June 29, 2012

Office of Health Plan Standards and Compliance Assistance
Employee Benefits Security Administration, Room N-5653
U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

Re: Request for Information Regarding Stop Loss Insurance

To Whom It May Concern:

On behalf of the American Academy of Actuaries Stop-Loss Work Group,[1] I am submitting comments on the request for information (RFI) on how small employers' use of stop-loss insurance or insurance for self-insured health plans affects the market for fully insured small health coverage under the Affordable Care Act (ACA). The following are responses to the questions posed in the RFI.

1) *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? 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)?*

   a) How Common is Self-Funding? What are trends before passage of the Affordable Care Act?

   The use of stop loss is common with self-funding. Exhibit 10.1 from the Kaiser Family Foundation/Health Research and Educational Trust (KFF/HRET) 2011 survey available at http://ehbs.kff.org/?page=charts&id=2&sn=25&ch=2186 and reproduced below shows

[1] The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

that in 2011 60 percent of covered workers are enrolled in plans that either are completely or partially self-funded.[2]

Exhibit 10.1: KFF/HRET 2011 Survey

Percentage of Covered Workers in Partially or Completely Self-Funded Plans, by Firm Size, 1999-2011

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
3-199 Workers	13%	15%	17%	13%	10%	10%	13%	13%	12%	12%	15%	16%	13%
200-999 Workers	51	53	52	48	50	50	53	53	53	47	48	58*	50
1,000-4,999 Workers	62	69	66	67	71	78	78	77	76	76	80	80	79
5,000 or More Workers	62	72	70	72	79	80	82	89	86	89	88	93	96
ALL FIRMS	**44%**	**49%**	**49%**	**49%**	**52%**	**54%**	**54%**	**55%**	**55%**	**55%**	**57%**	**59%**	**60%**

* Estimate is statistically different from estimate for the previous year shown (p<.05).

Note: Due to a change in the survey questionnaire, funding status was not asked of firms with conventional plans in 2006. Therefore, conventional plan funding status is not included in the averages in this exhibit for 2006. For definitions of Self-Funded and Fully Insured plans, see the introduction to Section 10.

Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999-2011.

Exhibit 10.1 also illustrates that self-funding increased from 2004 to 2010 among firms of more than 1,000 workers but remained relatively unchanged for smaller firms. The use of stop loss and self-funding gradually increased prior to passage of the ACA as employers and other plan sponsors sought ways to control the costs of providing health coverage. This growth is likely to continue, especially with larger employers as employers and plan sponsors seek ways to control costs.

b) How does self-funding usage vary?

Self-funding typically varies with the risk tolerance of the plan sponsor/employer. Because larger groups are more likely to be able to fund variations associated with greater financial risk, plan size may have an impact on the purchase of stop-loss coverage. The use of stop-loss coverage also is influenced by the attachment points that stop-loss insurers offer to employers based on size and risk characteristics.

Exhibit 10.10 from the KFF/HRET 2011 Survey, available at http://ehbs.kff.org/?page=charts&id=2&sn=25&ch=2195 and reproduced below, shows that usage varies by firm size— of the firm as measured by number of employees—and by region.

[2] The KFF/HRET survey does not clearly define the term "partially self-funded." It may refer to self-funded plans that purchase stop-loss insurance or it may refer to firms that offer multiple options to their employees, some of which are self-funded and others of which are fully insured.

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Exhibit 10.10: KFF/HRET 2011 Survey

Prevalence and Average Retention of Stoploss Insurance, by Firm Size and Region, 2011

