

RRGs the Rx for medical malpractice needs

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By Rodd Zolkos

Market conditions have cooled some risk retention group activity, but RRGs involved in meeting the medical malpractice coverage needs of health care facilities and practitioners continue to see widespread use.

The risk retention group structure has become widely used to provide an alternative risk financing vehicle for health care providers that have difficulty affording or even finding coverage in traditional markets.

Many believe the trend will continue in the absence of national tort reform and some expect it to increase as hospitals respond to provisions of the new U.S. health care reform law.

"The demand for risk retention group activity and creation is very specific to the state you're talking about," said Thomas M. Jones, a partner at McDermott Will & Emery L.L.P. in Chicago. In Texas for example, "with the tort reform they enacted six or seven years ago, there's little activity," he said.

"The state where we're seeing a big demand for alternatives, which include RRGs, probably No. 1 in the country is New York," Mr. Jones said, citing the state's difficult medical malpractice environment driven in large part by high claims severity.

"At one point in the early 2000s, you couldn't buy a med mal policy in Pennsylvania," said David F. Provost, deputy commissioner in the captive division of the Vermont Department of Banking, Insurance, Securities & Health Care Administration.

"A lot of folks formed RRGs here to try to solve that problem," Mr. Provost said. Today, "about one-third of the Pennsylvania med mal premium is written through Vermont RRGs," he said.

"Not only did they manage to be able to buy insurance, but they cut the cost of their claims by 60%, because now they had to manage them," Mr. Provost said. "They had an insurance company they had to run, and they ended up saving a bundle."

"It goes right back to Captives 101 again: Focus management control on losses," Mr. Provost said.

An RRG is an attractive option to many health care entities willing to control exposures that would like to benefit from those loss-control efforts, said Brady Young, president and CEO of Strategic Risk Solutions Inc. in Concord, Mass.

"There's demand from certain physician groups and certain specialties that don't want to be treated like another insured in the commercial market," Mr. Young said. "They recognize that the operating flexibility a risk retention group gives you makes sense."

"Sometimes you'll see some specialties form their own group to pull themselves out of the general physician population, if you will," said David McRoberts, senior managing director at advisory and consulting firm LECG Corp. in Chicago.

Risk retention groups also offer the ability to write coverage directly across multiple states, another appealing factor to multistate groups.

Many major offshore health care entities have had offshore captives for decades, Mr. Young said. But they might face regulatory problems trying to write coverage directly in the United States from those offshore captives. Meanwhile, fronted programs can be expensive.

Offshore captives can't write insurance coverage directly, "so one way to do that is to set up an RRG," Mr. Jones said.

An often-cited example of using an RRG in conjunction with an offshore captive is that of Controlled Risk Insurance Co. of Vermont Inc. (A Risk Retention Group), which Harvard Medical Institutions Inc. formed in 1995 to operate in conjunction with the Cayman Islands-domiciled Controlled Risk Insurance Co. Ltd. captive that it formed in 1976.

“One of our big health care clients in Cayman is looking at forming a risk retention group,” Mr. Young said, noting that the client covers 1,600 physicians through a fronted program.

RRGs offer a “very flexible structure to respond to multistate groups or even one-state groups,” said Mr. Young, adding that his company also has a client in South Carolina using an RRG there to write coverage just in that state.

LECG’s Mr. McRoberts noted, however, that proper governance and leadership are essential for an RRG. “One of the things that I think is important in forming a risk retention group...is to have the right people on board, the right kind of governance,” he said.

For smaller groups, that might mean looking to outsource some services at times, he said. “You want processes to be as good as they can be, but whether you can do it yourself is another issue,” Mr. McRoberts said.

U.S. health care reform might drive additional use of RRGs and captives as health care facilities, looking to benefit from new outcome-based reimbursement policies, bring previously independent physicians on board as employees and increase their liability exposures in the process, said Michael Maglaras, president of consultant Michael Maglaras & Co. in Stamford, Conn.

“What my clients are busy doing is taking a second look at their captives—and/or forming new ones—because they’re about ready, we think, in the next two or three years to acquire those (independent physicians) as employed physicians,” Mr. Maglaras said. “If they do, their liability accrual on their balance sheet or their captives will increase greatly.”

“So we’re going to see a strong uptick in captive formations and in the amplification of existing captives because of these alignment strategies that are going to add a significant amount of risks to hospital balance sheets,” Mr. Maglaras said. “I’m seeing a big push. We’re not just talking RRGs here; we’re talking single-parent captives in Bermuda, Cayman and Vermont, and we expect a strong push in domestic domiciles because of this issue.”

In some cases, new RRGs might be driven by efforts to achieve lower pricing by buying coverage as a group, Mr. Maglaras said.

“I think you may find hospitals joint venturing to form risk retention groups because of economies of scale,” he said. “You can buy reinsurance together. You can get one audit instead of (multiple) audits and all the economies of scale that come with an RRG. I expect that and I expect new single-parent captives to form, and I expect an increase in size of existing captives.”

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