2021-2022

CICA STUDENT ESSAY CONTEST

Using Captive Insurance Solutions to Address Coverage Gaps

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SAINT JOSEPH'S UNIVERSITY:

Connor Thomson & Nicholas Vagnozzi

CRAFT BREWERIES ASSOCIATION

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PERSONAL INTRODUCTIONS

My name is Connor Thomson, and I am a senior Risk Management and Insurance major in the Honors Program at Saint Joseph's University. I have passed five CPCU exams, received the Collegiate Studies for CPCU certificate, and secured two professional internships -- one handling loan policies of title insurance for V.I.P. Mortgage, Inc. and the other adjusting auto, non-injury claims for United Services Automobile Association (USAA). After graduation in May 2022, I will be attending Villanova University Charles Widger School of Law -- a top 53 program -- to earn my Juris Doctor. My goal is to practice as an insurance attorney.

My name is Nicholas Vagnozzi, and I am a senior Risk Management and Insurance major at Saint Joseph's University. I have spent the past two years working as an intern in part-time and full-time capacities at Lyons Companies -- an insurance brokerage in Wilmington, Delaware. I reviewed policies in the Quality Assurance Department, shadowed commercial and high net worth personal brokers in the Risk Management Department, and even placed captives with several accounts. On top of that, I gained my Property and Casualty License in Pennsylvania and Delaware and built a small book of business, which I managed as a busy college student. After graduation in May 2022, I will be employed as an Associate Underwriter (Alternative Risk Solutions) in Everest Reinsurance Group, Ltd.'s Private Equity Department.

Thank you for giving us the opportunity to compete in this student essay contest!

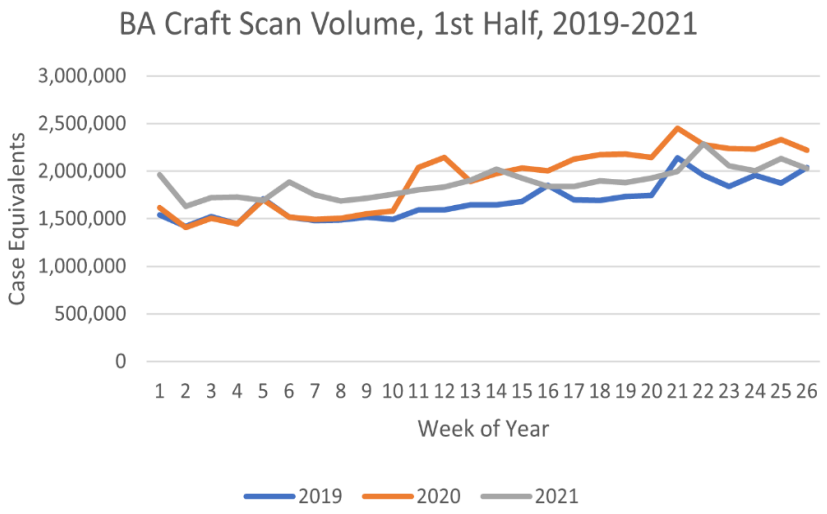
OVERVIEW

Craft Breweries Association

The Craft Breweries Association is the parent organization of over 6,300 member craft breweries throughout the US. These craft breweries are located in all fifty states, and they typically employ 25-75 full-time workers with a mix of part-time, seasonal personnel.

Craft Brewery Industry

According to *Brewers Association*, an American craft brewery is small and independent. Each firm produces roughly six million barrels of beer per year, and two of the most notable craft breweries are D. G. Yuengling & Son, Inc. in Pottsville, Pennsylvania and Boston Beer Co. in Boston, Massachusetts. They interpret historic styles and add their own unique twists with ingredients other than malted barley. Free from interest by non-craft breweries, this industry saw substantial growth from FY 2019 to FY 2020, but that has since slowed. The graph below shows the craft scan volume in case equivalents for the first halves of FYs 2019, 2020, and 2021.



Source: Brewers Association

Medical Stop Loss Coverage

Medical stop loss coverage protects against catastrophic and unpredictable healthcare losses. It is excess health insurance. If payouts surpass a certain threshold, a [captive] insurance company then becomes responsible. Essentially, it offers a layer of protection above what was already self-funded and "… provides a ceiling on the dollar amount of eligible expenses that an employer would pay…" under the commercial plan's deductible attachment point ("What"). We will focus on aggregate and individual medical stop loss coverage for this essay. The model on page eight elaborates on the loss fund layers.

