The Rx for Writing MSL in Healthcare Captives

Phillip C. Giles, CEBS

CAPTIVE SOLUTIONS INC

mslcaptives.com

Originally published in Captive International - 2021 Cayman Focus

CAPTIVE SOLUTIONS INC

Introduction

Healthcare risks, particularly large hospitals, healthcare systems and physician groups, have been among the earliest adopters of self-funding and establishing captives as a strategic risk financing mechanism for their casualty exposures such as medical malpractice and general liability.

More recently, an increasing abundance of single-parent healthcare captives have expanded their coverage lines to include medical stop loss (MSL) coverage for the self-funded healthcare plans provided to employees of their parent organizations. Numerous healthcare - specific (homogeneous) group captives have also been formed to provide a highly effective monoline MSL solution for mid-sized hospitals, health systems, and provider groups.

Effective for healthcare providers

Within the self-funded medical insurance industry, hospitals and healthcare systems are among the industry segments having the largest percentage of self-insured employee benefit medical plans, the highest average number of covered employees per employer and the highest average specific stop loss deductible (retained risk) assumed by employers.

Self-funding of employee benefit medical coverage is a particularly effective and efficient risk financing mechanism for larger hospitals and groups of healthcare entities due to the amount of intrinsic control they maintain over in-facility (domestic) claim charges incurred by employees. Domestic charges are the medical expenses incurred for services delivered to covered plan participants within the healthcare facilities being insured by the self-funded benefit plan and the MSL policy.

All hospitals maintain a "chargemaster" which is a comprehensive listing of all procedural charges at the facility and serves as the starting point for determining the "billing charges" that are assessed to the general, non-Medicare, insured public for treatment.

Healthcare providers that self-fund their employee healthcare coverage typically "discount" their domestic claims from employees by removing some percentage - if not all - of the normal profit margin that would be charged to the general insured public for treatment.

Because the plan is self-funded, maintaining a normal profit margin for claims charged against the benefit plan would be redundant to the employer and would result in unnecessarily inflated loss costs charged to the plan. If the actual costs for treatment at the hospital are less than the allowable charges applied to the benefit plan, the potential for unnecessary over payment by the plan and over reimbursement by the stop loss policy exists.

There is a wide swing in the rate at which self-funded healthcare entities discount their domestic claim charges. Most facilities tend to use 60 to 80 percent as the normal (discounted) reimbursement rate for medical expenses charged to the health plan. Some healthcare employers absorb the full cost of in-facility treatment charges incurred by their employees by assuming a zero-percent reimbursement for domestic charges against the self-funded health plan.

Having the ability to discount the cost of domestic claim charges is an enormous advantage for self-funded healthcare providers in comparison to other employers for reducing the overall cost of employee benefits.

Structuring the stop loss

Discounting the reimbursement rate for domestic claim charges accruing within the self-funded plan will have a direct effect on the cost of the MSL insuring the employer. In addition to the rate of domestic claim discount, the amount of stop loss rate reduction will also be based on comprehensive amount of services that are, or can be, provided "domestically". It may be helpful to think of this as an aggressive "in-network Preferred Provider Organization discount" for employees.

Most stop loss carriers will not provide coverage to healthcare facilities that request a 100 percent domestic reimbursement rate, as it would include the facilities' normal profit margins. That would establish the ability for domestic claims submitted to the health plan - and subsequently the stop loss carrier for reimbursement - to become a potential source of revenue for the employer.

Since MSL coverage is not intended to insure an employer's profitability, most carriers will limit domestic claim reimbursement in one of two ways:

- **Ground-up limit:** This allows domestic claims to accrue to stop loss levels at a percentage other than 100 percent. The reduced percentage will apply from the first dollar of the incurred domestic charges.
- **Excess-only limit:** This allows domestic expenses to accrue to the stop loss at 100 percent of billed charges but reimbursed by the stop loss policy at a reduced (discounted) percentage.

As mentioned earlier, most self-funded healthcare entities typically discount their domestic claims to 60 to 80 percent from their normal non-Medicare public rate, rather than seek a full 100 percent reimbursement. Some systems have occasionally elected to absorb the full cost of all domestic claims by excluding them from their stop loss coverage.

