

Date: May 15, 2012

To:

From: John Mitchell, President, ARM, Ltd.

Re: Responses to Request for Information Regarding Stop Loss Insurance

1. Question: How common is the use of stop loss insurance in connection with self-insured arrangements? Does the usage vary (and, if so, how) based on the size of the underlying arrangement or based on other factors?

Response: Stop Loss is very commonly used in connection with self-insured arrangements. ERISA imposes strict requirements upon the exercise of good judgment by plan fiduciaries and good judgment for most employer / fiduciaries normally indicates that the employer purchase stop loss coverage. Just as it is good judgment to insure other risks that are faced by the firm that would create unacceptable risk.

Generally speaking, there is an inverse relationship between stop loss prevalence and group size. This is so because the predictability of the risk is directly related to group size. But this is just a generality. The financial resources of the company also have a bearing upon the amount of risk the employer chooses to retain.

Historically, another factor in determining the use of stop loss was the total amount of risk that a plan assumed by providing benefits. Prior to PPACA, many plans limited this risk by imposing calendar year maximum benefits provided by the plan. With the elimination of these limits, more plans were motivated to purchase stop loss coverage.

Question: How many individuals, if known, are covered under stop loss insurance (either nationally or on a state-specific basis)? What are the trends? Are past trends expected to be predictive of future trends? Is the Affordable Care Act expected to affect these trends (and, if so, how)?

Response: We do not know how many individuals are covered by stop loss insurance, but there has been an increasing tendency of companies to sponsor self-insured health plans, so we suspect that more people will be covered by stop loss. PPACA causes an increase in demand for stop loss coverage with the elimination of calendar year benefit maximums. It may also increase the demand for stop loss as more small groups may be motivated to self-insure rather than participate in exchanges, which many experts predict will dramatically increase the cost of health insurance and health care.

2. Question: What are common attachment points for stop loss insurance policies, and what factors are used to determine these attachment points? What are common attachment points by employer size (e.g., for plans with fewer than 50, between 50 and 100, or between 100 and 250 employees, and how do these compare to attachment points used by larger plans)? What are the lowest attachment points that are available? What are the trends?

Response: Aggregate attachment points have historically and generally been set at 125% of expected claims for all group sizes. Some stop loss insurers will offer aggregate attachment points set below this level at an increased premium, but they are fairly uncommon. Specific attachments vary directly with group size and are generally from 5% to 10% of the aggregate attachment point. But again, these are generalities and guidelines, not rules. Each employer is different in their approach to risk management based upon many factors other than group size. Financial stability, budget constraints and historical claims costs, to mention just a few of these factors.

3. Question: Are employee-level (“specific”) attachment points more common, or are group-level (“aggregate”) attachment points more common? What are the trends? What are the common attachment points for employee-level and group-level policies?

Response: Specific attachment points are slightly more common than aggregate attachment points. It is common for self-funded employers to purchase “specific only” coverage, and very uncommon for employers to purchase “aggregate only” coverage. This is partially so because underwriting aggregate only coverage is difficult without the pooling provided by specific stop loss. We say “the specific protects the aggregate”. Self-funded plan costs are normally most closely tied to the claim cost associated with a small number of individuals.

4. Question: How do insurers work with small employers to integrate stop loss insurance protection with self-insured group health plans? What kinds of options are generally made available? Are policies customized to meet the needs of different employers? How are the attachment points for a stop loss policy determined for an employer? Do self-insured group health plans purchase stop loss insurance anticipating that they will purchase it every year?

Response: Insurers do not normally work directly with small employers in the determination of protection levels or the integration of coverage with the plan. This is normally effectuated by the joint efforts of the employer, the employer’s consultant and third party administrator (TPA).

Options on stop loss coverage are fairly narrow and well defined. Stop loss policies generally offer the following options:

Type of claims included (medical, dental, Rx, vision, etc.)

Claim incurred date range

- Claim paid date range
- Specific deductible
- Aggregate corridor, although almost always 25% for pure stop loss carriers
- Monthly rolling aggregate deductible
- Terminal liability protection
- Guaranteed renewability

Most employers that purchase stop loss coverage anticipate that they will purchase it every year, just as they would anticipate purchasing coverage for their vehicles, buildings and other liability risks.

5. **Question:** For a given attachment point, what percentage of total medical costs incurred by the employees is typically paid for by the employer and what percentage is typically paid for by the stop loss insurance policy? How much do the relative percentages vary for different attachment points? What are the loss ratios associated with stop loss insurance policies?

Response: It may be necessary to clarify the relationship between a stop loss carrier and an employer in the provision of benefits. Under a self-funded plan, even one offered by an employer that purchases stop loss coverage, 100% of eligible claims are the employer's responsibility. The stop loss carrier, except in the rarest of circumstances, protects the employer, not the plan or its covered employees.