Voluntary Benefits

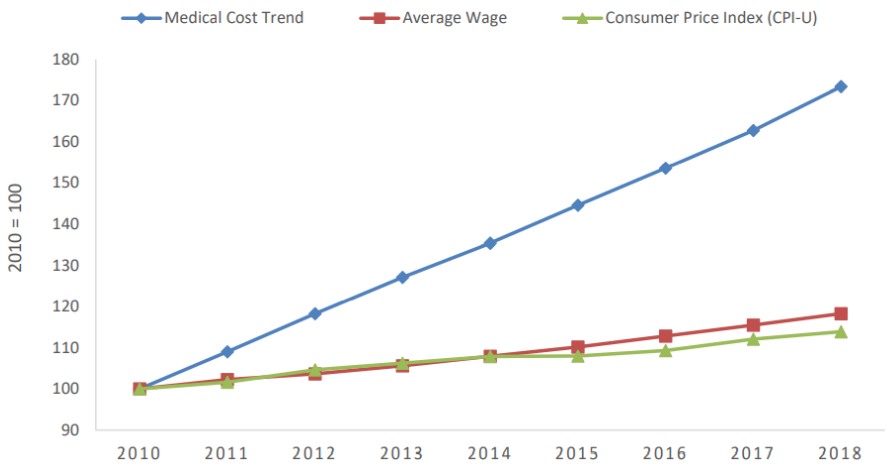
Voluntary benefits are, as they sound, voluntary. This coverage is optional, and the premiums are normally funded by the employer. They [voluntary benefits] "shield" employees, offer financial security, and may be used for critical illness, hospital indemnity, accident, life, and disability claims. Health insurance is *not* included in this mix; there is a difference.

ISSUE ANALYSIS

Rising Healthcare Costs (Broad Market Conditions)

Healthcare costs in the US have been on the rise since the 1960s. The total amount spent in 2018 was $3.6-3.8 trillion, and that number exceeded $4 trillion last year. What is causing this large increase -- one that has been outpacing median household incomes since 2011?

Figure 1: Medical Cost Trend is Increasing Faster than Wages and Inflation (2010–2018)
Source: PwC, Census, BLS, CAHC Calculations

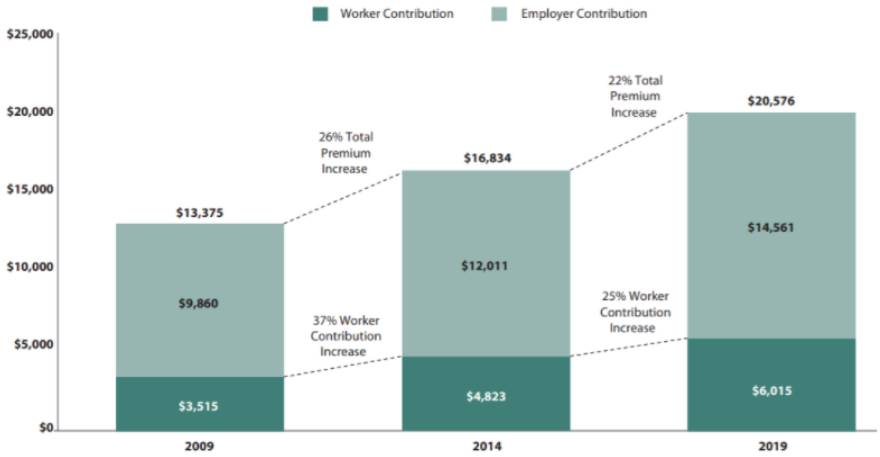


Government policies like Medicare and Medicaid have allowed private insurance companies to raise their rates, and our country is experiencing a growth in senior populations, chronic illnesses, and unhealthy habits. Americans' physical and mental health standards are declining, generally speaking, and that has been exacerbated by the COVID-19 pandemic. It is estimated that healthcare costs will amass to $18,000 per person by 2028 (Probasco).

We believe that rising healthcare costs for independent American craft breweries is a high frequency-high severity risk. They are burdensome for small business owners and entrepreneurs. The 6,300 member craft breweries under the umbrella of the Craft Breweries Association typically employ 25-75 full-time workers and likely do not have limitless capital or a designated HR representative to support their skilled staff.

