Pros and cons of a captive: Should you do it yourself?

Healthcare providers have been subject to the volatility of the insurance market for years, which has led some to look to the idea of establishing a captive as a way to cut costs, particularly with workers’ compensation coverage. A captive can be a great solution in some circumstances, but don’t jump without looking first.

A captive insurance company is a property and casualty insurance company established to provide coverage only, or primarily, for its parent company. A captive can be a valuable risk management tool that allows a hospital to more effectively manage corporate risks of all kinds, says Timothy E.J. Folk, vice president with The Graham Co., a healthcare consulting company in Philadelphia.

Captives often are set up to insure risks for which commercial insurance is not available or is too expensive, Folk says. The owner of the parent company is also the owner of the captive, but the captive can be structured so that it is owned directly by the operating company, another person, entity, or a trust, Folk explains.

This structure does not mean, however, that the captive is just a puppet for the hospital or health system. The captive insurance company must act as a legitimate business entity, complying with all insurance regulatory provisions and Internal Revenue Service requirements, Folk says. (See the story on p. 39 for more background on captives.)

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The interest in captives is driven by the fact that there is a very limited marketplace to insure a health provider’s risks, which leads to insureds being

EXECUTIVE SUMMARY

A captive can reduce long-term costs for a healthcare employer, but it comes with significant risks. A provider must weigh the potential benefits against the costs of covering a large claim.

- Captives might be best for larger, more established organizations.
- Workers’ compensation often is the first focus for a captive.
- Losses can be substantial, but are limited.
A captive is not an easy task, but one can be created proactively to take advantage of the opportunity created with worker’s comp so that claims and losses are managed properly rather than being forced by the lack of a viable option in the insurance market, Folk says.

Furthermore, once the captive is established, a healthcare provider has the captive as a mechanism to take on part of other exposures, such as professional liability, when the market swings. (See the stories on p. 39 and p. 40 for more on how captives work.)

Size matters. Providers considering a captive should have about $400,000 in premiums or more for the option to make financial sense. Also note that a captive will not serve all of your insurance needs. The only lines that will be

Premium should be similar to traditional
insured by the captive are general liability, professional liability, workers’ comp, and automobile liability, Keith explains.

Captives are most popular with for-profit entities because they can take advantage of tax benefits, Keith says. The premiums you pay to your captive become tax deductible, so non-profits have traditionally not been drawn to the captive option. Other benefits, such as being able to direct savings to underfunded programs and projects, and the tightening insurance market are making more non-profits consider forming a captive, Keith says.

With the right claims control processes in place, the captive premium you pay should be similar to what you would pay with a traditional insurer, yet you are able to keep the underwriting profit, Folk adds.

“In addition, while you are waiting for that period of time it takes for losses to be realized, evaluated, and paid, you’re realizing investment income,” Folk says. “At a time like this when providers are being squeezed in so many ways while expenses stay the same or get higher, the more you can explore creative solutions like this, the better off you will be in the long run. A captive truly has the potential to put dollars back in the pocket of the sponsoring organization.”

A captive also takes the organization out of the notoriously volatile insurance market, Folk notes. In the past, insurers with billions of dollars of premiums suddenly have announced that they were not making enough money in that particular market and would not renew any policies.

“That leaves a lot of people without a home, and with so few insurers to choose from in this market, the only option is to take a policy at a very high rate,” Folk says. “In a captive you are subject to a lot less volatility and you are assuring yourself that you have a home through which to procure insurance. It changes the whole negotiation of the insurance procurement process every year because you are no longer at the whim of the carrier. You’re now a business partner with them.”

**SOURCES**


When is a captive right for you?

Captive insurance companies aren’t for everyone, says Timothy E.J. Folk, vice president with The Graham Co., a healthcare consulting company in Philadelphia.

Risk tolerance is necessary, and you have to be willing to enter into a new line of business, he says. Some people are more content to simply write a premium check and know that another company is handling the claims.

“But if captive is a right fit, it can be a very strong business model that is supportive of the rest of your business strategy,” Folk says.

If a captive looks like a good option, one of the first decisions is what kind of captive is right for you. These are the different varieties of captives:

- **Single-owner captives**: A provider establishes a single owner captive to insure its own risks and the risks of its subsidiaries and affiliates.

- **Group captives**: These captives are owned by multiple, non-related organizations that serve as the policyholders. The group captive is usually sponsored by a trade group, group medical practices or hospitals, or other professional groups. Group captives can be homogenous, meaning all the members are similar organizations in the same industry, or heterogeneous, meaning the members vary in type. Group captives help spread the risk from any single claim.

- **Agency captives**: These captives are owned by insurance brokers or agents and insure some portion of the insurance sold by its agency or broker shareholders.

Group captives help spread the risk from any single claim, similar to the way a standard insurer spreads the risk by having all insureds pay premiums that will be used to pay the claim of one client. But the group captive is not the same as a standard insurer because you, the policyholder, have a say in who can join the captive, explains Christopher M. Keith, a producer with The Graham Co. in Philadelphia.

“This is very much a club-like mentality. The barriers to entry are tougher than a traditional insurance market,” Keith says. “It’s all about their five-year historical loss rate, and you’re not going to let a poorly performing organization into the