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2019-2020 CICA Student Essay Contest

Captive Insurance Solutions for Emerging Industries

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SJU

SAINT JOSEPH'S UNIVERSITY:
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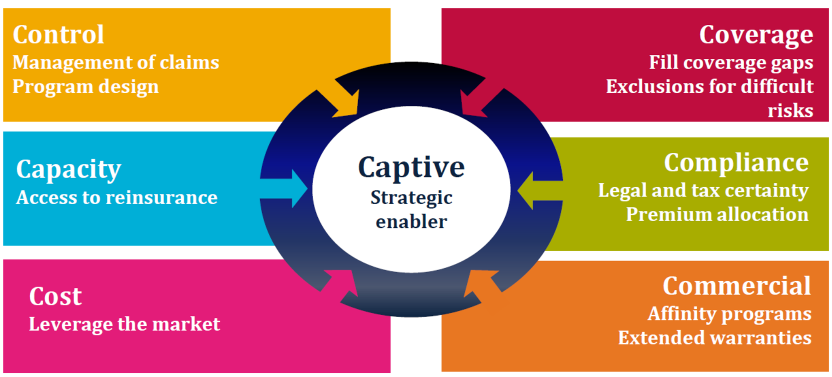
HOME HEALTH CARE INDUSTRY

Executive Summary:

The Insurance Industry is sophisticated and offers a vast variety of products and services to aid companies in pleasing their clients. For companies with big complex exposures, traditional commercial insurance policies are not economically practical or feasible. Captive insurance companies provide a more customized approach to financing those complex risks. Captives provide protection and offer numerous cost related benefits. Captives have the ability to offer customized coverages, provide reduction in insurance expenses, avoid multiple state filing and licensing requirements, eliminate rate redundancies, increase company stability, and retain profits from members and policyholders (see image below). Additionally, captives provide tremendous claims and loss control measures, which is very important for industries exposed to large expensive catastrophic losses[1].

The home healthcare industry can benefit from captives because their main exposures that would result in large losses are professional liability, workers compensation, and auto liability claims.



[1] "Risk Retention Groups: An Important Segment of the Captive Industry." *Risk Retention Groups: An Important Segment of the Captive Industry | Captive.com*, www.captive.com/news/2018/10/03/risk-retention-groups-important-segment-captive-industry.

Home Healthcare:

In 2018, the global home healthcare market was valued at 305.78 billion and is expected to reach a compound annual growth rate (CAGR) of 7.8% by 2026. Growing cases of chronic diseases coupled with the rise in the senior citizen population is anticipated to contribute and fuel this market growth increase. According to an article from the United Nations in 2017, the geriatric population accounted for about 13% of the global population and is predicted to increase by 3% annually[2]. The elderly population is particularly prone to chronic diseases, increasing the need for more healthcare services.

For example, about 65% of Medicare recipients reported that they suffer from more than one chronic condition. About 43% reported that they endure three or more chronic conditions. This translates to a growing workforce pertaining to home healthcare services due to increasing demand. Statistics published by the U.S. Bureau of Labor projected personal care and home care professionals to reach 13 million by 2020, representing a 70% increase from 2010[3].

Emerging technologies coupled with innovative home healthcare equipment is projected to influence growth opportunities for the market. In 2018, diagnostic equipment accounted for more than 38% of the overall market and is expected to increase steadily due to the vast amount of cases of diabetes, cardiovascular and cardiopulmonary diseases. The steady growth of chronic conditions that require continuous monitoring, technological advances and personalized medicine are key drivers in the forecasted demand for home healthcare services, as depicted below[4].

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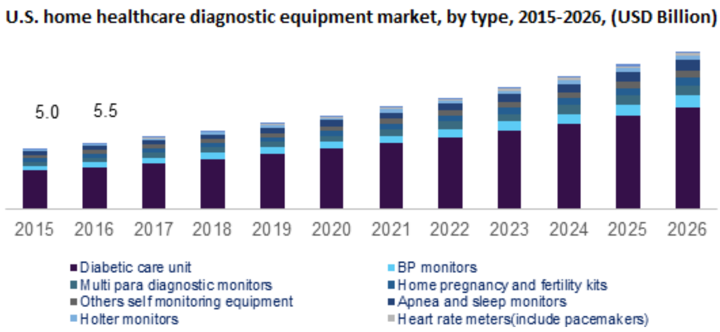
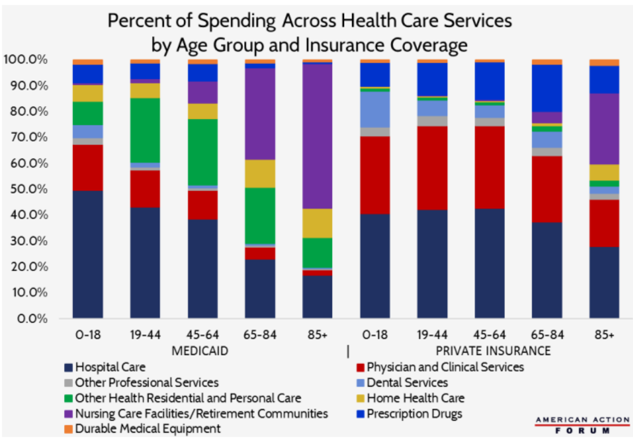
[2] "Home Healthcare Market Size: Industry Growth Report, 2019-2026." *Home Healthcare Market Size | Industry Growth Report, 2019-2026*, www.grandviewresearch.com/industry-analysis/home-healthcare-industry.
[3] "Home Healthcare Market Size: Industry Growth Report, 2019-2026." *Home Healthcare Market Size | Industry Growth Report, 2019-2026*, www.grandviewresearch.com/industry-analysis/home-healthcare-industry.
[4] "Home Healthcare Market Size: Industry Growth Report, 2019-2026." *Home Healthcare Market Size | Industry Growth Report, 2019-2026*, www.grandviewresearch.com/industry-analysis/home-healthcare-industry.



