EMPLOYEE BENEFITS FOCUS

MEDICAL SELF-FUNDING MACRO TRENDS

Phillip Giles, of QBE, talks to *Captive Review* about the knock-on effects on the insurance industry of more employers incorporating employee healthcare programs in captives

Self-insurance is generally considered to be the most pure and efficient form of alternative risk transfer and nowhere is the use of self-insurance more prevalent than employers self-funding their employee healthcare coverage.

Just 15 years ago, about 48% of US employers were self-funding healthcare coverage. This has risen to about 61% in 2015. The number will continue to grow as the progressive effects of the Affordable Care Act (ACA) continue to matriculate.

Now that self-funded healthcare has become the most widely employed form of alternative risk transfer, I thought it might be good to identify some of the more obvious and high-level trends that are projected to significantly influence an employer's decision to self-fund their employee healthcare plans.

Healthcare systems will continue to merge and consolidate

Large healthcare systems are purchasing smaller systems and independent specialty practices at a record rate. Consolidation of everything, from the primary care physician practices through the most sophisticated specialty providers, empowers larger systems with the ability to capture and consequently control all phases of healthcare in order to pyramid their internal income and profit. The independent family practitioner is quickly becoming a dinosaur and is on the verge of extinction; as the species evolves from independent practitioners to employee practitioners. Larger health systems, having more physicians and treating more patients, will also receive a bigger slice of the federal pie as Medicare and Medicaid payments are distributed to providers based, in part, on size. As healthcare systems consolidate and grow:

Written by
Phillip Giles

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■ PPO networks, in their present form, will become obsolete

Through consolidation there will be a reduction in competition among providers even while the Federal Trade Commission and US Justice Department are watching. The value of Preferred Provider Organisation (PPO) arrangements is being reduced. Decreased provider selection coupled with increased demand for provider access has diluted the concept and value of why these arrangements were created. The premise of the PPO at its core is steerage to a select panel of providers in return for competitive pricing. Consequently, it will make little sense for several different people having the same medical condition, going to the same providers, within the same healthcare system to be charged completely different costs for the same treatment simply because they have different medical insurance cards. As PPO networks become obsolete:

■ More employers will convert to referenced-based pricing (RBP) structures

Under the current PPO system, buying healthcare in the US has deteriorated to a process that is similar to purchasing an automobile; the sticker price has no relevance to reality. Many providers will charge a grossly inflated price knowing they are likely to receive only 60% of billed charges from a commercial insurer which is still much more than Medicare and Medicaid based on negotiated discounts. This will change.

Reference-based pricing (RBP) is a benefit design in which the healthcare plan defines the maximum amount it will cover for a particular health care service. RBP plans provide a more defined, or at least a less ambiguous, fee structure as provider reimbursements are tied to a specific reference point, Medicare's reimbursement for the procedure or service. This can either be Medicare Plus, the Medicare reimbursement point as a base plus a defined margin. The margin usually ranges between 20% and 60%, Medicare plus 40% for example. RBP plan design can also take the form of a defined benefit schedule. This type of schedule specifically defines the maximum dollar amount assigned by the benefit plan for each treatment or procedure. As self-funded plans have more plan design flexibility, RBP designs will become most prevalent with employers self-insuring healthcare coverage as a cost-containment strategy. As RBP plans become more prevalent:

■ Systemic healthcare consumerism will improve

Increased use of RBP plan structures will require employees to become better educated healthcare consumers as they will need to shop for practitioners willing to provide services within the RBP fee schedule of the employer's healthcare plan. Providers are increasingly willing to negotiate and accept realistic Medicare Plus structures. However, when more of a 'defined benefit' schedule is used, any cost coverages will become the responsibility of the covered individual. This will necessitate those employees to become more price conscious when shopping for non-emergency procedures and selecting providers for treatment.

