ART COLUMN FOR JULY

Leveling the field for smaller employers

There's a whole wing of the ART Gallery devoted to models of alternative risk transfer programs to support employee benefit plans. In recent years that mission has increasingly drawn the interest of those who toil in alternative funding – you could say it's the Holy Grail of captives.

Now a new program has come over the horizon from the Pennsylvania town of Conshohocken where Andrew Cavenagh is managing director of Pareto Captive Services. While many ART programs begin as a result of the captive manager's goal to form an ART structure, this one begins with a very tight focus on a potential customer's need.

"We're totally focused on the employer of 50 to 500 people who has had what we call the 'Dammit!' moment," Andrew explains. "That occurs when the employer says, 'Dammit, I'm not paying another ten percent premium increase without being able to see our experience data or have control of our coverage."

Pareto's new program is designed for what Cavenagh estimates to be the 30 percent of employers of small-to-mid-sized companies that have experienced that "Dammit!" moment and are ready to roll up their sleeves in order to control their future.

With a structure that includes both conventional stop-loss insurance and a captive for excess losses, it appears to me that Pareto has created an opportunity for medium-sized employers to take part in the inherent advantages ART provides. It puts them in the same game that larger companies have always been able to play.

Cavenagh says his company's new approach is based on four core beliefs that he cites as:

- The conventional health insurance market for employee groups of 50 to 500 is broken and won't be fixed.
- Self-insurance provides an employer greater control of coverage and an understanding of claims data that is not available in the traditional commercial health insurance market.
- It is possible to drive down claims and to drive down costs through interventions such as wellness programs that are based on claims experience data.

- Most employers believe the first three points but still fear the volatility that self-insurance implies. Catastrophic claims surpassing ordinary stop-loss limits can be borne by the employer of thousands of employees, but can devastate smaller employers.

"Our goal was to provide a mechanism to reduce that volatility and make a self-insured ERISA plan attractive and appropriate to medium-sized employers," Andrew told me. "A captive insurance company that is wholly-owned by employer members serves as a shock-absorber for the system.

"By sharing risks in a larger group, employers get the benefits of insurance for claims that would typically be lasered. They are willing to contribute to the pool to cover another employer's catastrophic claim because they may have a similar claim by one of their employees during the next several years," he said.

I noted that Pareto's group captive is a different structure from the popular segregated cell captives where each member's risk is managed in its own "silo."

"Cell captives have an advantage of being relatively easy and inexpensive to join," he acknowledged, "but they don't provide employer-owners ultimate control over their captive. Our approach provides the employers with a captive that they truly own and control at a fraction of the typical start-up costs."

Pareto has formed and funded a captive, Contrarian Re, which is currently gaining members in a triangular structure that includes conventional stop-loss coverage issued by an admitted carrier. In this program the stop-loss company buys coverage from the captive for a layer of excess losses. As owners of the captive, employer members stand to gain from successful experience in the form of reduced future premiums.

"We believe that a group captive needs an independent program manager," Cavenagh says, "in order to avoid the inherent conflict of interest that is created when the captive is effectively managed by either the stop-loss company or a retail broker or consultant. How can a broker make a decision in the best interests of the group captive if it's to the detriment of one of its clients? Or how can a stop-loss carrier fairly negotiate both sides of a reinsurance agreement? With our structure we're able to focus just on the group captive itself."

While the current program seeks employers of diverse industries defined by their size of 50 to 500 employees, Cavenagh envisions forming homogeneous future programs for groups of independent colleges and universities, rural hospitals, nursing homes or members of other industries that share a common risk profile.

Pareto has structured a two-step distribution system where it first aligns itself with selected benefits brokers in each geographic area and then seeks qualified employers for the program.

To my view, this program is coming along at the right time, when employers are increasingly nervous about the effects of national healthcare reform and when many conventional brokers are loading up their books of business to help withstand the changes to come.

It could be called a case of ART to the rescue.

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