The visual below depicts the breakdown of one's health care expenditures for each type of health care service used by individuals enrolled in Medicaid, compared to individuals who are covered by private health care insurance[5].

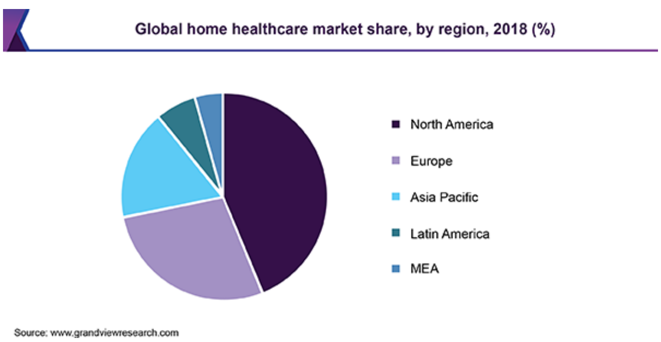


Individuals enrolled in Medicaid tend to spend a greater portion of their expenditures on hospital, residential and personal care. For Medicaid beneficiaries 65 years+, nursing facilities and retirement communities consume more than double the amount of an individual's share of health care expenses, compared to those individuals covered by private insurance. Privately insured individuals have a much higher percentage of their health care dollars going towards

[5] Hayes, Tara O'Neill, et al. "Health Care Spending by Age and Type of Coverage." *AAF*, 17 Aug. 2016, www.americanactionforum.org/weekly-checkup/health-care-spending-age-type-coverage/.

physician and clinical services. Home healthcare is a cost-efficient alternative to an expensive hospital stay. According to a study conducted at Brigham and Women's Hospital and Faulkner Hospital, the health care costs associated with home care are nearly 52% less than hospital stay costs for patients[6]. This difference in spending between the two groups highlights the need among the two populations, as well as portrays the differences in the cost drivers.

To help ease the costs of medical expenses, tailored captive solutions for home healthcare insurance may be a viable solution. As portrayed below, North America in 2018, held the largest revenue share of home healthcare due to the presence of complex medical infrastructure, high patient awareness, and large health expenditures. Research analysts at Market Data Forecast have predicted that the size of home healthcare in North America is predicted to reach $147.45 billion by the end of 2023, reaching a CAGR of 7.5%[7].



[6] "Home Healthcare Market Size: Industry Growth Report, 2019-2026." *Home Healthcare Market Size | Industry Growth Report, 2019-2026*, www.grandviewresearch.com/industry-analysis/home-healthcare-industry.
[7] "Home Healthcare Market Size: Industry Growth Report, 2019-2026." *Home Healthcare Market Size | Industry Growth Report, 2019-2026*, www.grandviewresearch.com/industry-analysis/home-healthcare-industry.

How a captive can help the home healthcare Industry:

Forming a risk retention group (RRG) would be a helpful captive insurance solution for the National Home Healthcare Association because of the similar risk exposures throughout the industry. As a company comprised of a network of 500 homogeneous independent organizations, forming a RRG will be beneficial for insuring the risks of its members while benefiting at the same time from the underwriting profits.

In a risk retention group, good results are rewarded, and bad results are penalized, which will force the RRG to increase their risk control because they will have a larger stake in the game. Putting an RRG in place will ensure more cost effective solutions because the NHHA and its professionals will be able to retain insurer profits and have controlling costs put in place if an event occurs. A risk retention group will allow the company to control market cycles and increase their members' ability to self-insure their own risks. The homogeneity of risk will make it easier to establish consistent rates and predict loss experience. This will provide a tailored solution for the members and offer an unbeatable level of customization with very little changes in premiums[8].