In 2014, the Affordable Care Act (ACA) required businesses with over fifty full-time workers to provide their employees some form of health insurance. Most craft breweries still offer health insurance as a part of their benefits package even if they employ under fifty people. Paul Siperke, the co-owner of Fat Head's Brewery in Middleburg Heights, Ohio, has been doing that since 2009 "despite some pretty dramatic volatility in rates" and slowed growth (Sarah). He said, "One year we got a 38 percent increase, another year we got 11. One year we got three" (Sarah). A majority of the full-time workers at Fat Head's are in their 20s and 30s, and they are young and enthusiastic. Siperke stated in disbelief, "It just seems odd that we get such a drastic price increase when nothing has really changed with us as far as our employees and health issues" (Sarah). According to the graph below, there has been a 48% spike in employer-sponsored health insurance premiums for family coverage over the past decade-or-so.

Figure A: Average Annual Worker and Employer Premium Contributions and Total Premiums for Family Coverage, 2009, 2014, and 2019



SOURCE: KFF Employer Health Benefits Survey, 2019; Kaiser/HRET Survey of Employer Sponsored Health Benefits, 2009 and 2014

If we use Fat Head's as a sample case study for the 6,299 other member craft breweries, it is clear that the rise in healthcare costs is due to broader market conditions. Fat Head's employees are Millennials who remain in superb shape; however, there are factors on a macro level that cause severe losses and volatile premiums. Without a captive, there is no way for the Craft Breweries Association to control these two issues.

ASSOCIATION CAPTIVE

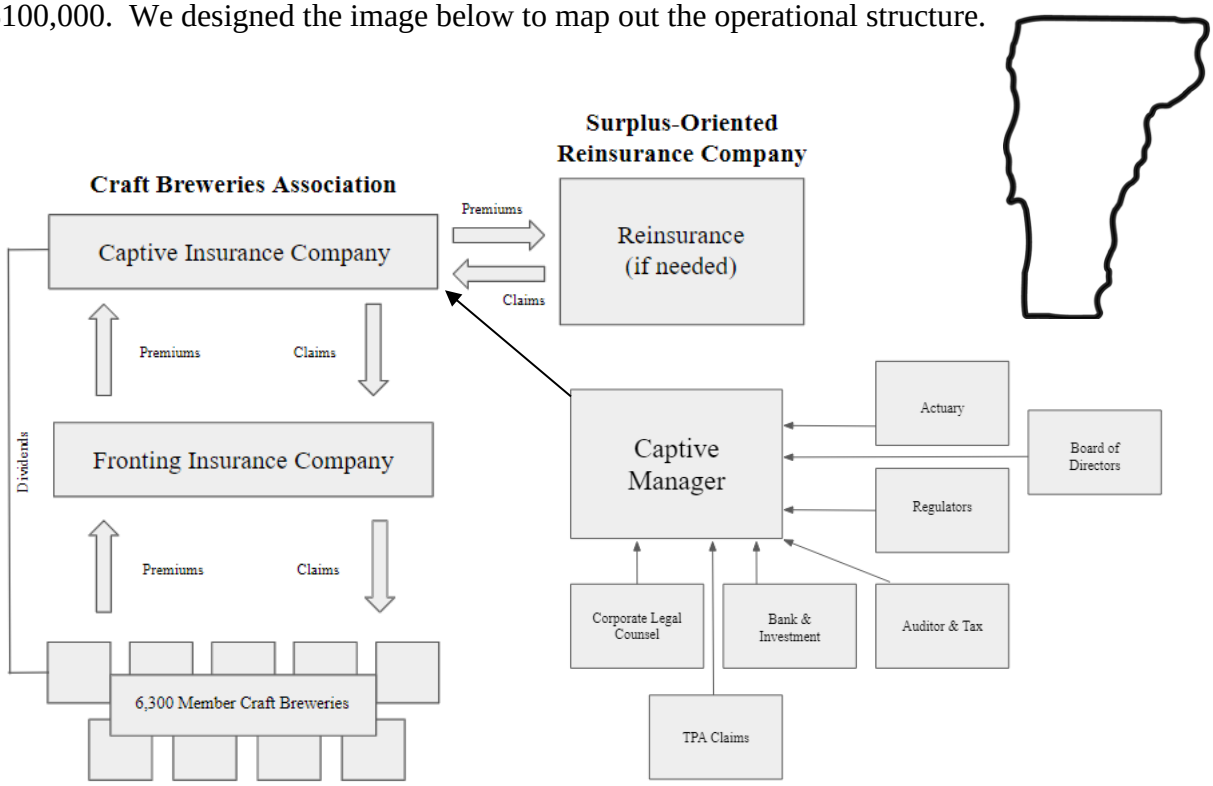
Why an Association Captive?

