PSP PLASTIC SURGERY PRACTICE

Issue Stories

Own Your Own Insurance Company

by Philip GD Bruno

Physicians can control costs and increase profit potential via alternative risk management strategies

As the Patient Protection and Affordable Care Act and the upward spiral of overhead costs continue to loom large on the horizon, physicians face a growing threat to the profitability of their medical practices.

One countermeasure on the radar screen of many physicians is the cost control and profit potential available through alternative risk management strategies—a strategy already used by many large health care providers.

For many years, one of the favored risk planning strategies of hospitals and large clinics has been the formation of "captive" insurance companies. Owners of middle market medical practices are attracted to the cost savings, risk management, and profit potential provided by owning their own insurance company.

Stewart A. Feldman is CEO of Capstone Associated Services Ltd, a Houston-based firm specializing in alternative risk planning for physician-owned professional practices and related businesses, and a veteran tax attorney. He is a foremost expert on captive insurance companies in the United States, with an academic background that includes graduate and undergraduate business degrees from Wharton.

According to Feldman, many physicians needlessly "self-insure" a wide range of risks, including change in insurance reimbursement rates, the costs of CMS and insurance company audits, the risk of delisting, malpractice deductibles, changes in government regulation, professional liability, employment practices, accounts receivables, administrative actions (such as HIPAA), disability, loss of professional license, and business interruption, among others. By self-insure, he means pay directly out-of-pocket as losses are incurred.

As an alternative to being self-insured, a physician can choose to form his or her own small insurance company (called a captive insurer). A captive allows the physician to convert certain inappropriately self-insured risks (such as business-interruption coverage) into P&C premiums. These premiums are tax-deductible to the business and tax-exempt to the insurance company.

Operating businesses are allowed only to deduct losses as they occur. In contrast, insurance companies are unique in that they are able to currently deduct future, unspecified losses. With a captive insurance arrangement, those reserves are available to fund future losses; or in the event that the loss does not occur, the profits can be distributed to the captive's owners. Meanwhile, the captive has a wide range of investment opportunities.

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What is the best course of action for a physician to put in place a more comprehensive risk management program? It should be one that protects against a wider range of risks than currently seen covered by conventional policies in the typical medical practice.

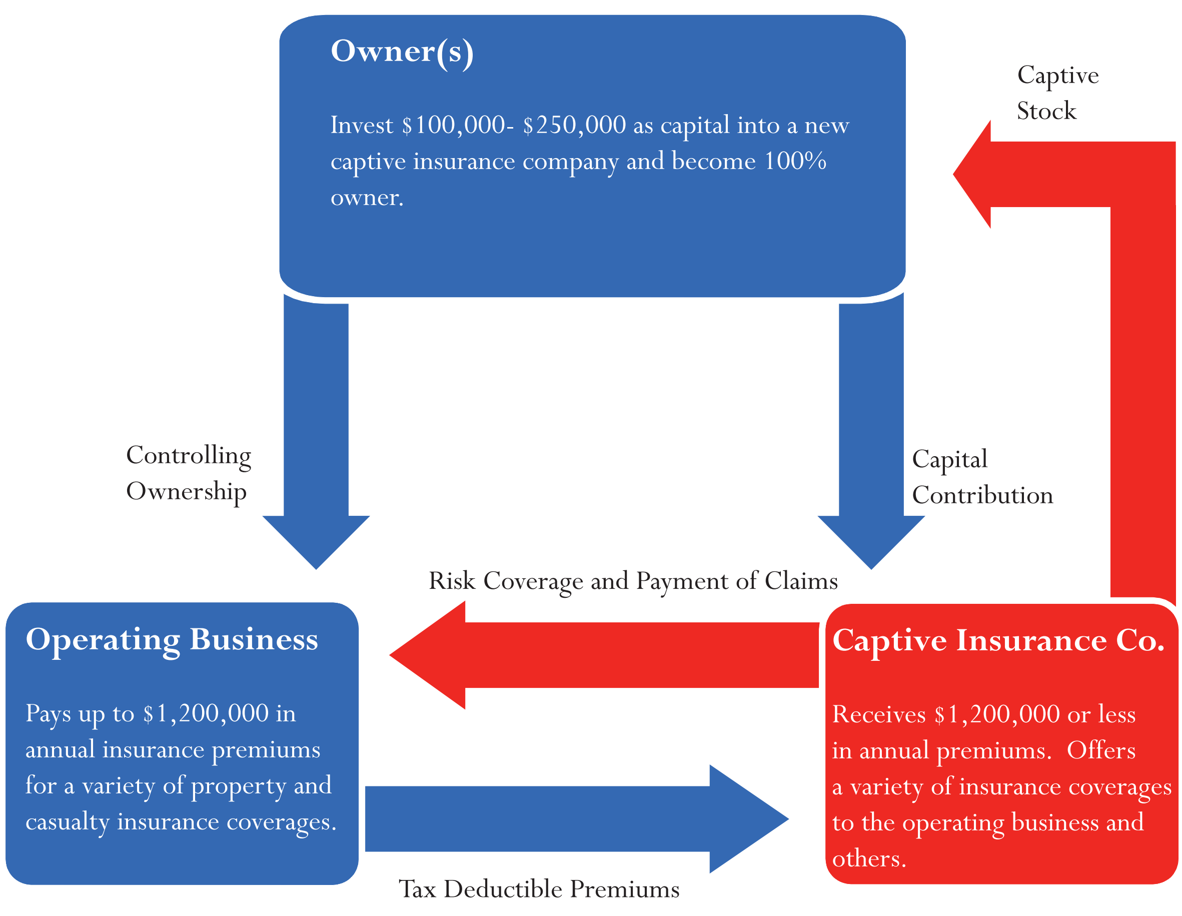
PSP: How can a doctor better insure their practice against risks?