	Percentage of Covered Workers in Partially or Completely Self-Funded Plans	Percentage of Covered Workers Enrolled in a Self-Funded Plan that Purchased Stoploss Insurance	Percentage of Covered Workers Enrolled in a Self-Funded Plan that Purchases Stoploss Insurance which Includes a Limit on Per Employee Spending‡	Average Per Employee Claims Cost at which Stoploss Insurance Pays Benefit‡
FIRM SIZE				
50-199 Workers	23%*	85%*	89%	$73,824*
200-999 Workers	50*	90*	75	136,719*
1,000-4,999 Workers	79*	88*	84	205,210*
5,000 or More Workers	96*	40*	80	301,815*
All Large Firms (200 or More Workers)	**82%**	**57%**	**80%**	**$208,280**
REGION				
Northeast	61%	51%	84%	$204,066
Midwest	65	62	85	184,860
South	64	54	81	218,586*
West	47*	66	75	183,554*
ALL FIRMS	**60%**	**58%**	**81%**	**$199,605**

* Estimate is statistically different from estimate for all other firms not in the indicated size or region category (p<.05).

‡Totals includes stoploss insurance plans that limit a firm's per employee spending as well as plans that limit a firm's overall spending.

Note: For definitions of Self-Funded and Fully Insured plans, see the introduction to Section 10. Retention refers to the amount at which the stoploss insurance begins to pay benefits.

Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 2011.

As noted, 60 percent of covered employees work for firms that either partially or completely self-fund their health benefits. In the 60 percent of firms that either partially or completely self-fund, 58 percent of covered individuals (35 percent overall) work for firms that purchase some form of stop loss. Smaller firms are more likely to purchase stop loss than larger firms. Smaller firms tend to purchase both individual (i.e., attachment point per individual) and aggregate (i.e., attachment point for the entire group) stop loss. Larger firms buy individual stop loss that attaches at larger attachment points than smaller firms. The average individual attachment point of firms with 50 to 199 workers is more than $70,000, and the average individual attachment point of firms with 5,000 or more workers is more than $300,000. Larger firms are less likely to purchase aggregate stop loss.

Self-funding is less common in the west than in other regions.

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Exhibit 10.4 from the KFF/HRET Survey available at http://ehbs.kff.org/?page=charts&id=2&sn=25&ch=2189 and reproduced below shows that HMO and especially point-of-service (POS) plans are less likely to be self-funded than other types of plans.

Exhibit 10.4: KFF/HRET 2011 Survey

Percentage of Covered Workers in Partially or Completely Self-Funded Plans, by Plan Type and Firm Size, 2011

	Conventional	HMO	PPO	POS	HDHP/SO
3-199 Workers	NSD	5%*	19%*	6*	11*
200-999 Workers	NSD	16*	65	39	45
1,000-4,999 Workers	NSD	54	84*	40	89*
5,000 or More Workers	NSD	67*	98*	NSD	98*
ALL FIRMS	**53%**	**41%**	**70%**	**26%**	**54%**

* Estimate is statistically different from estimate for all other firms not in the indicated size category within plan type (p<.05).

Note: For definitions of Self-Funded and Fully Insured plans, see the introduction to Section 10.

NSD: Not Sufficient Data.

Source: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 2011.

c) How is the Affordable care Act expected to affect self-funding?

The increase in self-funding is likely to continue. The ACA may accelerate this trend due to the following:

i) Self-funding is not subject to the medical loss ratio (MLR) requirements; some insurers therefore may encourage their clients to self-fund to decrease the amount of their business subject to the MLR requirements.

ii) The MLR requirements may cause insurers to reduce or not pay commissions on fully insured premiums. Brokers who prefer to be paid on a commission basis (as opposed to a consulting basis) may encourage their clients to self-fund.

iii) The ACA 3:1 age-rate-limit requirement will make self-funding relatively more attractive to younger and predominantly male groups. This attraction may be partially

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offset by the ACA MLR requirement (80 percent to 85 percent) that, at times, may be higher than self-funding expected loss ratios.[3]

iv) The elimination of many rating characteristics currently allowed in a number of states, including average group morbidity, industry, group size (and experience for groups in the 51 to 100 employee group sphere) in addition to the 3:1 age limit will result in material premium increases for groups that, as a result, have enjoyed significantly lower-than-average rates.

2) *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?*

a) What are common attachment points for stop-loss insurance policies, and what factors are used to determine these attachment points?