Given this, we will not restate the question in an accurate way, but will try to get at the intent of the question, which seems to focus on the net funding requirements imposed upon the employer.

Under a typical aggregate stop loss policy with an attachment point set at 125% of expected claims, we would expect about 2% of employers to have claims against this coverage. You can generally look at 125% aggregate attachment point being set at two standard deviations from the mean, so it is fairly uncommon to have a claim. As the percentage margin is decreased, to say 20%, aggregate stop loss claims become more likely and the carrier will reimburse a higher percentage of claims at equilibrium.

Under specific stop loss, we expect that at equilibrium the carrier will pay out about 75% of the premium they collect. Due to the unpredictable nature of medical claims costs, however, this claim level varies wildly from year to year and from employer to employer. Stop loss coverage is purchased to cover a very volatile risk.

One's general view should be that an employer purchases stop loss coverage with attachments set at appropriate levels on both the specific and the aggregate. Further understanding that this coverage is purchased with all hope that claims will not exceed the specific deductible and, normally, a genuine confidence that claims will not exceed the aggregate attachment point.

6. **Question:** What are the administrative costs to employers related to stop loss insurance purchased for the employers' self-insured group health plans? How do these costs compare to the administrative costs related to purchasing a health insurance policy from an issuer?

Response: Administrative costs are generally lower for employers that self-fund their benefit plan than for those that purchase an insured plan. Administrative expenses for typical self-funded employers are less than 5% of plan cost. There is generally no separate administrative cost associated with the purchase of stop loss coverage.

Stop loss carriers generally require a slightly higher expense load than do traditional insurance companies, but this load is applied to considerably less premium than for a traditional fully insured policy. This is of course understandable as stop loss carriers normally only see large claims that tend to be much more complex to evaluate.

It is not surprising that self-funded plans and their sponsoring employers incur lower overhead for their efforts. Self-funded health plans are required to be efficient, and of course not-for-profit, under ERISA.

7. **Question:** Is stop loss insurance more prevalent in certain industries or sectors? Are there any minimum employee participation requirements for a small employer to be offered stop loss insurance?

Response: Stop loss insurance does not appear to be more prevalent in certain industries or sectors. The Kaiser Family Foundation studies, upon which most of us rely, make this fairly clear.

Participation requirements are similar to those imposed by fully insured carriers, but not nearly so diligently enforced. We need to get back to the basics to understand why this is so. Stop loss coverage has been historically experience rated. When there is consistency during the experience period, and rates are based upon that experience, there is a good argument that participation levels do not matter. But when stop loss coverage is underwritten based upon "manual rates", participation levels appear to be more important. The fact is, however, that manually rated stop loss products are a very uncommon.

This is actually a bridge to an issue that has been bantered about for many years. Why don't insurance companies release claims experience for the groups they cover? The reason is that it cannot help them. The fact is that certain employers have an environment that consistently produces underwriting results that run one way or another. If the group has good underwriting results over an "experience period", then

the rates charged by the insurance company will appear to be too high, and self-funding gets an opportunity. If, on the other hand, claims are high during the experience period, the insurance carrier will be “stuck” with the account.

The fact is, we have learned that information is valuable. It doesn’t matter what the industry or endeavor. Self-funded small employers have the information, while insured small employers do not. Making decisions based upon either poor or limited information is a problem.

So, no. Participation levels don’t matter in the traditional self-funded world, while they may matter in the very marginal world of manually underwritten small group stop loss.

8. Question: What types of entities issue stop loss insurance? How many small entities issue stop loss insurance policies?

Response: Stop loss coverage is issued by a broad range of entities. Essentially all carriers that issue fully insured policies also issue stop loss insurance. Additionally, there are many smaller entities that issue only stop loss coverage. The stop loss industry, although it has seen its own share of consolidation, is a much more vibrant and competitive market than is the market for fully insured insurance policies. In our market there are but a handful of insurance companies issuing fully insured policies, while we could likely find five handfuls of stop loss carriers.

This question is the one that gives me the best opportunity to adequately describe the “market” for employer sponsored health coverage. The problem that PPACA attempted to address is really about this market, but the participants appear to have been either poorly informed or blinded by the power of the group health insurance carriers that do business within our United States. Someone got confused in the differentiation between “healthcare” and “insurance”.

Health Insurance companies are really not insurers at all. They are Managed Care Companies. They do not compete based upon any value other than their managed care networks, which derive their value based upon “discounts” from the billed charges of providers. But these billed charges are a fallacy. Essentially no one pays the amount indicated in the “charge master” for a typical hospital. So we are left with a market that competes on a basis other than its perceived and widely understood central value proposition: the spreading of risk. That is a problem.

