

Financial risk in healthcare

Pamela Popp of West Litigation introduces the *Captive Review healthcare guide 2009* with a breakdown of the world of ART

There is nothing easy about risk management in healthcare. There are challenges of declining reimbursement, demands of evolving technology and the ever present concern for the safety of our patients and employees. And yet there's the appeal of the complexity that not only allows us to be pulled in, but to actually try to tame, and control, the challenges before us.

Welcome to the world of ART – alternative risk transfer solutions. Self-insurance layers, risk-retention groups and captives are all mechanisms to take the financial risks of the healthcare entity out of the traditional commercial insurance market and into a self-directed realm of risk identification, mitigation and resolution.

Risk identification: The greatest challenge for a healthcare risk manager is to identify the various means of risk that may present at any time in the operations of the entity. This requires an intimate knowledge of all aspects of the entity, such as awareness of marketing messages, staffing challenges, financial benchmarks and chemical hazards, as well as the probability that current policies and procedures truly illustrate the processes needed to supply a safe and healthy environment. It is only with this

knowledge of the risks that efforts can be implemented to reduce them.

Risk mitigation: Once risks are identified, efforts can be implemented to mitigate, or reduce, the impact of the risks. Risk mitigation means the application of solutions to a risk already incurred, such as the waiver of a bill balance, a meeting with an upset patient and the proactive training of staff.

Risk resolution: But not all risks can be completely avoided or mitigated. For those, resolution must be done, whether issuing a payment to an injured patient or replacing a piece of failed equipment. And more importantly, the learning of lessons provided by each resolution, from the revision of a policy to the complete change of a process. Each change must be evaluated and monitored, to be sure that the result is as desired.

But even where risks are controlled, the risk manager must be involved with the ongoing growth and development of the captive operations. Much like the management of the investments that serve to fund the captive's claim costs, managing the risks is a process. Two areas are key for involvement of the risk manager: claims management and underwriting processes.

Claims management: The best known of the captive operations, the claims



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management programme is one that must be carefully tended by the risk manager. Premiums must be appropriate to fund future losses, and trends of frequency or severity must be addressed. The language of the policy must reflect the intentions of coverage and, where unclear, needs to be interpreted so as to not bring in any risk unintended (and thus unfunded) for the captive. Defence costs must be managed for efficiencies and effectiveness, as do administrative costs and service providers. Diligence in the review of each and every claim with paid costs will allow the risk manager the opportunity to identify ways that the 'lessons learned' can be incorporated back into the operations of the entity.

Underwriting process: Often overlooked (especially when the captive

programme is new), the underwriting process is the most effective way to control and monitor the risks brought into the captive. The process requires that there be a discussion, and philosophy, around what risks are desired to be addressed by the captive, and which are to be excluded. This allows for the establishment of parameters on the amount of risk accepted, balanced by the amount of financial security needed to sufficiently address those risks.

It is also these two areas that bring the most potential risk to the captive itself. If the claims programme is not effective, a large settlement or verdict could arise, without notice for sufficient reserving. Such unanticipated loss amounts can impair future funding as well as divert the captive's cashflow.

Expense costs could be uncontrolled to the point of depletion of reserves, and liabilities thought to be shifted could reappear. Exposures unintended for the captive could develop, as well as exposure for the captive management personnel for the failure of economic accountability. These exposures could trigger directors' and officers' claims, or invoke other allegations focusing on the inappropriate acceptance of risk into the captive.

These are not risks to take lightly.

So what are the true measures of success for a captive? Success is a term best addressed by the audience awaiting results. But for the healthcare risk manager, the measures of success for a captive should be threefold:

Does the captive adequately address the risks intended?

At least annually there should be a conversation of the board members of the captive to determine if the policy language is still appropriate for the risks being accepted into the captive, as well as to review the underwriting process. Again the goal here is to be sure that only those exposures meant to be intentionally covered into the captive be accepted. If a review of all matters covered in the past year yields outliers, it is time to review the underwriting process (to perhaps include more stringent criteria) as well as to inventory other coverages available for future losses felt to be outside of the captive coverage. Proactively identifying other coverages available for losses will allow for efficient decision making when a claim is presented for acceptance by the captive.

Decisions to accept claims or expand the captive's exposure outside of the accepted philosophy parameters should be done only by approved personnel,

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after a sufficient analysis and review by the captive board. For each decision to expand coverage, the following questions should be asked: How will this expand the current coverage offered? How will funding be established for this new exposure? How will claims arising from this exposure be incorporated into existing processes? Requiring a formal process for expansion of coverage prevents unauthorised decision making that could jeopardise the viability of the captive.

Is the funding mechanism sufficient for the risks accepted?

With the involvement of a healthcare specific actuary, a biannual review should be undertaken to look at the sufficiency of cash flow, loss coverage by premiums and the financial status of the captive. Decision-making around funding levels (at a percentage of anticipated losses, rather than at the full 100%), premium determination and investments should be done by selected, experienced money managers, who bring expertise as well as errors and omissions coverage to the programme. Selection of these investment personnel should be thorough, including obtaining references from other captive owners in regards to both successes and failures of investments and money management programmes. Interview questions should include: Does the philosophy of investments match those of the captive board? What is the experience of both captive money management and investment management? If there is a disagreement on a financial transaction, what is the process to address the disagreement?

Are there checks and balances in place to prevent fraud?

Probably the most important aspect of captive management, the prevention of fraud is more than a goal – it should be a guiding principle accepted by all indi-

viduals and service providers performing work for the captive. Consider inclusion of such language in the contracts and agreements with every service provider working with the captive. In addition, an annual audit of both process and financial status should be completed, to provide oversight into the sufficiency of fraud prevention efforts within the captive.

Where possible, signature authorisation should be vested in multiple persons for control, and sufficient documentation must be provided to allow any payments to occur. At no time should there be a single individual who is able to create, approve and pay invoices through the captive without oversight. No single individual should be collecting premiums, nor have final review on any financial reports. While potentially cumbersome, these prevention techniques are needed to prevent the opportunity for fraudulent transactions.

Of course, no one risk manager will have all of the background needed to evaluate the success and failures of a captive programme. However, the skill of the risk manager should be to bring resources to the board of the captive, educating on how to select the best service providers, how to best document the philosophy and processes of the captive and how to benchmark progress against other healthcare captive entities. Success truly is to be defined by the board of the captive, and the risk manager should use that guidance to help the captive achieve success.

Built with more than simply financial motivation, the development of a captive brings with it the goal of successful control of risks throughout the organisation: a goal that requires a lot of hard work, an appreciation of complexity and an element of hope for the prevention of future losses. It takes resolve to see the complexity and yet to be motivated – even inspired – to find a way to recognise and address the challenges presented.