As employees become more accustomed to shopping for healthcare services:

■ Provider pricing and patient outcome scores will become more transparent

Providers are facing increasing pressure to publish their pricing structures and making them more accessible to consumers thus allowing covered employees to shop for the best price. There is a significant variation in medical prices, even for the most common procedures, throughout the US Increased provider transparency will ultimately contribute to lower costs and reduced spending. Many large insurance carriers are now publishing the fee schedules of their contracted providers. Online 'transparency tools', such as Castlight Health, Mpower360, and Healthcare Blue Book, publish provider pricing information and make pricing information widely available. Many of these tools are available in mobile application format.

It is also important to note that employees, whether covered under an RBP or even a 'traditional' plan, should not select providers based solely on price. Quality of care is also a critical consideration. Just as pricing has become more transparent, so have the qualitative patient outcome of scores of providers. These scores measure the success and related complication rates of procedures performed by various providers to determine a qualitative score. Precise qualitative scoring is currently a bit more difficult measurement. However, when available, it can be paired with pricing data to effectively find the best care at the best price. For self-funded plans, PPO networks will gradually evolve into negotiated RBP networks that contemplate both pricing and quality of care into the provider reimbursement schedule.

A study published by the Employee Benefit Research Institute last year concluded that RBP plans can 'save billions in healthcare costs'. Self-funded plans currently have the most flexibility in terms of being able to implement a Referenced Based Pricing design. As more employers elect a self-funded approach, more will also implement an RBP structure. The combined advantages associated with self-funding and the installation of a well-planned RBP schedule can ultimately lead to decreased costs and increased quality of care. Effective employee communication, education and advocacy are critical to the success of a RBP plan. As employers seek to increase employee engagement relative to benefits:

■ Cost-sharing with employees will escalate

The looming 'Cadillac Tax' provision of the Affordable Care Act (ACA) to be implemented in 2018 calls for a 40% non-deductible tax on the value of any benefits provided to employees exceeding a maximum threshold of $10,200 for enrolled individuals or $27,500 for family coverage. Barring repeal, the tax will cause many employers to shift plan costs to employees as a way to reduce the overall value of the benefits. The cost shifting will normally take the form of increased out-of-pocket (OOP) deductibles and coinsurance.

The 2015 OOP maximums for 2015 are $6,600 for individuals and $13,200 for families. The increased cost sharing will create a surge in the popularity of voluntary products such as 'GAP plans' designed to provide hospital indemnity and critical illness benefits in amounts that dove-tail with the higher OOP burdens that will be faced by employees. Some of these plans can be provided on a voluntary or employer-paid basis and as such are 'excepted benefits' and not subject to the Cadillac Tax valuation. The Cadillac Tax will also lead to increased interest in employer self-funding.

As interest in self-funding escalates:

■ More employers will embrace 'big data' to identify and analyse cost trends

More data is now readily available throughout the universe than ever before. Large self-funded employers, and those using captives, are increasingly accessing and mining large amounts of data to identify claim trends and large cost drivers. Use of external data to establish specific industry, geographic and demographic trends for comparison with the employer's own data will help larger employers identify potential benefit plan modifications to address both claim frequency and severity.

The primary issue for data users will be how to effectively distill huge amounts of data into what actually becomes useable information for predictive modelling. In order to convert the data into useable information, the employer must have pre-established objectives and know what specifically they are trying to measure. These data benchmarks can include: underwriting probability, specific claims trends or outcomes within specific geographic areas, diagnoses or even healthcare providers. The objective of the analysis needs to be clearly defined in order to know what information needs to be extrapolated. The resulting data can be applied to the benefit plan design to structure cost containment strategies.

Given the volatility and uncertainty of the current political environment, especially with a presidential campaign on the horizon, I'll reserve the right to amend any of these predictions on short notice. One thing that won't change is that a properly constructed self-insurance or captive plan is the most efficient hedge against insurance cost uncertainty.

