Group Captives
Changing the Face of Healthcare Delivery

1. The Intricacies of Health Insurance

Wild volatility. Inevitable price hikes. Hidden fees. Crushing annual renewals. Dwindling reserve funds.

For mid-sized businesses looking to offer health coverage to their employees, the best option is often the least terrible option. Access to more autonomous and affordable plans feels more like a pipe dream than a possibility.

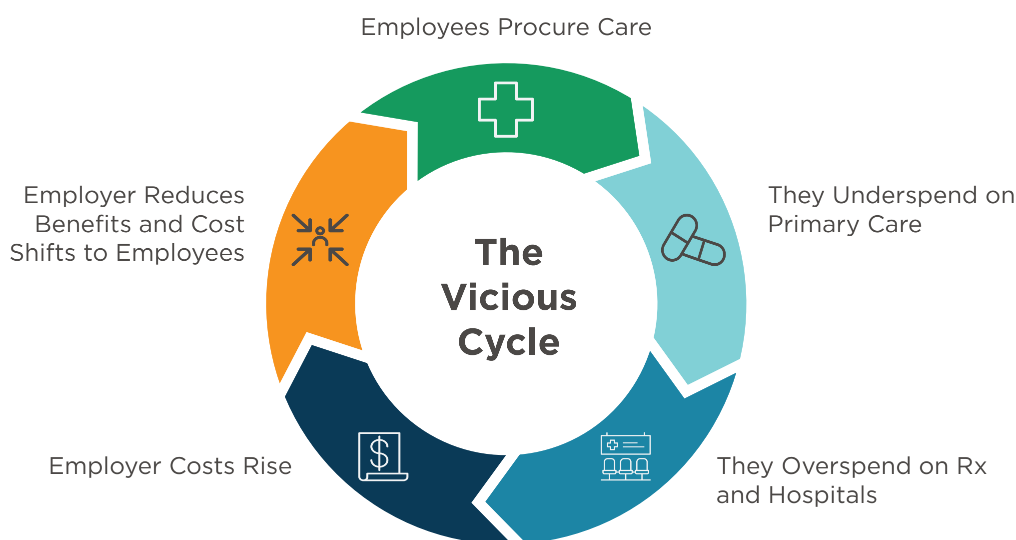
If a mid-sized employer is fully-insured, the odds are good they are over-insured and buying unnecessary insurance for all sorts of services, ranging from doctor's visits to knee replacements to MRIs. For the few that are self-insured, the reality is they are likely under-insured, and leaving themselves exposed to all sorts of avoidable expenses and risk (to name three: multiyear claims for dialysis, injectable oncology treatments, and specialty drugs).

Most employers opt to take the fully-insured route because it seems like the only game in town. And they might be fine with their decision, for the first year. What felt like the best logic at the time starts to become slightly less tenable a year later, when their renewal comes complete with a crippling price increase. Every subsequent year with their existing carrier feels even less manageable, and the thought of re-upping with nothing but rising costs ahead turns into one of the things keeping CEOs up at night.

This merry-go-round occurs in tandem with another scenario we see stuck on repeat for employers. It might go by a few different names, but "The Vicious Cycle" feels reasonably true to form:

- Employees seek medical care with flawed incentives and limited medical literacy.
- They get reactive primary care that leads to prescription drug overuse and expensive procedures.
- Costs rise for the employer, who often has no choice but to shift these costs back to their employees.
- By cost-shifting to employees, employers actually lay the groundwork for future problems. Cost-shifting discourages employees from seeking care for chronic conditions, ultimately increasing future costs for both the employer and their employees.

Real cost-reduction starts when this cycle is broken.



2. A Unique Opportunity for Insurance Brokers

Today, savvy insurance brokers are seizing the opportunity to solve two problems for mid-sized employers:

- How to reduce the year-to-year volatility associated with being self-insured (since traditional fully-funded insurance isn't cutting it, not now and certainly not for the foreseeable future), and;
- How to reduce the cost of healthcare.

These brokers have figured out how to level the playing field for smaller companies and help them reap the benefits previously only available to Fortune 500 companies. They're also making self-insurance both palatable and accessible for a huge swath of employers that otherwise would have been uncomfortable or unsuitable for self-insurance, and therefore would have been averse to abandoning "insurance as usual." And they're empowering employers in the process—to buy the right amount of insurance, to take back control of their healthcare costs, and to decrease their overall long-term spend. How are they doing it?

Through captive insurance.