A captive is an alternative risk retention vehicle that comes in many different molds. We chose an association captive, also known as a group captive, because its primary purpose is to insure the risks of homogeneously sponsored members (owners). It will offer the Craft Breweries Association certain benefits like improved loss forecasting, increased loss control, and specialized loss treatment. The law of large numbers declares that more exposures will result in a more accurate forecast of future losses. 6,300 *similar* member craft breweries may help achieve a combined ratio of less than 100% -- an underwriting profit, which could be applied towards reserves or used in the form of dividends. Additionally, an association captive's "sharing of losses" encourages members to enforce safety and controls, so no [craft brewery] feels like they are generating more than [their] 'fair share' of claims expenses" ("What"). Lastly, "a group captive has the ability to retain higher levels of risk than each of its members could retain on a stand-alone basis … [and] can provide catastrophic coverage limits that commercial markets are unwilling or unable to offer" ("What").

This structure will also mandate that each craft brewery pay a premium based on their past claims history. An association captive promotes equity, facilitates long-term cost stability, and saves 10-30% because it eliminates an insurance company's immoderate overhead.

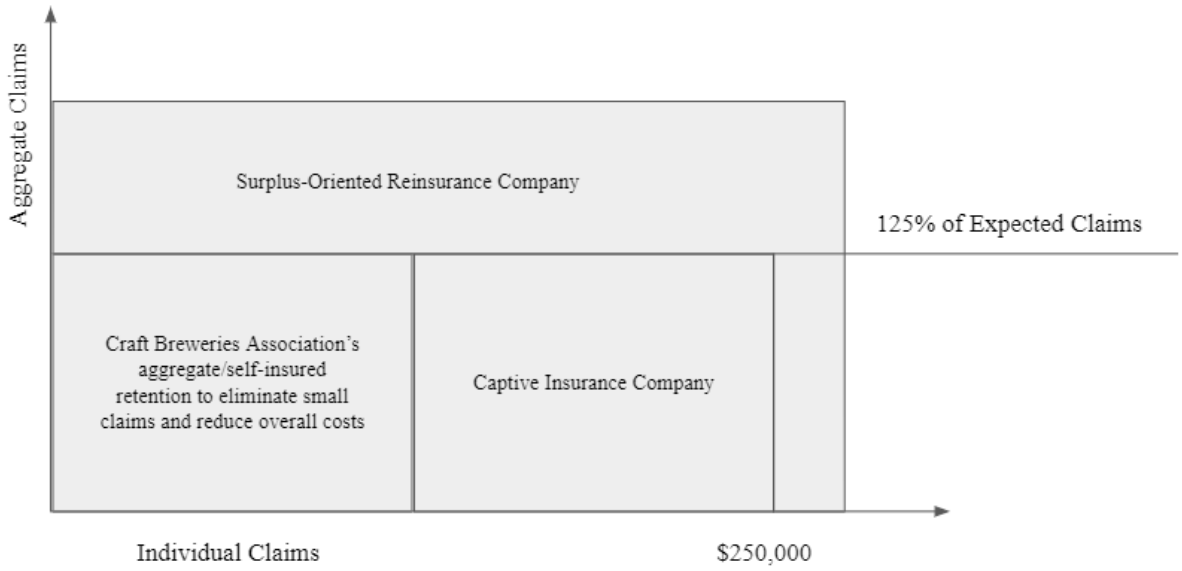
Operational Structure

The group captive for the Craft Breweries Association will be domiciled in Vermont, US. Vermont is the largest national market for captive insurance companies because of its favorable corporate laws and robust regulatory environment. As of now, the minimum capital and surplus requirement in Vermont is $250,000, but legislation has been proposed to lower that number to $100,000. We designed the image below to map out the operational structure.