> "Increased use of RBP plan structures will require employees to become better educated healthcare consumers as they will need to shop for practitioners willing to provide services within the RBP fee schedule of the employer's healthcare plan"

EMPLOYEE BENEFITS

THE BUSINESS CASE FOR HUMAN RESOURCES

Stephen James of Mercer discusses how employee benefit captive solutions can aid HR departments

Using a captive to reinsure employee benefits is a hot topic – it has been discussed at recent captive and risk management forums. However, there are still only around 65 captives globally that include international employee benefits (i.e. benefit programmes outside of the US). Given that there are more than 6,000 captives, and the apparent interest in the area, this number seems low and rather surprising. There are many reasons for this, although with the right support the obstacles can be overcome.

The financial advantages of using a captive for reinsuring employee benefits are the same as those for non-life risks: direct cost savings predominantly through the capture of underwriting risk and profit margins, and tax optimisation. The key to making the change for employee benefits is to leverage the human resources function as it is they who have traditionally been involved in not only the design of the benefits, but also their management and purchase.

Written by
Stephen James

Stephen James is a principal within the Mercer International Consulting Group, based in London. Along with his expertise on a broad range of global issues, he leads Mercer's support to companies on employee benefit captive solutions outside of the US.

Making the business case for HR

Clearly, the cost savings can be compelling, but using a captive for employee benefits can provide so much more to the organisation, especially to human resources.

- **Improved benefit design**

Within the external insurance market, benefit designs and terms and conditions are largely dictated by the insurer. The use of a captive to bear the risk and cost of the benefits enables an organisation to create a more flexible benefits environment. This can be through enhanced benefits, improved terms and conditions, fewer restrictions/exclusions, or harmonisation across markets.

It is also expected that the premium cost of supplying the benefits will reduce under the captive model, so the cost of providing any enhanced benefits may be broadly equivalent to the cost of what is currently delivered under the external insurance model. In organisations where benefits play a large role in employee engagement and retention, these enhanced benefits can be a critical tool.

- **Capacity issues**

For some organisations, it is impossible or cost prohibitive to provide life insurance to high-net-worth individuals. For example, owing to a high concentration of risk in Canary Wharf in London, insurers are sometimes unable to provide the coverage needed for senior executives based there. However, when the risk is passed to the captive, this capacity issue with the insurer is bypassed.

It is also important for the captive to understand its risk profile, and reinsurance protection can be purchased to protect the captive from any catastrophic or concentration of risk. It should be noted that when it is difficult to obtain cover for senior executives due to capacity issues and the captive has provided the capacity for them, reinsurance protection may be difficult for these individuals.

- **Underwriting waivers**

From a human resources perspective, the medical underwriting demands of the insurers are a sensitive topic for the individuals involved and the company. Having senior executives or other employees undertake medical examinations is a difficult message to communicate, but the use of a captive enables an organisation to be more discretionary with medical underwriting requirements as 100% of the risks are being borne internally.

- **Improved governance, oversight and control**

Many large global organisations have a detailed and thorough understanding of the benefits practices in their headquarter country, and for some of their larger operations, but not in other locations. Additionally, as organisations expand into different geographies, ensuring the benefits given to employees meet both internal company policies and local regulatory requirements is extremely important.

There are many ways to address this:

- **Benefit inventories** provide a snapshot of design but are often poorly maintained and limited by a lack of clarity on cost/financial data;
- **Multinational pooling** provides summary cost data but the reporting lags can make the data relatively meaningless. Also many organisations take a passive approach so the pools only encompass a fraction of the global benefits;
- **The use of a global broker** provides a mechanism to encompass full support on legislative updates, design elements, and improved reporting and transparency on costs. However, if a company wants to take full control of the cost and risks of benefits then more is required, and using a captive is an ideal step-change.

We recommend that a senior representative of the human resources function is made part of the captive board if employee benefits are included to help establish a rigorous governance framework. The framework should not only cover items such as strategic insurance partners, internal and external roles and responsibilities, and suggested timings and processes, but also stipulate that benefit design change approvals must be ratified by the captive. It should also detail the escalation procedure for any claims disputes, ensuring the captive has the final say on whether a disputed claim should or should not be paid. Although an additional cost, the ability to pay or continue to pay sensitive claims to a valued employee or to his/her beneficiaries may be particularly welcome by human resources from an employee perception and value standpoint.

