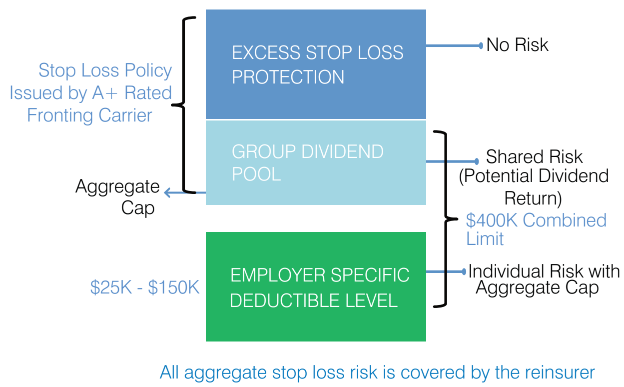


Figure 2: Pioneer captive risk structure



> "CUMULATIVE EQUITY AND PROFIT BUILT UP BY THE SHAREHOLDER CAN BE USED TO OFFSET ANY POTENTIAL LOSS, WHICH HELPS MINIMISE VOLATILITY TO THE INDIVIDUAL MEMBER."

While it is not necessarily unique to Pioneer, not all captives have this governance structure, which promotes participation and accountability.

Profits and losses

Pioneer uses a simple, but fair formula to allocate profits and losses to employer groups in the layer of risk retained by the captive. Companies that individually made money are allocated a share of the captive profit proportionate to its earnings. If one company contributes half the earnings, it gets half the captive's earnings. A company that takes a loss individually does not receive a dividend. They are neither rewarded nor debited as long as the captive achieves a profit in total.

If the captive posts a loss, each group will have some share of the negative earnings, regardless of individual performance. Pioneer has a proprietary formula where all shareholders take a share of the loss which spreads the risk over a wide base. Companies that individually lost money are allocated more and companies that made money are allocated less. It is important to note that cumulative equity and profit built up by the shareholder can be used to offset any potential loss, which helps minimise volatility to the individual member.

Reporting

The carrier and TPA are primarily responsible for generating experience reports and reports for reimbursement of specific and aggregate claims.

Information is power. The client owns the data and has full access to it. Pioneer and its service partners provide timely and accurate, meaningful data. They assist the client employer groups in understanding their exposures and risk of loss to put them in the best position to make coverage decisions.

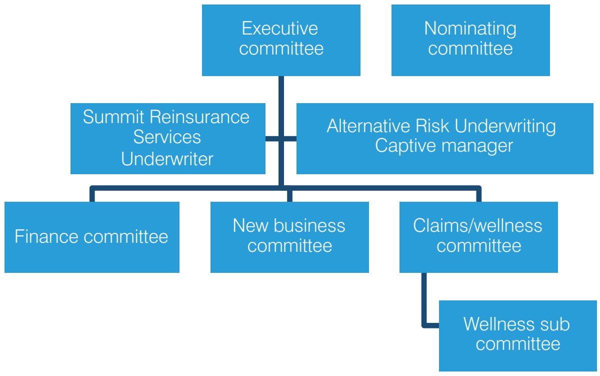
Underwriting

A captive is neither a panacea nor a placebo for managing employee benefit costs. It still requires strong underwriting. Jack Snyder, the Summit Re underwriter for all employer stop loss risks placed with the Pioneer captive, explains, "I underwrite each group the same way I would normally. It is the usual delicate balance to determine the rates which make each risk acceptable for the captive and meet the pricing and underwriting goals of adequacy, equity and simplicity."

All client candidates were individually underwritten and every candidate has pricing developed based upon its own exposures and experience. Our approach is to minimise the volatility to each member employer group, embrace wellness programmes that work, and use our data as leverage in the underwriting and reinsurance process.

We seek out only new shareholders and business partners that share our long-term approach to improving the control and cost of healthcare for our

Figure 3: Pioneer captive committee structure



members. Since no-one knows when they may have a tough year for loss experience, it is especially important to stay the course in order to build stability and dividends over the long-run. For middle-market companies that qualify for this Pioneer captive programme, owning the process and the financial results is the best way to control the outcome. This is exactly the approach we have taken for all of our property and casualty captives.

Summary

An employer group which elects to join a captive programme should plan to participate for the long term. This is not an easy-in, easy-out venture because, in order for the concept to work appropriately, its costs and cost control features must be practised over time.

While the traditional employer stop loss case renewal percentage typically registers around 75 to 80 percent in a normal year, with this captive business, 100 percent of all original entrants have been retained at each renewal, and we've added new clients each year.

You don't get in unless you believe in the concept and are in it for the long haul. Much like a diet or exercise programme, you are not likely to see results if you don't stick with it.

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