The fronting insurance company will cede all risks to the group captive and issue manuscript policies to the 6,300 member craft breweries. Some benefits of this arrangement include customized coverage, more affordable premiums, greater underwriting, claims, and loss control expertise, a possible "preferred vendor" relationship, insurance certificates, and tax deductibility. A caveat, however, is the cost. Fronting insurance companies may charge anywhere from 6-10% of the gross written premium. Nevertheless, we believe that the rewards of this operational

structure outweigh the risks. We created the pseudo-A/B loss fund model below to demonstrate how it relates to medical stop loss coverage, specifically.



POLICY OPTIONS

The group captive for the Craft Breweries Association will include provisions in their benefits program, which may help the member craft breweries stabilize and reduce their rising healthcare costs. The specific underwriting factors for their manuscript policies will engender tiered premiums, not one-size-fits-all. Mitigation premium discounts will also be given to firms that invest in employee wellness and mental health counseling initiatives.

Tiered Pricing

"Group business" is underwritten according to the structure and needs of the insured group -- hence the name. With tiered pricing, the 6,300 member craft breweries will benefit from cheaper premiums that take into account the details in the matrix below. While an individual health insurance application asks for someone's sex, height, weight, and pre-existing conditions, Munich Reinsurance Company evaluates the number of employees, geographic location, age distribution, and number of dependents for group health insurance.

	Gold Tier	Silver Tier	Bronze Tier	
Number of employees	75+ employees	74-25 employees	24-01 employees	
Geographic location	E, NE, MW	C, Pacific NW	W, S, SW, SE	
Age distribution	51+ years old	50-30 years old	29-21 years old	*must be at least 21 years old to work in a craft brewery
Number of dependents	04+ dependents	03-02 dependents	01-00 dependents	
	$450 per month	$350 per month	$250 per month	
	$5,400 annually	$4,200 annually	$3,000 annually	

This is a mock version of what the Craft Breweries Association's health insurance premiums will look like. For reference, in the current US marketplace, the annual cost of health insurance is $7,149 per enrolled employee. It is much higher than our example.

Mitigation Premium Discounts

We intend to reward the member craft breweries that take extra steps to prevent and reduce the likelihood of a material claim. The group captive will look to partner with the National Restaurant Association (NRA). The NRA has a program that costs seven dollars a month per employee for access to telemedicine visits and mental health resources. This is a simple but profound way to "care for the hardworking folks who work behind the bar and among stainless steel tanks" (Broesder). It will encourage the 6,300 member craft breweries' employees to remain in superb shape, physically and mentally, so they will not drive up group healthcare and prescription drug costs for non-work-related injuries or illnesses.

FEASIBILITY STUDY

Association Captive

According to *Capstone Associated*, "in the case of medical stop loss [coverage], an actuarial study should be the first step to make certain that … the resulting loss experience can support a medical stop loss program and to identify alternative costs. Once the actuarial analysis is complete, pro forma financial statements covering the next five years should be generated … to assess the surplus requirements and rate adequacy" ("Medical"). Because the Craft Breweries

Association already has the necessary capital to fund a captive's development, implementation, and formation, there should not be any issues. In fact, it is our opinion that an association captive is the best choice for the 6,300 member craft breweries. It is a growing, homogeneous class that has been adversely affected by rising healthcare costs, which are broad market conditions out of their control. A group captive for medical stop loss coverage will limit the severity of these losses and allow the Craft Breweries Association to avoid excess volatility.

Voluntary Benefits

It was just established that a group captive would be feasible for the Craft Breweries Association's medical stop loss coverage needs. However, the parent organization of over 6,300 member craft breweries has a long-term priority of offering voluntary benefits to employees as a "safety net." The statistic is that "52% of households … have less than $10,000 in liquid assets available for use in an emergency" *(Business Insurance)*.

There are some challenges because insuring employee benefits through a captive may be a "prohibited transaction" per ERISA. Since we domiciled the captive in Vermont, it will take approximately 12-18 months for DOL approval and over $500,000 in legal, tax, and advisory fees. Although captives for medical stop loss coverage are relatively straightforward and do not need a fronting insurance company, **one is required for voluntary benefits**.

Despite these drawbacks, we believe that it would be possible and advantageous for the Craft Breweries Association to implement voluntary benefits into their captive. They [voluntary benefits] tend to improve employee well-being and retention because the employer is "investing" in the health of their workers with ease. The premium is deducted straight from payroll at no charge to the parent. Firms may experience anywhere from a 20-25% net return on this strategy.

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