We'll get into the who, what, how, and why (and why now) momentarily. However, to truly understand what captives are, how they work, and who they can help, mid-sized employers will need to be convinced not to stay their current course.

Inertia is powerful. To overcome it, brokers will need to tell a powerful, disruptive story that shifts a prospect's perceptions about staying the course versus changing. They will need to show them how their status quo situation is actually unsafe and unsustainable, and that by not changing, they are putting themselves at greater risk of not achieving their business goals.

That story begins with why healthcare as they know it is broken.

3. Why Healthcare Is Broken

One could make the argument that healthcare today might actually be more accurately described as "sick care." In our current system, primary care is about being sick, not about staying well. Remember the vicious cycle? Employees with limited medical literacy seek reactionary primary care, and the spiral begins.

A 2019 survey of 2,012 companies found that the average annual insurance premium now costs $7,188 for single coverage and $20,576 for family coverage (Kaiser Family Foundation 2019)[1].

Another study investigating factors on the increase in healthcare spending over a 17-year period concluded that the rising costs were largely correlated to increasingly expensive healthcare services, with aging population and population growth as secondary contributing factors (Dieleman et al. 2017)[2]. The cost of expensive healthcare services and medicine carries over into the insurance industry, where premiums are bloated with administrative costs, taxes, and profit margins before being passed to consumers.

As the cost of medicine, medical procedure rates, and insurance premiums continue to climb, fully-insured companies are being subjected to skyrocketing healthcare expenditures over time. Take, for example, a company that enrolls 100 employees in their fully-insured healthcare program and pays an estimated premium of $1 million. Following the trend of premiums increasing by 9% every year, said company could expect to pay an accumulated total of over $15 million after ten years.

1 Kaiser Family Foundation. 2019. "2019 Employer Health Benefits Survey." Accessed June 10, 2020. https://www.kff.org/health-costs/report/2019-employer-health-benefits-survey/

2 Joseph L. Dieleman, Ellen Squires, Anthony L. Bui et al. 2017. "Factors Associated With Increases in US Health Care Spending, 1996-2013." Journal of the American Medical Association 318 (17): 1668-1678. https://doi.org/10.1001/jama.2017.15927.

The main benefits of a fully-insured plan appear to be two-fold: 1) the system does not have hidden pitfalls beyond its high initial cost, and 2) employers are protected from a high volume of claims and unprecedented large claims. The second comes with a caveat, however: protection only lasts for a single year. Bad claims can still lead to a massive increase further down the line. The other downsides to fully-insured plans are more obvious, but no less painful: companies will not get their money's worth on years with fewer claims, and they can more or less kiss all of the surplus they create for the insurance provider goodbye.

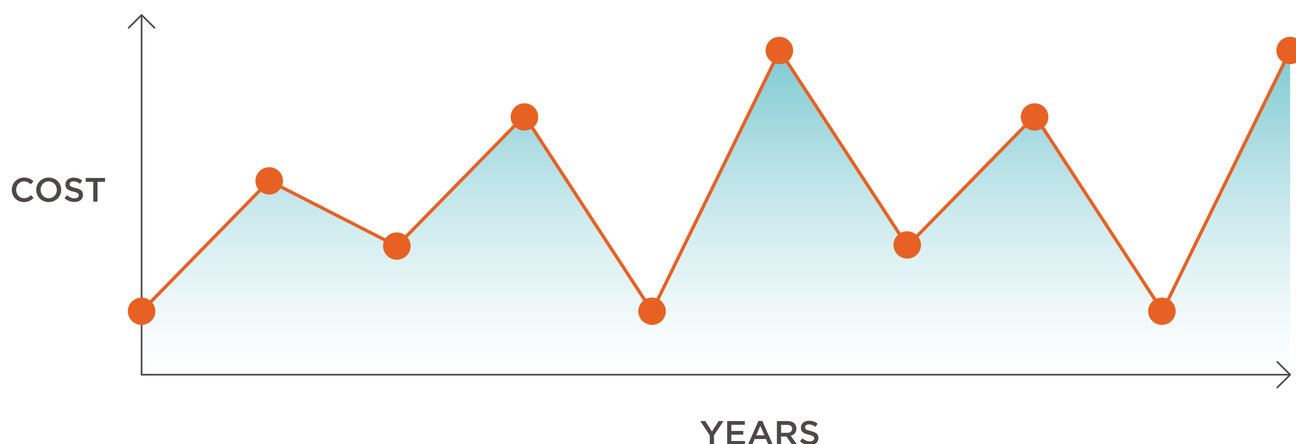
Again, the most popular alternative to a fully-insured plan is a self-insured plan. This is a better option for large companies that have bigger balance sheets and can absorb higher volumes of medical claims. Since the amount employers pay out matches the value of their claims for that year, there is no overspending. On years with fewer claims, employers enjoy significantly lower healthcare costs.