Attachment points for individual stop loss (ISL) vary by size of employer and stop-loss insurer and increase as the number of covered lives increases. State regulations may limit allowable ISL levels in some states.

b) 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)?

Common attachment points in the smaller plans noted above are generally in the $50,000 to $100,000 range. Attachment points for larger plans generally will run into multiples of $100,000, with a typical attachment point for jumbo cases often reaching $500,000 or more. Besides the size of group, the employer's ability to take risk and the financial strength of the firm also are important factors.

c) What are the lowest attachment points that are available?

The lowest ISL attachment point that may be available for smaller groups (less than 50 employees) is generally $20,000. Typical attachment points for aggregate stop loss (ASL) are set at 125 percent of a group's expected claims level, with some groups being written at lower levels—115 percent or even 110 percent. The 125 percent level is by far the

[3] Equivalent self-funding expected loss ratios are claims divided by the self-funded "premium equivalent." The self-funded premium equivalent is the sum of expected claims and non-claims costs, including the costs of administration and stop loss.

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most common. Smaller groups may only be offered attachment points of 130 percent or more.

d) What are the trends?

All things being equal, both the ISL and ASL attachment points tend to increase over time. Employers are encouraged to increase the ISL annually to partially offset the leveraged trend increases that are standard for specific stop loss. The ASL increases annually at rates approximately equal to first-dollar trend, although the ASL corridor (i.e., the difference between the ASL attachment point and expected claims) typically remains stable as a percentage of the group's expected claims.

3) *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?*

a) Are employee-level ("specific") attachment points more common, or are group-level ("aggregate") attachment points more common?

Small employers will purchase both specific and aggregate stop loss if self-funded, since both are important to the mitigation of risk. Large groups may purchase both, though they are more likely to purchase specific rather than aggregate.

Large groups may purchase both and are requesting more quotes than in the past, but they still tend to purchase specific stop-loss coverage.

Stand-alone aggregate stop loss is generally uncommon, and is not offered by most stop-loss insurers.

There are a few aggregate-only stop-loss programs that are marketed as maximum premium plans. One company markets under the trade name "Spaggregate." This product competes with small group fully-insured products. The premise is that the employer pays the brokerage and/or consulting fees, administrative fees between these products and stop-loss premiums, and then funds its claims to the aggregate attachment point. The aggregate attachment points that are offered vary widely. If claims are lower than expected, then the employer may earn a refund. Only a handful of companies offer this product today. Those companies that do offer this product limit the business partners (i.e., brokers and third party administrators) through which they offer it. The business partners they use are knowledgeable about self funding. They also fully understand stop-loss products and, thus, can avoid the potential pitfalls associated with this business line. There are other companies exploring opportunities to offer this product today.

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b) What are the trends?

Two common trends seen in stop loss are 1) the greater use of aggregating specific attachment points and 2) changes due to the ACA.

- Aggregating specific coverage reimburses an employer only if the total of one or more individual claims over the specific stop-loss attachment point exceeds a specified level (the aggregating specific attachment point). For example, a group may be reimbursed when the total of individual claims over $150,000 (the ISL) exceeds $200,000 (the aggregating specific attachment point). This is a variant on traditional ISL. Aggregating specific attachment points are used to mitigate premium increases as an alternative to increasing the ISL attachment point.

- In response to the removal of lifetime maximums by the ACA, most stop-loss insurers increased the specific stop-loss maximum from lesser amounts, typically $1 million or $2 million lifetime maximums, to an unlimited lifetime maximum.

c) What are the common attachment points for employee-level and group-level policies?

The typical specific stop-loss attachment point coverage will be in the $25,000 to $250,000 range. Very small employers may purchase lower specific stop-loss attachment points, if available. Very large employers will purchase much higher levels. The larger the group, the more risk they can and will take. As a result, they tend to purchase higher attachment points. The minimum attachment point may be regulated in some states (Maine is one example), although there have been legal challenges to the extent that states can regulate self-funding arrangements.[4]

For aggregate stop-loss coverage, the typical attachment point is 125 percent of expected claim cost, although lower levels may be available to smaller employers.