> "From a human resources perspective, the medical underwriting demands of the insurers are a sensitive topic for the individuals involved and the company"

Additionally, in locations where the captive has full transfer of premium and risk, it has the ability to stabilise premium increases and reductions as appropriate rather than being at the mercy of the vagaries of the insurance market cycle as is the case with multinational pooling.

- **More detailed and more frequent reporting**

Through the selected fronting network partners, reinsuring employee benefits to an organisation's captive enables access to a wider range of more granular and frequent data. This data can be used to identify key claim drivers and enable organisations to focus health and wellbeing initiatives to the areas that will have the most impact. Although there are many external and internal organisational factors that influence an employee's health and wellbeing, having data on top claim causes is an important weapon in the battle against the rising costs of low productivity due to employee illness, disease and absenteeism.

So why aren't more companies doing this?

It seems the case for human resources is relatively clear given the potential advantages that using a captive can bring to the organisation, but there are still relatively few companies that have made the journey. Why is this?

One reason could be simply that human resources are not aware of the captive and how it could be used for employee benefits. It is the risk management department who would traditionally be involved in the management and operation of the captive and any non-life insurances, not human resources, and unfortunately in many large organisations these two important corporate functions have little interaction. Involvement of the risk management department could be seen as encroaching on human resources' territory. Similarly, there may be individuals in the risk management department who are comfortable with non-life insurances but are not familiar with the local complexities of the employee benefits market and this may cause reluctance to include these risks.

There is also little doubt that along with increased involvement, control and oversight that using a captive can bring, comes an additional work burden. One advantage of using multinational pooling, other than for key sign-off and decision authorisation, is that much of the work is outsourced to the global broker. This is particularly advantageous for organisations with limited resources in the corporate function, or with little human resources presence in some countries. In a captive model, much more of the work is managed centrally. This can be daunting and it will be important for such an organisation to either obtain additional internal resource or to seek external support.

A suitable organisation for the use of a captive for employee benefits is one with operational will and control that is willing to lead from the top. Too often in the case of multinational pooling, the decision making authority remains in the hands of local human resources and the result is that the pooling arrangements do not grow or are not well maintained. If an organisation is serious about moving to a captive, decision making authorities must shift more towards the corporate centre to generate large, stable arrangements, and to ensure these are maintained.

The future

We expect a continued increase in the use of captives for reinsuring employee benefits. The shift in costs from the public sector to the private sector and demands of increasing globalisation has forced multinational companies to find ways of better controlling, monitoring and evaluating their employee benefit programmes. A captive is a useful tool in achieving these objectives.

MAKING EB RISK AN ADVANTAGE

Marine Charbonnier of AXA Corporate Solutions and David Schupak, MetLife regional director, explain how the MAXIS Global Benefits Network can help captives efficiently incorporate employee benefits risk into their captive vehicle

Captive Review (CR): As an expert of P&C Captives, what are the advantages for a multinational organisation to put employee benefit risk into its captive?

Marine Charbonnier (MC): When P&C Captive clients incorporate employee benefits (EB) into their captives, it gives them greater purchasing power. Pooling risk between all the countries they operate in creates advantages relating to economy of scale, and by having a larger pool, you also decrease volatility.

Speaking about volatility, by integrating EB risk, which is historically less volatile, into P&C risk which has very high-level risk, our clients are also able to decrease the overall volatility within the captive. At the same time, our clients increase the solvency of their captive in case of a major incident without significantly adding to the captive's overall risk.

It can be advantageous for both the local subsidiaries and the parent company to participate in a captive arrangement. Benefits include a more even distribution of risk, cost savings, and a more consistent EB policy throughout the world.

CR: In the context of Solvency II, does EB risk offer a substantial opportunity to optimise risk and capital management?

MC: Solvency II gives people an additional incentive to incorporate EB programs into their captives, but it isn't the only driver. Captive EB risk programs are a legitimate strategy regardless of Solvency II. I think we'll start to see more captives incorporate EB into their risk portfolio under Solvency II in the near future. Some have already done it and a lot are thinking about it.