The problem is that the business of the Managed Care Network has high barriers to entry. Small companies cannot compete in this space as they have no power with the providers to extract significant “discounts”. These discounts, it may be noted, are really a sham. In our market, about five managed care companies split up most of the market. There is little or no “steerage” to particular providers, and A simpler way to regulate the outcomes of the health “insurance” industry would be to impose a system like the one

successfully implemented in Maryland, “any payor pricing”. This very simple concept simply states that everyone gets the same price. This would cause competition in coverage fundamentals to drive outcomes, rather than legacy agreements that cause the market to be dysfunctional. Unfortunately for lawmakers, it would greatly upset Blue Cross and Blue Shield, who have had a government sponsored monopoly in healthcare for many years. These are tough decisions for elected officials, but any thinking person with knowledge of this market would realize that “The Blues” are the source of the problems we face and that to continue with the Managed Care Network environment is misguided.

9. Question: Do stop loss issuers increase fees for groups below a certain size or exclude those groups? If so, how?

Response: Stop loss expense loads are inversely related to premium, as is true for most products. Underwriting stop loss coverage is historically quite different than underwriting fully insured coverage. Vary rarely is stop loss coverage written at a “manual rate”, it is based up claims experience. Although it is becoming more common to see carriers underwriting without claims experience for groups of any size, it is still not broadly practiced in a competitive way. Stop loss coverage is historically an experience rated product, offered primarily by companies that understand only this way of underwriting. A fairly small number of stop loss carriers will consider using individual underwriting questionnaires in lieu of experience reports, but they really are not efficient as they are not set up for this kind of process. So, in the end, most groups with poor experience are rated high, but rarely declined or excluded. Those groups that submit underwriting questionnaires need very few unknown claims situations to show up on these questionnaires to be declined by the underwriter.

10. Question: How do stop loss insurers evaluate the plans seeking coverage and how is this evaluation reflected in the coverage or premiums offered? Does the profile of the plan have an effect on the attachment points available?

Response: Remember that it is generally not plans that seek coverage, it is the employer. The employer is the plan sponsor and is the primary insurer; stop loss coverage provides reinsurance to this employer, not the plan.

Every element of the claims experience and plan design is relevant to the underwriting process. Attachment points, both specific and aggregate, are affected by this information, as are rates.

11. Question: How do States regulate stop loss insurance? In States that are regulating this insurance, what are the licensing processes and standards? Have States proposed laws, regulations, or best practices with regard to stop loss insurance? Do such proposals focus on attachment points, size of the group, percent of total claims paid by

the stop loss insurer, or other criteria? What are the issues States face in regulating stop loss insurance?

Response: Some states regulate stop loss insurance and some do not. In our experience, it is regulated to the extent that an individual must have a state producer's license to place it. The few other regulations of which we are aware primarily focus on minimum specific deductibles and on minimum aggregate margins. Some states further impose minimum group size requirements.

The main issue the States face in regulating stop loss coverage is that they really seek to regulate self-funded plans, which is prohibited under ERISA. Regulating stop loss coverage gives States an indirect power over ERISA plans as these regulations can impact the functional availability of self-funding as an option for employers. Whenever people use their power to affect something that is not within their jurisdiction, it is always going to be a challenge.

12. Question: What effect does the availability of stop loss insurance with various attachment points and other particular provisions have on small employers' decisions to offer insurance to employees?

Response: We need to clarify language on this. The coverage that employees receive is not insurance. A self-funded plan is a Welfare Plan, it is not insurance. A person covered by an insured health plan is an Insured. A person covered under an Employee Welfare Plan is a Plan Participant. The primary "insurer" of a Welfare Plan is the employer, who also is normally the Plan Sponsor. The person that is in charge of the operation of the plan is called a fiduciary, because he or she has a duty to plan participants. A person that is in charge of an insurance policy has no such relationship.

A small employer relies on a vibrant market for stop loss coverage because health plans create too much risk for a small employer to retain. Because of this, availability of stop loss coverage with various options and provisions has a large impact on an employers' decision to provide a plan for employees.

13. Question: What impact does the use of stop loss insurance by self-insured small employers have on the small group fully insured market?

Response: At this juncture, the use of stop loss by small employers has very little impact on the small group market. Self-funding is not right for all small employers as is evidenced by the fairly limited number of small employers that are self-funded with stop loss coverage.

This could change under PPACA. If the cost to purchase health insurance in the exchanges gets as high as many predict it will, employers will have additional motivation to self-fund their employee benefit plans.