THE CAPTIVE ALTERNATIVE

President Obama's Affordable Care Act remains high in US employers' thoughts, and captive insurance companies provide an alternative to the traditional market

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As conversations over the Patient Protection and Affordable Care Act (PPACA) continue in both the media and legislature, two things are known to be true. One, it is not going away. Two, it will continue to evolve.

The definitions of minimum essential coverage (MEC), minimum employee offered percentages (70% to 95%), full time employee (30 hours per week or 130 hours per month), small versus large groups (more than 50 unless it's over 100), seasonal versus short-time employees, as well as the penalty amounts ($2,000 for no offer, $3,000 for inadequate coverage) will change.

Many employer groups and their agents have spent considerable time and resources determining how to stay compliant while the fact remains that the stated intent of PPACA is to see all Americans covered with health insurance either through exchanges or by their employers.

All employers are now responsible, through offering or paying penalties, for their employees' health insurance and that insurance must be affordable to the employee and provide a governmentally determined minimum coverage requirement.

For two years the federal government has pushed back the requirement that employer groups report if they are actually in compliance. The actuality is catching up on 1 January, 2015.

Employer groups in the staffing, construction, agricultural, logistics, food service and franchise concept industry are all going to be affected in a greater manner than the rest of the population as many have traditionally either not offered benefits or have provided voluntary, limited medical products that do not meet the current minimum essential coverage or are too expensive to meet the definition of employee affordability if they do.

What are these groups to do with an expense, both administrative and financial, that they have to either absorb or attempt to pass on to a budget-conscious consumer who sees many of their services as a commodity?

Intent of the reporting period

The intent of the reporting period is to ensure employers are being compliant with the ACA regulations – companies must offer benefits and prove it. The initial reporting drop date was January 2014.

And after a string of delays, the employer mandate was pushed to January 1, 2015. As we loom closer to the fourth quarter, the insurance industry is on the brink of being forced to provide coverage for a large population with no prior or limited coverage. The traditional options in the market are:

Health insurance marketplace/health exchange

In accordance with the Patient Protection and Affordable Care Act (ACA), organisations were established in each state to facilitate the purchase of individual health insurance. These organisations were to be fully operational by January 2014, with enrolment beginning in October 2013. The Health Exchange provides a set of government-regulated and standardised healthcare plans that individuals can purchase. Enrolment was most recently announced at 8.1 million people as of May 2014.

Traditional fully insured insurance

The ACA changes will affect the fully insured market more than any other. The increased requirements, regulations, taxes and fees on insurers will leave them with less of an ability to selectively underwrite groups while adding more expense to their administrative load. The trend

in the market has been to share these increases with employees in the form of increased premiums, out of pocket maximums, and not as rich benefit plans.

Self-funded insurance

The ACA treats self-insurance more favourably regarding taxes and fees. This reality paired with tremendous uncertainty had many small and mid-sized employers considering a switch to self-insurance even before the ACA reporting mandate. Smaller organisations, however, face new challenges with exposure to poorer loss experience – unstable reinsurance renewals, increased administrative and reporting load, changes in tax accounting and short-term cash flow.

Challenges to traditional options

The concerns regarding lack of credibility and unpredictability in renewal for fully insured groups and apprehension regarding risk corridors and claims reporting and repayment are not new. Compounding these concerns are issues related to data and PPACA on either a fully insured or stop loss basis.

Underwriting of new groups by carriers is usually done by a combination of census manual underwriting and experience gathered from premium history or actual claims data. For groups that have not had coverage in the past, the carriers have no starting point, claims or premium. In a price-sensitive world, manual underwriting is often the least competitive. The question for many carriers at present is not how to price these groups, but if they will even offer coverage.

Secondly, medical inflation on the public side (Medicare, Medicaid and subsidized exchanges) is shifted to the private sector. There is no trend of the cost of claims or their frequency being decreased throughout the country. Private providers are being forced to absorb this while private carriers also have to pay higher taxes to support the exchanges.

The captive alternative

Group employer benefits captives take self-funded insurance a step further by allowing self-funded employers to pool a part of their excess claims costs with other similar organisations while decreasing the premium backlash of large losses within a policy year and eliminating a portion of the administrative load.

By bringing together like-minded organisations, captive members are able to help control up-front costs of health insurance coverage. Over time, the captive can assume a higher level of risk than they might otherwise be comfortable with in the traditional insurance market.

The captive members also learn best practices from each other – sharing corporate initiatives that can help lower the trajectory of claim trends.

Hourly employees are not a traditional target for group employee benefit captives as participation and retention has been lower compared to other industries. Conversely, the new regulatory environment has created an opportunity to look at them again.

Driven mainly by employer interest, groups are partnering with captives and carriers to expand upon their previous management carve out programmes. Management groups who have been insured can utilise their existing experience as a smaller portion of the now larger total.

An assumption is made regarding the participation of those now eligible who will be manually written. This creates a blended rate which will often be more competitive than the alternative, though employers must understand that if reality is different than the assumption, premiums will be as well.

Lastly, if the underwriting is more conservative than the group's experience, they can recapture some of their funding and premium by the use of the captive, which is not possible in the traditional fully insured marketplace.

According to Ken Gumbiner, executive vice president of IHC Risk Solutions, one of the primary carriers in the group stop loss captive space: "We have been discussing for over a year how to support these groups and their regulatory challenges.

"We feel that a captive option allows them to smooth out the volatility of their own increased claims risk with the larger credibility of a captive pool. Furthermore, most groups who join a captive are interested in doing so for multiple years so we can price them as long-term partners."

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Predictions for 2015-2016

As we arrive at the employer mandate deadline and groups with no prior, or very limited, coverage flood the market, we are seeing tremendous increase in activity on the employer side.

Our thought is that benefit providers are going to flex on the extremes. Many will hedge their risks and price off of a very conservative manual rate.

A few will try to grow quickly to outrun claims with market share and discounted pricing. At some point in the future, there will be a new normal in pricing these groups as well as an understanding of which employers are going to pay penalties rather than participate.

Employers with no prior, or limited, coverage are being forced to join a market they never wanted to. The majority of the interest we have seen continues to be from hourly employers (construction, franchise, staffing as stated before) who are used to having risk associated with their employee retention but not with the health insurance market.

Employers with no prior/limited coverage are looking for the most economical way to cover their employees. We continue to see increased interest in groups looking to self-fund or join captives who normally would not. For the right employer, an alternative risk solution may be the best way to be compliant with the ACA, protect themselves from unknown experience and be given credibility by a sceptical marketplace.