Additionally, the underwriting profits and gains from the invested premiums, that would otherwise be held by an insurer, are retained by the RRG. With underwriting success, the insurer will eventually be able to use this retained surplus to reduce member premiums or pay dividends to the insureds.

The risk retention group could be structured to be a limited liability insurance company domiciled in Delaware. Risk retention groups are federally regulated under the Liability Risk

[8] "Risk Retention Groups: An Important Segment of the Captive Industry." *Risk Retention Groups: An Important Segment of the Captive Industry | Captive.com*, www.captive.com/news/2018/10/03/risk-retention-groups-important-segment-captive-industry.

Retention Act of 1986, which preempts state regulation. After meeting the licensing requirements of one state, risk retention groups can register to be admitted in other states. This allows RRGs to provide coverage to professionals in any state and eliminates the need for fronting insurers to issue admitted policies. Although, a front may still be desirable for its financial strength rating until such time as the RRG may be rated. Being domiciled in Delaware will allow the captive to receive a flat rate premium tax structure while also being able to issue policies anywhere in the United States. Delaware is one of the fastest growing domiciles for captives because of its flexibility with respect to legalities and better than average tax rates on premiums.[9] Having this tax favored treatment of insurance will allow the captive to reduce the costs of providing benefits to members. This will lower rates for individual professionals while granting the captive the means to provide more extensive coverage.

Challenges:

Although forming a captive of this kind will allow the NHHA to control claims and loss exposures, it is important to understand the extra cost that will be needed in order to implement a risk retention group. Before forming the RRG, the organization needs to make sure it is meeting all requirements and that the benefits outweigh the additional expenses. During the initial formation of the RRG, there will be various start-up costs that must come out of the NHHA's financial resources. At least half or 75% of the parent company's premiums will be spent in order to form the RRG. There is also a required capitalization put in place by the domicile's regulatory process[10].

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9 "The Delaware Advantage." *Image Widget*, 2018, www.delawarecaptive.org/i4a/pages/index.cfm?pageid=3278.
10 "Captives: An Overview ." *Cicaworld.com*, www.cicaworld.com/docs/default-source/cica-publications/download-your-copy-of-the-captives-an-overview-publication-.pdf?sfvrsn=0.

In addition to the financial challenges that the company will have to face, there will also be an increased administrative burden on the NHHA. Management will have to invest time and money into making sure the RRG is correctly formed and overseen. In order to have the most productive type of captive solution possible, administration will often hire outside experts to take control of the insurance related details.

All of these challenges will end up reducing the amount of premium that is able to be saved within the NHHA at the inception of the RRG.

Future Considerations:

Captives have the ability to insure unique risks and fill gaps where commercial markets are unable to do so for our members. Risk retention groups cannot write property insurance, including collision and comprehensive coverage for autos, or workers compensation insurance. As a result, the NHHA would have to utilize other solutions for non-liability lines of coverage.

To fund retained losses via the RRG, a deductible reimbursement policy will be issued to the professionals. The premium is agreed upon between both parties, and the professional agrees to reimburse the RRG for losses within the agreed deductible. This policy will provide indemnification, workers compensation coverage and commercial casualty insurance. These continue to be the major overhead expenses for home healthcare companies. This deductible reimbursement plan allows the professionals to realize their upfront premium savings while having their RRG handle claims and insure the large deductible[11]. The captive is able to defer income by deducting underwriting profit. The professionals would be able to deduct the

[11] "Funding Benefits through Captive Insurance Companies Continues To Grow." *Funding Benefits through Captive Insurance Companies Continues To Grow | Captive.com*, www.captive.com/news/2017/11/15/funding-benefits-through-captive-insurance-companies-growing.

premiums paid to the company, similar to the premium paid to a workers' compensation commercial insurer.

Taking past losses into consideration, the NHHA's track record has been doing well overall with only a few exceptions. With the loss ratio ranging from 40-70%, it is likely a RRG could be profitable. There were three significant auto accidents that occurred last year. In the home healthcare industry, there are very few auto claims that reach $1 million - $5 million, giving the company the perfect opportunity to provide a $500K additional limit. Because of this, we recommend the NHHA's RRG provide excess policy limits for personal auto claims. In this scenario, members can purchase low limits for personal auto coverage, and the RRG will cover large claims if they occur.

By tapping into the reinsurance market, the RRG can transfer some of its own insurance liabilities to another insurance company. This mechanism can allow the RRG to lower their risks and reduce their exposure to large catastrophic events, such as major auto claims. Having too much exposure to a potentially costly event can cause the captive to shut down or go bankrupt if they are not able to cover losses[12].

[12] "How Do Captive Insurers Use Reinsurance?" *How Do Captive Insurers Use Reinsurance? | Captive.com*, www.captive.com/news/2019/05/20/how-do-captive-insurers-use-reinsurance.

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