However, it's a long process to efficiently incorporate an EB program, as you need a lot of claims data which you won't initially have gathered whilst getting EB insurance from the traditional market. EB typically takes longer to incorporate than other risks in the P&C market.

Marine Charbonnier

Marine Charbonnier joined AXA Corporate Solutions in 2013 as head of Risk Financing Solutions for Group AXA clients. She helps clients to identify financial solutions for their specific P&C risks and create customized solutions.

David Schupak

David Schupak, based in London, UK, is the European regional director for MetLife and works with the MAXIS Global Benefits Network. He joined Alico, now a part of MetLife, in 1998 and has worked throughout Latin America and Europe. Schupak has extensive experience with employee benefit captive programs and currently has overall responsibility for ten of the largest captive programs in the MAXIS network.

CR: What is the MAXIS Global Benefits Network's solution to this issue? How can your program benefit businesses?

David Schupak (DS): The MAXIS Global Benefits Network, which is a strategic venture between MetLife and AXA, has been a pioneer in EB programs for captives. We have been in this industry since 1992, and we have really grown with the industry in this time. Even today, the majority of captives still primarily comprise property and casualty risks, but employee benefits is becoming a lot more common. One of the reasons behind that is that it's a great way for captives to diversify their risk. We offer solutions in over 110 countries and we are able to reinsure from many of those countries to the captives; not only are we present in developed markets but also in the developing world. The key advantage of that is that our clients get access to data that allows them to predict, with much greater accuracy, how risks will behave.

We are arguably leading the market with the analytics tools we're providing to captives, specifically within the medical insurance space.

CR: What does your offering have that others in the space do not?

DS: We stand out in the way we provide data to our clients. Our competitors are all doing well at providing basic data, but we take it one

step further by providing a deep analysis that gives clients detailed insight into medical claims cost drivers in specific countries. Once our clients have that data, they can begin to tailor their plans and take action with the goal of lowering claims volume over time.

We offer this type of analysis in many of the countries where we currently have a presence. By developing a template we can take medical data, standardise it, and offer that to the captive manager and the parent company so they can really understand and compare how each country is behaving.

> "Our competitors are all doing well at providing basic data, but we take it one step further by providing a deep analysis"

CR: What kind of variations are you finding between regions?

DS: Claim drivers are impacted by several factors, including the kind of industry, the way the state system operates, and different demographics. For example, in the US, Mexico and even in the Gulf, we are now seeing hypertension, and diabetes is a massive claims driver; we didn't see it much before, but now it's a global issue. In order to counter this, we've started focusing on health and wellness, because once you understand where your claims come from, you can act to minimise claims and the costs of those claims. We offer a great deal of flexibility to tailor plans to do this.

CR: What are the challenges of implementing this strategy? What are the most common pitfalls?

DS: Internal communication issues are primarily the problem. Captives historically sit under risk, whereas employee benefits sit under HR. A business' HR department may want to follow a particular health plan, whilst a captive may not agree that makes sense, and this can only be resolved through efficient communication from the top down. On the other hand, a captive may well want to take on EB, but if they haven't explained that to the HR side of the business there will be on-going challenges and push-back.

Communication between the captive and the parent company is key, but also between the parent and local partners, who may not initially understand why they must work with a captive network or how a captive works. It's not difficult to explain the concept, but we still see a lack of communication more often than we would like. Again our offering includes a service to assist in regard to this issue.

MAXIS GBN

MAXIS Global Benefits Network is one of the world's leading global benefits networks. Established by AXA and MetLife, two of the world's largest and most trusted companies, MAXIS GBN is able to offer holistic global benefit solutions, tailored to meet the unique needs and objectives of our clients in 110 markets around the world.

Catastrophic medical claims aren't just a probability — they're a reality.

As a Captive Director, Risk Manager, VP of HR or CFO, QBE's Medical Stop Loss Reinsurance and Insurance can help you manage those benefit costs. With our pioneering approach to risk and underwriting, we make self-insuring and alternative risk structures possible.

Individual Self-Insurers, Single-Parent and Group Captives

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