CLARITY

White Paper

Healthcare Captives – An Important Risk Management Vehicle
Part 3: Underwriting: The Science…and the Art

Introduction

If you know us, or if you've been reading along through Parts One and Two of this Captive Management Series, you know our mantra for the healthcare industry is **Evolution, Evolution, Evolution**! Indeed, the industry continues to evolve under, among other things, the Affordable Care Act (ACA), and is experiencing significant changes such as a growing number of physician practices being purchased and operated by hospitals. These new employment trends add new exposures for potential claims related to the negligent acts of employed physicians. In addition, we have seen more and more hospitals entering operational agreements with other healthcare institutions, broadening the complexity of their care delivery base and fostering a need for more integrated patient safety management strategies. With all of these changes occurring, now is the time for healthcare providers to look for more effective ways to manage expanding risk exposures.

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In addition to these recent trends, professional liability insurance remains one of the most significant costs that healthcare providers and organizations face. One way to control this cost is through an alternative risk financing vehicle, such as a captive insurance company. A captive insurance company can be cost-effective, even as it shifts more control of the risk to the healthcare organization, because it places a larger emphasis on patient safety. For a captive insurance company to be successful then, it requires performing a combination of several functions well: aggressive claims management, robust risk-quality-safety (RQS) management and appropriate underwriting. These three areas together create a Captive Risk Management Triad that sustains a stable environment for the management of the professional liability risks of the

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healthcare organization and forges a successful operation to protect the assets of the insurance company as well as the parent organization.

For Part Three of the series, we will take a look at some of the characteristics of a careful and well-informed captive underwriting approach.

The Impact of Underwriting on Captive Success

The benefits of a high-quality captive program go far beyond just the insurance coverage. However, consistent and well-informed underwriting is imperative to the success and longevity of any insurance company. By definition, the purpose of underwriting is to assess the exposures of a given risk and develop appropriate coverage and pricing to insure it. While this is an explicit action, some of the decisions behind effective underwriting involve not only a direct data-driven assessment, but also an intuition developed with experience, drawing from a holistic knowledge of the factors at play in the overall organizational landscape.

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The Science of Underwriting in a Captive Setting

The purpose of underwriting is to look at all known exposures and develop pricing to fund those risks. This means focusing on a variety of factors:

- **Known exposures:** An underwriter is going to need details about the nature of the exposure under consideration for coverage. If the insurance will be for a physician, what is the medical specialty? How long have they been practicing? Are they board certified? Are they full time or part time? How many patients do they see a year and are they doing invasive procedures? Do they need "prior acts" coverage, and if so, going how far back? Have there been any coverage gaps? For hospitals or other facilities, how many beds? What services are provided? How many employees are there? Where is it geographically located? What is the financial strength of the organization? Will they be able to pay their premiums and reimburse any deductibles (if

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applicable)? This is the sort of information needed to get a good sense of the risk.

Knowing what has contributed to past claims or events can provide an underwriter with important insight…as does having confidence in the risk mitigation capabilities of the applicant.

- **Claims history:** Knowing what has contributed to past claims or events can provide an underwriter with important insight, and a typical analysis window for looking at claims history is ten years. Has an applicant been sued before? If so, how many times? Have any of those suits resulted in a settlement or jury award? And if so, for how much?

- **Risk mitigation:** Does the applicant have an active risk management program? Are there data to shed some light on its effectiveness? These factors instill confidence in the risk mitigation capabilities of the applicant.

- **Limits:** How much insurance is desired? Are there any statutory requirements? Are defense costs inside or outside the limit?

- **Deductible:** Taking a deductible can lower the premium, but the insured will assume a portion of the liability. Some things to consider with deductibles are whether or not the insured will be in a position to pay their share in the event of a claim. Are they financially solvent? Does the retained layer need to be collateralized? Is the deductible indemnity-only or are legal expenses included?

- **Prior Acts:** If the policy form is claims-made and the insured is coming off a claims-made policy, consideration has to be given to the retroactive date to avoid potential coverage gaps.

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The Art of Underwriting in a Captive Setting

We just took a look at the various factors underwriting must consider from a strictly scientific, data-driven perspective, but that is only part of the picture. A truly holistic strategy from an underwriting perspective will involve making abstract judgments, which can contribute to the overall patient safety and risk management goals of the organization and contribute to a climate of increased safety throughout the entire care-delivery system.

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- **Claims history:** There is much more to an organization's claims history than simply a categorical summation of the suits filed and moneys paid. Are there any similarities among known suits that might highlight a pattern? Are there identifiable trends from a procedural perspective to isolate risky procedures? If so, an underwriter may consider excluding coverage for a certain procedure or excluding a certain individual who has an adverse claims history. Additionally, a higher premium may be assessed to offset the risk potential.

- **Risk mitigation:** What is the organization doing to demonstrate they are proactively managing their risk and staying in front of things to keep potential incidents from occurring and actual incidents from developing into lawsuits? Is there an "early warning system" in place to alert providers of potential issues that may result in a claim? Has the practice or organization undergone any outside professional accreditation process and what are the results? Is there any continuing education in place or do they have any special programs or certifications? What processes are there for employee selection and training? Is there a particular risk management initiative that the captive owner would like to roll out to its insureds or a behavior they would like to encourage as part of their overall risk and quality strategy? The captive can be used to influence risk management behavior by tying premium credits to participation in a risk program.

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Underwriting + RQS Management + Claims Management: The Captive Risk Management Triad

As stated above and in Parts One and Two of this series, an efficient, effective, progressive captive patient safety management strategy will involve performing the functions of RQS Management, Claims Management and Underwriting in harmony. We call this the Captive Risk Management Triad.

RQS works hand-in-hand with claims management to understand known safety trends and risk issues that were involved with past claims. Oftentimes, the primary allegation isn't the only safety-related issue in a given claim, and cooperation between RQS and claims means that any knowledge gained from the claim process can be translated into recommendations and strategies for safety and quality improvement.

Aggressive and consistent claims management supports the overall financial integrity of the captive. The results of the claims management process also impact the underwriting associated with the captive.

Underwriting is a science and an art that requires as much information as possible in determining appropriate premiums and funding levels for the captive.

To truly develop a successful captive insurance company, though, a knowledgeable and experienced underwriting process is also key. Underwriting is a science and an art that requires as much information as possible in determining appropriate premiums and funding levels for the captive. To this end, underwriting will look to RQS for any and all patient safety and quality data that helps them to evaluate the risk exposures of the captive and to the claims history of the individual and/or organization to determine patterns of behavior that may signal increased or decreased risk exposure. Underwriting is the area that assures the captive owners that they are accurately pricing the insurance being provided.

In summary, engaging in the formation of a captive insurance company can provide the owners several long term benefits: financial control over a significant expense, quality control over the actual healthcare services they are

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providing and claims management control over potential and actual claims that can impact the company and the owners. To realize these benefits, captive owners must adopt the principles outlined in the Captive Risk Management Triad. In addition, proactive engagement between the board of directors and the captive's insured entities and providers can lead to increased opportunities to mitigate potential patient safety issues before they become claims. Thus, communication and shared learning between all three facets of the triad is crucial.

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Be sure to read Part One of Clarity's Captive Management Series, *Foundations of Successful Claims Management*, and Part Two, *The Development of RQS Management Programs*.

For more information on Clarity's Captive Management Services, please visit www.claritygrp.com

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