But this "solution" is rife with risks. Self-insured employers purchase **stop-loss** insurance, which serves to protect themselves from bearing the costs of large individual claims over a certain threshold or a high volume of small claims over the course of a year. However, costly treatment that takes place over a long period of twelve months or more (for example, dialysis and treatment for certain types of cancer) may not be covered by stop-loss, so the astronomical claims will continue.

There is another issue at play here. It's common for stop-loss carriers to practice **lasering.** To issue a laser is to isolate high-risk individuals and assign them higher stop-loss thresholds than other employees in a company's healthcare plan, essentially creating a donut hole in their insurance policy. Lasers protect the stop-loss carrier from having to cover a large portion of claims from high-cost claimants, which prevents the employer from facing a large increase in premium by the stop-loss carrier the following year. But needless to say, this still hurts the employer, who now bears the costs of the extra claims not covered by stop-loss.

In the long run, this combination of factors makes the costs of self-insured healthcare volatile and unpredictable. This inherent instability (and the associated price tag) can be easy to track with one quick glance at a company's financial records. This takes us full circle—this fear of volatile costs is why mid-sized employers don't self-insure.

Volatility of Self-Insured Healthcare Costs



4. A Better Way: Captive Insurance

What if there were a way to combine the best of both worlds and apply the self-insured healthcare model to a group cooperative structure?

Welcome to captive insurance.

A captive is an insurance company whose purpose is to assume risk on behalf of its owners. Conceptually, captives bring together a group of like-minded businesses that pool their dollars into a collective fund. By doing so, a captive can:

- Greatly reduce the volatility that mid-sized clients would face if they were self-funding on their own

- Use collective buying power to build benefit programs that rival most Fortune 500 companies

In practice, captive members contribute anywhere from 15% to 35% of their total healthcare spend for large and catastrophic claims via premiums to the stop-loss carrier and captive. The captive or carrier then pays the large claims, and employers use the rest of their healthcare spend to pay for their broker, their third-party administrator, and any smaller, more predictable claims. If the captive runs better than expected, the employer receives their share of the profits. If the smaller claims don't happen, then the money never leaves their control. **That's self-funding, with less volatility.**

An off-the-shelf, self-insured healthcare plan might be described this way:

- Eric would like health insurance for his family and signs a one-year deal with Steve, who agrees to pay for more expensive treatments that Eric cannot afford. Eric has enough money to handle small expenses for things like bandages and cough syrup, and when his son gets badly hurt in a bike accident, Steve helps to cover the cost of a trip to the clinic. But when the little boy develops a serious health condition and has to be hospitalized for two years, Steve cancels the agreement for the following year since he now knows about the boy's condition, leaving Eric and his family in a crunch.

Within the captive model, here's how the same scenario plays out:

- After signing the initial deal with Steve, Eric meets ten other friends who introduce him to this new idea they want to try. They all agree to pool together some money as a sort of backup insurance. Anyone who is short on money to pay for treatments can take what they need from the pool. When Eric's son lands in the hospital and Steve cannot help him pay the bill, Eric is able to take what he needs from their pooled funds to settle it. At the end of the year, the group finds that they still have money left over. They decide to keep their brilliant idea going and top off the group fund with more money to cover their bases for the following year.