[4] In 1995, Maryland passed regulations prohibiting employers from purchasing stop-loss insurance of less than $10,000 per employee. American Medical Security (AMS) sued. AMS won in the lower courts. On June 22, 1998, the U.S. Supreme Court rejected Maryland's case, refusing to hear the state's appeal. http://articles.baltimoresun.com/1999-07-22/business/9907220191_1_Stop Loss-insurance-and-benefits-insurance-claims

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4) *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?*

a) 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?

Carriers provide flexibility in coverage, although not all carriers will offer all options. Stop-loss carriers work with employers to present a selection of specific and aggregate stop-loss attachment points that meet employers' comfort levels with particular amounts of risk.

Specific stop-loss coverage serves to protect the employer's plan from less frequent—but catastrophic—member claims. ASL coverage typically is integrated with specific stop-loss coverage to protect the employer's plan from a greater frequency of overall member claims falling below the specific stop-loss attachment point.

Attachment points depend somewhat on an employer's size and other employer and plan characteristics, but there is some choice available to the employer.

In addition, stop-loss carriers also may offer various cost-containment programs to help employers' control costs, including:

i) Large claims management services, such as clinical case management, forensic claims audit, and subrogation services;

ii) Centers of excellence, contracting with medical institutions for high-cost procedures based on quality, expertise, and cost.

b) Are policies customized to meet the needs of different employers?

The purpose of stop loss is to protect an employer's cash flow. It does not focus on when a claim is incurred but rather on when it is paid. Customization of stop-loss insurance is dependent on the capabilities of the stop-loss carrier and the needs of the particular employer. Some available options or customizations are:

i) Run-in protection—stop-loss coverage of claims incurred prior to the stop-loss contract period;

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ii) Run-out protection—stop-loss protection for claims paid after the end of the contract period;

iii) Aggregation of specific attachment points—defined in 3) b) above;

iv) Monthly funding of aggregate stop loss—aggregate stop-loss claims are measured on an annual basis, but aggregate stop-loss claims may be funded monthly (on a proportional attachment-point basis) to better control the employer's cash flow;

v) Multiple-year-rate arrangements—although less frequent, these sometimes are offered to help control financial risk.

c) How are the attachment points for a stop-loss policy determined for an employer?

Individual attachment points generally are selected by employers based on their desire and need for protection and the cost of protection, within ranges made available by the insurer for their size. When stop-loss carriers expect existing ongoing large claims to continue for certain employees, the individual attachment point may be set at a higher amount for those employees. Aggregate attachment points are set as a percentage of expected claims, based on credible experience of the group, if available.

d) Do self-insured group health plans purchase stop loss insurance anticipating that they will purchase it every year?

Although we have seen no data on this, we believe that self-funded plans that purchase stop-loss insurance are likely to continue with stop-loss coverage as long as they remain self-funded.

5) *For a given attachment point, what percentage of total medical costs incurred by 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 relevant percentages vary for different attachment points? What are the loss ratios associated with stop loss insurance policies?*

a) For a given attachment point, what percentage of total medical costs incurred by 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 relevant percentages vary for different attachment points?

When a plan is either partially or completely self-funded, the employer pays 100 percent of its costs. When a claimant exceeds the individual attachment point of a stop-loss policy purchased by or for the benefit of the employee benefit plan, the stop-loss policy typically reimburses 100 percent of costs in excess of the individual attachment point. Costs in excess of a $50,000 individual attachment point are on average about 25 percent

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of total plan costs. Costs in excess of a $500,000 individual attachment point are on average about 1 percent of total plan costs. Few individuals incur costs in excess of these attachment points. But it is rare that these percentages are realized by any particular single employer's plan in any one plan year.

b) What are the loss ratios associated with stop loss insurance policies?

