

Alternative Risk Financing

What's the Proper Use of This Sophisticated Consulting Approach That Uses Tools Like Captives in Managing Risk and Controlling Costs in the Health Care Setting?

By Jonathan I. Katz, MBA

The medical professional liability market has long been a volatile and unpredictable subject for health care providers to deal with. The current crisis is nothing new, as previous crises occurred in the mid 1970s and early 1980s. As a result, sophisticated health care providers have long turned to alternative risk financing solutions. In this article, we're going to explore what alternative risk financing is and how best to use it.

Financing is the act or process of obtaining the funds required to carry out an organization's mission. Risk financing focuses only on raising or providing funds to pay for claims (both expenses and indemnity). Historically, the most popular choice for financing claims has been commercial insurance. Insurance works well when the losses to be incurred by the insured group as a whole are relatively predictable and when the losses sustained by any one entity are rare and random. Unfortunately, the reality of medical malpractice is that many organizations sustain losses and the ability to predict the losses of the group as a whole is diminishing as the size and types of claims escalate. Further, the structure of the insurance industry itself promotes wild swings in the pricing and availability of insurance. Alternative risk financing is simply the use of various methods to raise cash to pay for claims, other than just commercial insurance.

The question we normally pose while beginning a new alternative risk financing consulting assignment is "what is the lowest cost to transfer risk over the longtime horizon." The areas we typically study in alternative risk financing are:



- Insurance
- Self-insurance
- Deductibles or retentions
- Retrospective insurance
- Formal self-insurance
- Trust funds
- Rent-a-captives
- Protected cells
- Captive insurance companies (captives)
- Finite insurance
- Bonding
- Hybrid solutions

Alternative risk financing solutions are usually undertaken by larger more sophisticated health care providers. So, how large or sophisticated do you need to be? It's hard to say for sure, but as a general rule of thumb you should be paying at least \$1 million per year in premiums and have someone in the organization capable of and willing to become well versed in the alternative solutions being studied. The interesting thing about an alternative risk financing consulting project is that if done properly, you are not sure what the answer to the question is until after you complete the study (commonly referred to as a feasibility study). Therefore, it's possible an organization can pay for a consulting project that does nothing more than confirm that purchasing commercial insurance with absolutely no changes to the structure is the best alternative. To help avoid this from happening, in the initial interview process we look for indicators as to if it would be a good idea to begin a project in the first place. Listed below are some of the indicators we typically look for:

- Affordability of insurance issues
- Availability of insurance issues
- Desire to gain control
- Need for flexibility
- Being grossly overcharged for insurance
- Your business being misunderstood by underwriters
- Desire for access to reinsurance markets
- Disgust with insurance companies
- Negotiating tool in getting fair pricing from commercial insurers

An alternative risk financing consulting project done correctly would include a truly customized feasibility study tailored to your organization's needs, an independently conducted actuarial study produced by a member in good standing of the Casualty Actuarial Society, and the advice of an independent knowledgeable tax and regulatory attorney. You should expect the consulting firm to begin with an all day strategy session with the senior management team of your organization. The goals should be to truly learn about your operation, what your problems are, and to offer you an in depth overview of alternative risk financing methods. Many firms have employed actuaries who will conduct studies for clients. We believe that health care providers should engage independent actuaries and attorneys who have no interest or incentive as to what the outcome of the study is (and no ties to the firm doing the feasibility study), as a means of creating an ideal environment of unbiased advice. We also feel that an upfront fee for the feasibility study with no incentives as to the outcome is ideal.

Unfortunately, alternative risk financing is often misused in the marketplace. Watch out for firms that employ or are connected to actuaries and attorneys, and who begin studies with the conclusion already in hand. Pay close attention to consulting firms who own captive management firms, rent-a-captives, protected cells or segregated portfolios and companies

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that administer claims (TPAs). Not all are bad. However, some have been known to give away a "canned" feasibility study for low upfront costs while driving business to and overcharging for these vendors on the back end. Lastly, there are those who only market rent-a-captives, protected cells or segregated portfolios for health care providers as a solution. The problem here is that it might initially cost less than the commercial insurance, but you won't know if it is the lowest cost to transfer risk over the longtime horizon unless a full unbiased feasibility and actuarial study is conducted. Also, most of these arrangements typically require full funding of the aggregate exposure, and offer little real control. In our opinion, the proper uses for these vehicles are for short-term situations, testing the waters, or being caught at the last minute with no solution. Quite often, we find that a hybrid solution combining risk financing tools is chosen. We also find that organizations in general tend to buy too much insurance in the primary layer and too little insurance in the catastrophic layer. If done well, the alternative risk financing experience in general should be one of self-discovery for an organization. You should feel that the solution was tailored to your specific needs, that it focused on the long-term cost of risk, and that it put you in "the driver's seat" in controlling your future.

In conclusion, risk financing alternatives are commonly used by sophisticated health care providers as a means to manage risk and control costs. Hybrid solutions that combine an alternative tool and insurance are good choices. Excellent reasons to investigate an alternative solution are availability or affordability of insurance issues, being overcharged, having your line of business misunderstood by commercial

underwriters, far outperforming your peers from a loss perspective, or flexibility. Be careful to select consultants who will offer you unbiased advice and who will put you in the driver's seat. I recommend that medical groups and other health care providers be represented by a specialist in alternative risk financing and medical professional liability insurance when exploring alternative risk financing solutions who can properly advise them in conjunction with their other trusted advisers. If you are not currently represented by a specialist in these areas, please call us for a consultation.

Jonathan has more than 15 years of experience in the insurance and health care industries. He currently serves as President of Oros Risk Solutions, LLC, a health care liability specialty company, serving health care providers as an advocate for risk modification and risk transfer. The company provides insurance brokerage and consulting services for physicians, hospitals, managed care organizations and non-hospital facilities. Jonathan earned a degree in finance from the University of Florida and an MBA at Rollins College in Winter Park, FL. He is a member of the Healthcare Financial Management Association and the Florida Society for Healthcare Risk Management and Patient Safety. For information about having Oros Risk Solutions represent you, please call (407) 838-3444 or 1-866-596-3859 toll free. ■