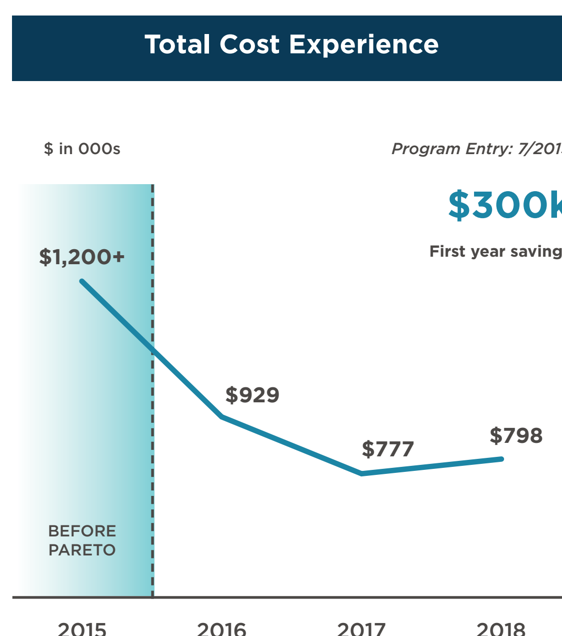
An important part of an effective captive structure is the use of **cost containment programs** by employers. Pareto's portfolio includes an array of integrated solutions and strategic resources, including better pharmacy benefit manager contracts, an on-staff clinical pharmacist, Medicare & COBRA participation optimization, specialty networks, care coordination services, cancer support, clinical prior authorization review, and access to population analytics and intelligence (to name a few). These programs help both improve the overall health of employees and reduce aggregate claims made to the employer, generating significant savings for members in the long run. Comparing the pros and cons of captive insurance with the pluses and minuses of existing insurance models clearly reveals which is the better healthcare option:

	Fully-Insured	Self-Insured	Captive
Cost	Constantly rising, regardless of claims incurred	Pay only for claims incurred	Pay only for claims incurred
Volatility	Large claims covered by plan	Unprecedented; ongoing large claims go back to the employer	Stable; captive funds can cover large ongoing claims
Savings	High wastage from administrative cost, carrier profit, and tax	Only possible on years with fewer claims	Generate savings through preventive care; captive surplus is carried over or distributed

5. Pareto Health Captive Success Stories

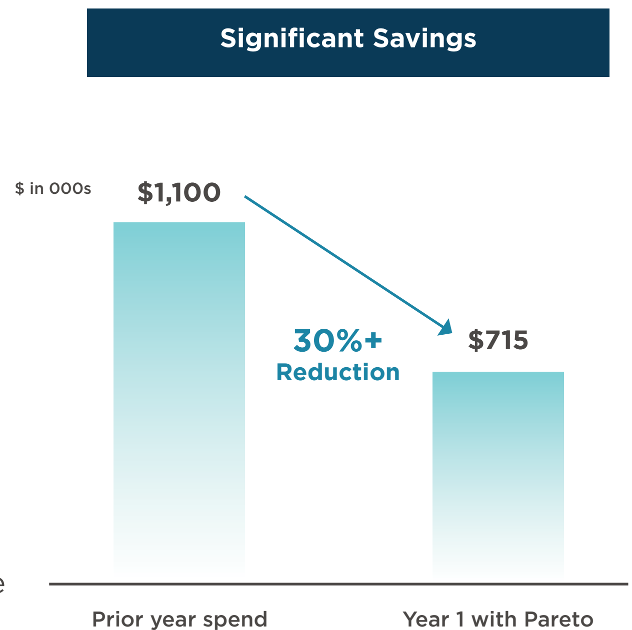
Case Study #1:

- **Who:** A non-profit that helps adults with intellectual disabilities remain independent and work towards their goals.
- **What:** This employer faced rate hikes and large unpredictable assessments while previously under a multiple employer welfare arrangement (MEWA).
- **Results:** Faced with costs exceeding $1.2 million, said employer switched to Pareto's captive in 2015. After implementing several healthcare programs as part of cost containment measures, the employer reduced annual healthcare costs by over $300,000 after three years.



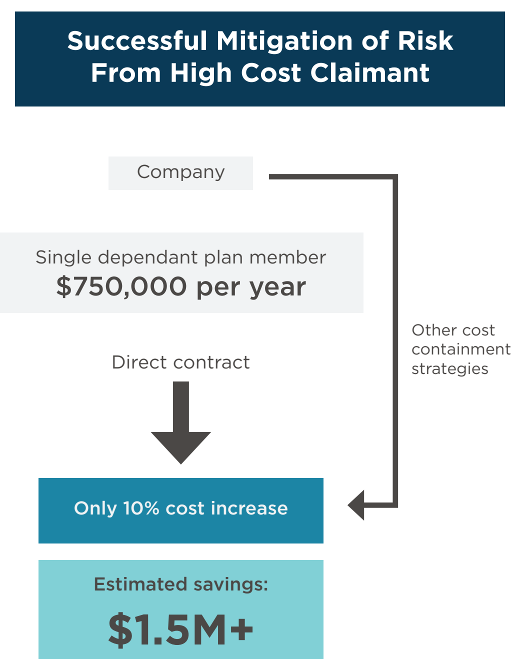
Case Study #2:

- **Who:** A highway contractor with 100-125 employees enrolled in a fully-insured plan.
- **What:** Prior to joining the captive, this employer received a 109% rate increase to their fully-insured premium, taking their annual spend up to $1.1 million.
- **Results:** After just one year in the captive, they saw their overall spend shrink to $715,000. Even after taking high cost claimants and increased claim activities from the prior year into account—AND matching the benefits offered the previous year—the company saved 30% on their total healthcare spend.