Stewart A. Feldman: Rather than recoiling from insurance, many physicians are embracing insurance as a means of retaining their profits and protecting their future. A growing number of high-income physicians—such as surgeons, cardiologists, pain specialists, and electrophysiologists—are finding that owning their own insurance company can be an effective and profitable component of their overall business and financial strategy.

PSP: What is a captive?

Feldman: A captive is generally thought of as a privately held insurance company that principally insures related businesses owned by a doctor or a group of doctors. Today over 90% of Fortune 1000 companies, and many other successful small to midsize companies throughout the US, have captives. Forming a captive may be one of the best risk management and financial planning tools available for physicians.

SIMPLIFIED OWNERSHIP STRUCTURE
FOR A CAPTIVE INSURANCE COMPANY



PSP: How does a captive work?

Feldman: A captive allows its owners to use specifically tailored and customized policies that are often too expensive or unavailable through the conventional insurance markets. A captive provides a platinum level of coverage to a medical practice, imaging center, and ambulatory surgery center or specialty hospital, while allowing the physician owners to benefit from the profits of the insurance company in a tax-efficient manner.

PSP: What size practice would be ideal before a captive makes sense?

Feldman: Generally, a doctor or group of doctors would form a captive once they are established, say with pretax profits (before partners' salary, bonus, and other forms of compensation) of $1 million or more, and they have already expanded beyond a small practice into a larger medical venture, group practice, surgery center, imaging center, or any other medical-related operation. The more they grow, the greater the risk. Therefore, the need for a captive becomes more obvious.

PSP: What are the benefits to the physician?

Feldman: The captive insurance company's potential risk management and asset protection benefits—combined with the federal tax incentives—often combine to make it a very attractive option for successful doctors. Bottom line, a captive gives owners ultimate control over their insurance needs, and in the event that premium revenue exceeds claims, physician owners benefit from the profits of their own insurance company.

PSP: How does having a captive affect taxes?

Feldman: Captives are usually tax advantaged, for-profit insurance companies. While a captive may be a great financing tool, it will not work for every business. Provisions in the Internal Revenue Code have been in place prior to 1920 providing tax-exempt treatment for small insurance companies. Similar provisions now apply to insurers with annual premiums under $1.2 million.

PSP: Would a doctor form a captive rather than using a traditional insurance company?

Feldman: Captives typically provide supplemental coverage to existing conventional policies, which upon examination are often found to be inadequate. A captive is the skydiver's second parachute. Physicians find that owning their own insurance company helps control the rising cost of risk and provides broader insurance protection by filling in the holes and exclusions of conventional policies.

PSP: Is it necessary for the physician to be the sole owner of a captive?

Feldman: Ownership of the captive often mirrors the ownership of the practice. However, the ownership of a captive might also include key employees, children, grandchildren, family partnerships, limited liability companies, or trusts.

PSP: How would a physician protect their assets?

Feldman: Captives are one of the better asset-protection tools available. Designed correctly, assets in a captive are very difficult for creditors to reach. The captive's assets are only available to pay valid claims—those approved by the claims department of the captive insurer that the physician or group has formed and approved.

PSP: Is a captive easy for a doctor to establish and manage?

Feldman: Captives must be operated according to two separate sets of regulatory provisions: the Internal Revenue Code and the domicile where the insurance company has been established.

The formation and ongoing management of a captive must be overseen by experienced professionals that understand the insurance, tax, and legal aspects of the captive. Because it is a regulated insurance company, our clients often prefer to have a third party administer the captive on a turnkey basis. Most regulators demand ongoing professional management.

PSP: Can a physician choose what to insure against?

Feldman: Absolutely. [He] can choose to insure his practice against events where his current conventional polices fall short. One of [my] Houston-area clients, for instance, lost 3 full weeks of practice and surgery time due to hurricane-related power outage at its ambulatory surgical center.

While the physician's conventional property and casualty insurance covered the cost of the physical damage (there was no physical damage to the center), significant lost income came from the loss of electricity at the surgery center for almost 3 weeks, which forced doctors to schedule surgeries elsewhere. Losses not related to physical damage were not covered by conventional business interruption insurance. They were, however, covered by the captive.

PSP: Are captives commonplace in the business world?

Feldman: Yes. Already thousands of businesses—representing industries ranging from manufacturing to fabrication to distribution, finance, and construction—now participate in some type of alternative risk planning program to better insure risks of its parent company. Even Google and the United States government operate their own captives.

PSP: Are captives new to health care?

Feldman: Not at all. And captives are becoming increasingly more prevalent due to changes in health care reform and reimbursements. For years, hospitals and large medical practices have realized the benefits of alternative risk financing/ captive planning.

Principal among the reasons is the ability to customize coverage to the insured's needs rather than simply relying on "standard," conventional policies riddled with restrictive exclusions.

Additionally, traditional carriers pay out only a portion of premiums received for actual losses, with marketing costs, regulatory expenses, executive compensation, commissions, investment losses, and litigation with insureds absorbing a disproportionately high amount of the actual premium dollars.

A well-designed and implemented captive arrangement can recoup these dollars for the physician.

PSP: How are premiums paid to the captive?

Feldman: A captive is a regulated insurance company that must first be licensed by an insurance commissioner in a US state or foreign jurisdiction. Once established, premiums are paid to the captive like any other conventional policy premiums—except instead of being paid to an outside organization, monies are paid into the physician-owned captive insurance company.

PSP: How would a physician set up a captive?

Feldman: A captive insurance company must always be established with a bona fide insurance purpose—that is, as a facility for transferring risk and protecting assets. The transaction must make economic sense.

Beyond this general rule, there is a great deal of flexibility in how the captive insurance company can benefit a client.