The loss ratio of any one stop-loss policy varies widely, from 0 percent (i.e., no claims) to more than 1,000 percent. It is common for stop-loss insurance companies to target loss ratios in the range of 65 percent– 75 percent. Lower target loss ratios are appropriate for stop loss because stop-loss premiums are low in comparison with total medical costs, stop-loss risks are much more volatile, and there is less premium over which to spread fixed costs.

6) *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?*

The questions as posed do not constitute a meaningful comparison. We believe a more appropriate comparison is to compare the administrative costs of a self-funded plan with stop loss versus a fully insured plan. We would further assume that the comparison is on identically sized employer groups with comparable health benefits being provided to the employees. This comparison would be of total expenses to the plan other than actual claim payments.

For a fully insured policy, premiums will include charges for administration of the plan (enrollment, plan documents, claim payments, cost-control programs, and various other services required to maintain the plan) as well as charges for premium tax, broker commissions, and risk/profit.

For a self-funded plan with stop loss, the same administrative services will be required with the exception of premium tax. The administrator may be an outside third-party administrator (TPA) or the same insurance company providing stop-loss insurance. There still will be profit charges built into the fees charged by the administrator of the plan, but no explicit charge for insurance risk. Any stop-loss coverage, however, will require premium tax and risk charge/profit on the stop-loss premium itself (which is generally a small percent of the total cost associated with a self-funded plan).

There is no one blanket statement that can be made about the relative total non-claim costs. It is very much a function of the specific TPAs and/or insurers involved as well as plan design and other services being provided. In general, costs are reasonably comparable,

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particularly the basic costs of administering benefits. Larger groups often elect to self-fund due to plan flexibility (e.g., they don't have to include state mandates), lower premium taxes on the self-funded portion, and possible cash-flow advantages. Purchasing a fully insured product transfers the total risk of adverse morbidity experience to an insurance company for a fairly modest risk charge that is regulated by MLR requirements.

Depending upon the employer group involved and the particulars of the benefit arrangements, there may be somewhat different administrative demands and costs to the employer, but we don't view this as the focus of the question.

7) *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?*

a) Is stop loss insurance more prevalent in certain industries or sectors?

Government entities and schools are less likely to use stop-loss insurance than other employers. For budget reasons, these entities often prefer guaranteed fixed cost (i.e., fully insured) medical coverage.

b) Are there any minimum employee participation requirements for a small employer to be offered stop loss insurance?

We have seen recommendations of 75 percent participation (of those employees not covered elsewhere). This generally is consistent with fully insured requirements.

8) *What types of entities issue stop loss insurance? How many small entities issue stop loss insurance policies?*

a) What types of entities issue stop loss insurance?

Stop-loss insurance typically is issued by health insurance carriers and/or property and casualty (P&C) insurance carriers. In general, the companies that offer stop-loss insurance are rated A- or better by A.M. Best & Co., so they tend to be larger insurance companies.

b) How many small entities issue stop loss insurance policies? (For this purpose, a small entity is defined as (1) a proprietary firm meeting the size standards of the Small Business Administration or (2) a nonprofit organization that is not dominant in its field.)

Data are not available.

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

It is not clear what is referred to as "fees" in the above, but we assume that it refers to stop loss premium rates given the context of this RFI. In general, stop-loss insurers will have underwriting guidelines on the size of groups under which they will not offer stop-loss coverage. Premium rates for stop loss vary due to a number of characteristics, but size of employer is not typically a significant determinant.

10) *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?*

a) For individual stop loss, carriers use both manual rating and experience rating to determine the coverage and premiums for a given employer. The manual rating assesses such factors as:

i) The age and gender composition of the group being insured;

ii) The nature of the claims-discount-reimbursement arrangements the plan has with providers as well as its cost-management programs;

iii) The geographic area(s) where the plan's participants are located;

iv) The attachment point and coverage limits of the stop-loss coverage;

v) The characteristics of the underlying plan. In general, attachment points selected by plan sponsors are high enough that any employee cost-sharing requirements have been satisfied before the stop-loss policy begins reimbursing an employer, so plan-design elements such as deductibles, coinsurance, and co-pays are less important in the evaluation of a specific stop-loss policy than with the cost of the employer's plan;