It is worth noting that prior to the Affordable Care Act (ACA), many large employers, especially healthcare systems, would not purchase stop loss coverage as the ability to define a lifetime benefit limit, typically $1 million, within the benefit plan would serve as *a de facto* stop loss by capping losses at a level that could be manageably assumed. However, a cause-in-fact extension of ACA's mandate for unlimited benefits was an almost instantaneous increase in the frequency of large, potentially catastrophic, medical claims.

Even though healthcare entities have a unique ability to control the pricing of domestic charges, they remain highly susceptible to an increasing frequency of large, potentially catastrophic, claims. This has become an important consideration as accelerated merger and acquisition activity among health systems expands the range and complexity of treatment capabilities that can be offered on an in-facility basis.

This increases the domestic claim exposure base of the healthcare system. For this reason, most healthcare entities now elect to include some level of domestic claims within the stop loss coverage.

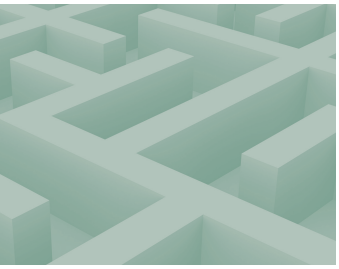
Integrating the captive

MSL is typically added to a single-parent captive that has been established for long-tail lines of business such as general liability, medical professional liability, and workers' compensation. As a short-tail line of business, MSL can serve as an effective risk and financial hedge by providing beneficial diversification of a captiveís coverage portfolio. Group captives have proved to be highly effective, on a monoline basis, for providing MSL to smaller and mid-sized hospitals and health systems.

Many health systems do not formalize the funding of their health plan or adequately track domestic claim expenditures. Converting segments of retained risk into defined layers of stop loss coverage and formalizing

continues

CAPTIVE SOLUTIONS INC



Integrating the captive *continued*

the funding of those layers in the form of regular contributions or monthly premiums enhances efficiency from a cash flow, budgetary reporting, accounting, and claim tracking perspective, compared to simply paying claims out of general assets as they are incurred.

A captive will provide more clarity to financial reporting relative to the medical plan. Enhanced reporting will help determine the accumulation of surplus from underwriting profit and investment gains. Declared surplus can then be deployed to offset future benefit plan costs more efficiently, expand, or enhance benefits to employees, reduce employee contributions, or returned as dividend distributions to the health system.

Providing better reporting will also enhance the ability to use data analytics to identify specific financial and claims cost drivers of the benefit plan.

More than MSL

The premise of an MSL captive should not be just about trying to save money only on the MSL itself. The captive should be viewed as a contributing component within a much larger strategy for reducing the overall cost of healthcare delivery on a long-term basis. Because they have more control over the cost of their domestic claims, many hospitals and healthcare systems have even more to gain from integrating their MSL coverage with a captive.

MSL captives, especially for healthcare entities, have been among the industryís most significant growth segments for several years. This growth trend is expected to continue for both single parent and group captives that serve as a conduit to enhanced certainty within a continuously unpredictable regulatory environment and increasingly firming market conditions across most lines of coverage.

About the Author

Phillip C. Giles, CEBS is Managing Director of MSL Captive Solutions, Inc. He has more than 30 years of Accident and Health and Property and Casualty alternative risk experience and leads the firm's business development initiatives.

In 2019, Phil was named Reinsurance *Specialist of the Year* by Cayman Captive Magazine. In 2017, Phil was presented with the *Captive Professional of the Year* recognition at the U.S. Captive Awards. He has been named to Captive Review's *Power 50* listing of most influential individuals in the worldwide captive insurance industry and is a regular content contributor to several industry publications.

About MSL Captive Solutions, Inc.

MSL Captive Solutions is the industry's only platform devoted exclusively to the development of comprehensive (re)insurance solutions for group and single-parent medical stop loss captives.

MSL Captive Solutions provides consultative underwriting support to some of the industry's leading stop loss carriers and opperates independently to work with all qualified brokers, consultants and captive managers.

For more information visit www.mslcaptives.com.