Case Study #3:

- **Who:** A provider of cutting-edge payment mechanisms for international companies.
- **What:** 18 months after joining Pareto's captive, a dependent plan member was diagnosed with hemophilia and it became apparent that the individual would rack up $750,000 in claims (their total fully-insured spend prior to joining the captive).
- **Results:** With the help of their broker, the employer formed a direct contract with a local hemophilia infusion company, saving the captive $150,000 a year. In comparison to estimated costs of a fully-insured plan, the employer saved a total of $1.5 million in the captive.



6. Why Pareto: Benefits for Brokers

For brokers, Pareto's value proposition can be conveyed in four numbers: 40, 97, 0, and 30.

40

40% of all our business is new business for brokers. Translation: There is huge opportunity here. To grow your business, to shake up your standard spiel, to separate yourself from your competition, and to provide mid-size employers with a unique solution with proven results. Our partners are like us: they want to be a market disrupter (not just talk about it), they're hungry for results, and they let the scoreboard speak for itself.

97

97% of groups that join the captive, stay in the captive. That's right—Pareto's retention ratio is just shy of 100%.

What's the fine print, for employers? Not much. They put up a small amount of capital to join, and if the captive runs as it should, that investment comes back to them. There is no multi-year commitment. They can leave whenever they want.

What does a 97% retention rate mean for brokers? These mid-sized businesses are actively choosing to utilize a multi-year strategy to minimize healthcare costs. They are sick of chasing the cheapest rate and changing carriers every year. They believe a better option exists.

As a broker, this employer mindset shift does three things:

- Grants you the peace of mind that comes from the security of an extended partnership
- Gives you an opportunity to become a true strategy partner with long-term solutions
- Dramatically increases your ability to write new business

0

0 is the number of new lasers received by captive members since Pareto's inception. Taking away the year to year volatility inherent in traditional stop-loss markets is one of the most attractive outcomes of the captive model. The way Pareto achieves this goal is to guarantee no new lasers for the duration of an employer's membership.

"No new laser" policies are getting harder to find in the traditional market, and their accompanying terms are getting worse. Being pulled at renewal or for "changing risk characteristics" is increasingly common.

With the certainty of no new lasers, both brokers and employers can funnel all of their efforts towards minimizing the cost of healthcare instead of getting concerned over annual changes to "rates" or risk.

To reiterate, in simple terms: **There is a program out there that eliminates lasers. Forward-thinking brokers don't want their self-funded clients to be the last to know.**

30

30% is the largest stop-loss increase ever given out of 3,000 renewals. Stop-loss typically represents 20% to 25% of a group's overall cost. In other words, a group would be looking at anywhere from a 6% to 9% increase in overall costs from large claims. By taking away lasers forever and limiting stop-loss increases to 30%, the captive offers a proven way to limit the volatility that pains so many mid-sized employers.

What's Pareto's goal? To arm brokers and their clients with the strongest stop-loss policy that can be found on the street.

At Pareto, brokers aren't simply insurance brokers. Those chosen to be one of Pareto's preferred partners will join a small, select group of professionals interested in:

01 Working with entrepreneurs who aren't afraid to make waves

02 Tapping into a segment of the market with significant opportunity

03 Providing a unique solution to clients committed to changing the way their people think about health and wellness

All vetted broker-partners gain immediate access to:

Training programs for brokers

Education programs for prospects and clients

Regular support from regional representatives

Protection against BORs

In select cases, the ability to designate prospects for protection

Lead generation support

Data analytics software

Monthly and on-demand reporting

About Pareto Health

Established in 2011, Pareto Health is a leading employee benefit group captive manager that helps mid-sized businesses self-fund and access high-quality health benefits with greater savings and lower volatility. With over $400 million in stop-loss premium under management, 300,000 lives covered, 1,100 active employers, and a 97% retention rate, Pareto is uniquely positioned to help a large swath of the market adopt smart, sustainable, multi-year strategies to optimal healthcare delivery.

Become a preferred partner today.

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