vi) Based on these characteristics, the manual rate for the group is determined. The manual rate then may be modified based on the actual experience of the group; and

vii) Few groups have sufficient experience to develop rates based solely on experience, so rates are set based on the manual rate along with any modifications to that rate or coverage indicated by experience. The carrier will request experience under the current stop-loss plan (if any), and any large-claim information over the past few years. The actual experience and types of claims will be examined to determine whether the manual premium should be modified, or if the group should not be offered coverage. In cases in which there are large claims or conditions in the experience that can be expected to produce further large claims during the coverage

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period, some carriers will exclude or limit coverage for certain individuals (known in the industry as lasering).

b) For aggregate stop-loss coverage, less emphasis is placed on the manual rate and more on the actual experience. Past experience for the group generally is used to develop the attachment point for coverage. The carrier also uses a rating manual to provide assumptions as to future trend rates, the cost impact of past or future changes in the plan characteristics, and premium rates for various attachment points.

11) 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?

a) How do States regulate stop-loss insurance?

State regulation of stop-loss insurance is accomplished by each state's insurance regulatory authority and the specific regulations vary by state. In general, states require stop-loss policies and require that the rates for those policies be filed as group accident and health insurance with the state regulatory body and be approved prior to initial use in the jurisdiction. Only about half of the states require filing of rates and rate-manual changes on an ongoing basis. States' advertising rules and fair trade practices for the business of insurance apply to stop-loss insurance. Stop-loss insurers are subject to state market-conduct activities including state-mandated reports and state examinations of insurers' stop-loss business practices.

States do not regulate self-funded employee welfare benefit plans governed by the Employee Retirement Income Security Act of 1974 (ERISA) because ERISA preempts state regulation in relation to these plans.

b) In States that are regulating this insurance, what are the licensing processes and standards?

In states that regulate stop-loss insurance, only insurers that are authorized (licensed) by the state insurance regulatory authority are permitted to market stop-loss insurance policies in the state. State requirements vary, but the same general licensing processes that are in place for health insurance are applied to stop-loss insurance.

c) Have States proposed laws, regulations, or best practices with regard to stop loss insurance?

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The Stop Loss Insurance Model Act, proposed for adoption by states by the National Association of Insurance Commissioners (NAIC) in 1995, would prohibit an insurer from issuing a stop-loss policy that has an annual specific attachment point lower than $20,000, or a comparably low aggregate attachment point for small groups. This requirement may represent a higher risk than a small employer may be able to budget for and sustain to purchase stop-loss coverage. These requirements limit or, in many cases eliminate the option for a small group to offer health care benefits to its employees under a self-insured arrangement. Very few states have adopted the model act as written, but approximately a third of the states have adopted similar laws and there appears to be renewed interest by the states as a result of the impact of the ACA, particularly on small groups. We understand that the NAIC is working on an updated Stop Loss Model Act.

d) Do such proposals focus on attachment points, size of the group, percent of total claims paid by the stop loss insurer, or other criteria?

Various states as well as the NAIC are looking at all of the above.

e) What are the issues States face in regulating stop loss insurance?

Although state regulation in relation to self-funded employee welfare benefit plans is preempted by ERISA, the states can and do regulate stop-loss insurance policies, rates, and stop-loss insurers' business practices. In general, states face the same regulatory issues regarding stop-loss insurance that they face regarding other regulated types of insurance.

12) 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?

Small employers that self-insure may have limited capital to withstand large fluctuations in claims, and the existence of stop loss-coverage that is flexible enough to be tailored to their capital levels and desire for claims stability is vital for the small employer that wants to self-insure.

The major issue for small employers is the overall cost of the plan. Over the long term, stop loss can save a modest amount of money for the small employer—although the price of this savings is reflected in less stability in annual costs.

For all groups, self-insurance can save an employer on average as little as a few percent for large employers and perhaps up to 5 percent or more for small employers. The actual savings depend on the level of state premium tax that is required for insured plans, the profit and

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expense charges of the insurer, and the level of rates negotiated with providers that the small employer can achieve.

For many small employers, the savings are not that large and often can be achieved simply by raising employee deductibles or other plan changes. Because of this, it seems unlikely that the existence of self-insurance and stop loss as an alternative to fully insured products would be a material factor in most small employers' decisions to provide coverage before the ACA.

For example, the Early Retirement Reinsurance Program (ERRP) program that the government offered to employers to encourage providing pre-65 retirement coverage (55-64) had a minimal effect on the number of employers offering coverage. This was because savings were not enough to attract new employers and, for the most part, employers that already provided coverage were the ones that took advantage of it. The modest savings from stop loss seems like it would have similar effects.

There are circumstances in which stop loss can be important to a small employer. If it is a group with better-than-average experience that has had fewer claims than other similar groups, the insurers' rate manual may not reflect this appropriately. For such an employer, the savings realized by self-funding may be significant. This will be aggravated in 2014 with the migration to modified community rating, elimination of gender, 3:1 age bands, etc., and again in 2016 when groups of 51–100 employees that currently are not subject to rating rules in the various states and that often have some portion of their rate based on their own experience will be required to migrate to modified community rating. There may be other reasons why insurers may not reflect the costs of the group appropriately, or provide the benefit flexibility that an employer desires. Stop loss also can offer a significant one-time reduction in cash expenses since, because of the processing lag, the claims are paid one or two months later than when they occur. This deferral does not affect ultimate costs, but it does offer a small cash flow advantage in the first year. And even small savings might be attractive to some employers despite the lack of stability in cost levels.

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

It is theorized that the following small employer groups currently are attracted to self-funding (especially in those states that already have community rating or modified community rating in place):

a) Younger groups, especially males;

b) Other groups with rating characteristics (area, industry, etc.) that are better than average;

c) Groups that believe they have better experience;

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d) Groups that like benefit flexibility (to allow uniformity of benefits for multistate employers).

Opinions vary on how the above would affect the small employer market. Some of these commonly held opinions are listed below.

To the extent that lower cost groups (when fully insured) believe they are charged more than expected due to rating/pricing restrictions, they will be attracted to self-funding. They will not be available to subsidize the higher cost groups that remain fully insured. The premium paid by the remaining fully insured small groups that no longer are subsidized therefore will need to be increased to reflect more closely their expected claims.

Small groups shop for medical insurance and want to pay the lowest possible cost for a set of benefits. If small employers believe that their experience is better than the fully insured commercial pool, then they may explore becoming self-funded. Some employers prefer to have a customized plan in which they can have something that is not "off the shelf" at an insurance company/HMO. There is a belief that going self-funded will mitigate risk charges that an insurance company charges (e.g., 2 percent–4 percent) plus reduce premium tax (e.g., 1 percent–2 percent). Note that there are still risk charges in stop loss and potentially premium tax so this impact is reduced. They are willing to take the trade off and assume more risk.

One school of thought is that the typical small group does not want to deal with cash flow management and volatility and would rather pay a fixed premium for insurance per month knowing that it can be budgeted for.

Health care reform and states having more transparency in commissions may result in further changes depending on how fully insured and self-funded health plans are marketed. Transparency and compression of administrative expense ratios (i.e., 100 percent–80 percent, or 85 percent MLR) may lower commissions, especially on a fully insured basis, and may result in more brokers being compensated through consulting services or other fees that are more clearly defined. It also may result in brokers considering more self-funding options for their clients, including smaller groups, as an alternative approach to preserve fee levels. They can negotiate consulting fees (fixed fees per head) rather than face lower commission levels on a fully insured basis.

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The work group welcomes the opportunity to speak with you about any of the items discussed in this letter. If you have any questions, contact Tim Mahony, the Academy's state health policy analyst (202-223-8196. Mahony@actuary.org).

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Sincerely,

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