Time to Take Another Look at Stop-Loss Insurance

For self-funded health plans, stop-loss insurance can spread the cost of very large claims out over several years. A plan sponsor can take steps to reduce the cost of stop-loss premiums.

by | Peter F. Kavanaugh, CEBS

Reproduced with permission from Benefits Magazine, Volume 49, No. 9, September 2012, pages 26-29; published by the International Foundation of Employee Benefit Plans (www.ifebp.org), Brookfield, Wis. All rights reserved. Statements or opinions expressed in this article are those of the author and do not necessarily represent the views or positions of the International Foundation, its officers, directors or staff. No further transmission or electronic distribution of this material is permitted. Subscriptions are available (www.ifebp.org/subscriptions).
Do self-insured group health plan sponsors need stop-loss insurance? Consider the following: A plan with 1,000 participants spends approximately $10 million on medical claims annually and experiences 8% annual medical trend. Typically, the plan sponsor would see its claim costs increase about $800,000 for the next year. But in 2011, the sponsor experienced three very large claims that totaled $1.5 million over the course of the year. Without stop-loss insurance, the group would not only bear the full cost of these claim events, but these claims would also lead to an annual increase in costs that would be well above annual trend (more than 20% over 2011 costs). However, a group that purchased a stop-loss policy would blunt the impact of the large claims spike by spreading that cost over a number of years through the payment of the relatively more predictable stop-loss premium.

This article will explain the benefits of stop-loss coverage and how it can help many sponsors control the risk they may face. It will also explore strategies for reducing the cost of coverage and review how the Patient Protection and Affordable Care Act (ACA) will affect stop-loss insurance (see the sidebar, “Health Care Reform and Stop-Loss Insurance”).

What Is Stop-Loss Insurance?

Stop-loss insurance is an insurance/financial vehicle that protects self-funded plans from insolvency due to extraordinary claim risk. There are typically two types of stop-loss insurance:

- **Specific (or individual) stop-loss insurance** provides protection against a catastrophic or large claim event. A plan sponsor would buy, for example, protection against individual claims that exceed a high dollar amount, such as $200,000 in a policy period. This is sometimes referred to as the “individual deductible.” The plan sponsor would be responsible for the claim dollars up to the $200,000 deductible. In this example, claim dollars that exceed $200,000 would be reimbursed by the stop-loss carrier.

- **Aggregate stop-loss insurance** provides protection in the event that a group’s total claim dollars far exceed its expected annual costs, which could be due to a risk event, such as a spike in utilization or an unforeseen economic or catastrophic event. Aggregate stop-loss insurance will establish an “attachment point,” which is a limit over expected claim projections. For example, a common attachment point is 125% of expected claims. If the total claim dollars exceed 125% of the expected claim levels, an aggregate stop-loss policy will reimburse the dollars in excess of that amount, although stop-loss insurance carriers often put a limit on their aggregate reimbursements.

Using Stop-Loss Insurance to Control Risk

To illustrate by elaborating on the example at the beginning of this article, in one year, the hypothetical 1,000-participant group experienced the following:

- Claimant A had renal failure and underwent kidney dialysis. The plan paid $500,000.
- Claimant B had a premature baby who spent several weeks in intensive care. The plan paid $600,000.
- Claimant C had cancer that required chemotherapy and surgery. The plan paid $400,000.

The table illustrates the increased risk this sponsor would assume with no stop-loss coverage compared with three different stop-loss policies with varied levels of specific deductibles.

Under the $200,000 and $300,000 stop-loss deductible scenarios, the sponsor paid stop-loss premiums that were less than the amounts reimbursed by the insurer. In years with little to no claim activity, the plan sponsor may pay more in premium than it receives in reimbursements, as the $500,000 stop-loss deductible scenario—in which the sponsor chooses to assume more risk in return for a lower premium—illustrates. This is the way stop-loss works: While the premium is predictable, claim events are expected to occur over time, but they are not expected to occur every year.

Although stop-loss insurance does not save the sponsor money every year or under every scenario, it does provide less volatility and a mechanism to fund catastrophic claims over time. Stop-loss insurance protects plans against the impact of shock claims in a compressed time period. Therefore, it gives the plan more time to either make needed changes to programs designed to manage large claim costs or to adjust contribution rates. Essentially, stop-loss insurance is a risk-management tool that provides a plan sponsor with a valuable asset: time.

How Can a Plan Sponsor Determine if Stop-Loss Insurance Is Appropriate?

The decision to purchase stop-loss insurance is contingent on many factors, including the adequacy of plan reserves, the
Stop-loss insurance

ability to meet cash-flow needs during highly volatile claim periods, and when plan sponsors take on added risk (e.g., from mandates that remove plan limits). Stop-loss insurance helps manage the impact of cost on the following factors:

- **Increasing frequency of high-dollar claims.** Even though extremely high-dollar claims ($500,000 or greater) are still relatively infrequent, they are increasing. One Segal client recently incurred two claim events that exceeded $1 million in annual paid claims.

- **The increasing morbidity and age of the population.** This, along with rising obesity, hypertension and diabetes rates, is increasing medical care utilization and costs for sponsors.

- **Nonnetwork providers.** Patients who obtain care outside the sponsor’s contracted network of preferred physicians and hospitals likely result in higher claim costs.

- **Changes to group-specific demographics.** An older group, or one with a significant family population, will pay more medical costs than a younger group, or one with few enrolled dependents.

### Health Care Reform and Stop-Loss Insurance

Under the Patient Protection and Affordable Care Act (ACA), plan sponsors will no longer be able to impose annual or lifetime dollar maximums on essential benefits beginning in 2014. Therefore, groups that self-insure their health care plans without stop-loss insurance may want to reconsider purchasing stop-loss protection because they will be exposed to unlimited claim amounts. Some fully insured plan sponsors may find that as a result of ACA, the additional expense of staying insured may support taking on more risk by moving to a self-insured arrangement.

Several ACA requirements are increasing risk for sponsors, including those with plans that have “grandfathered” status:

- **All group health plans are required to remove annual dollar maximums on essential benefits by 2014, which will leave them with unlimited exposure.** This is likely the greatest concern to self-funded sponsors. The Segal Company recently sampled a group of plan sponsors and found that two out of 12 had claimants with more than $1 million in annual claim expense. The risks are real as the cost of intensive care continues to rise.

- **Dependents up to the age of 26 may now enroll in their parents’ group health plan, regardless of student or marital status.** Although this is usually a low-cost group of people, those who choose to stay on the plan could potentially be those who need the insurance, creating a selection risk issue.

- **Plans must remove preexisting condition limitations on adults over the age of 19 by 2014.**

- **New insurance regulations can lead to unintended cost shifting to some fully insured groups.**

- **It is uncertain how the state health insurance exchanges, to go into effect in 2014, will affect future group premium rates.**

### Controlling the Costs of Stop-Loss Insurance

Once the decision has been made to purchase stop-loss insurance, health plan sponsors need to understand what affects the cost of the insurance and what they can do to control those costs. The following factors have an impact on the cost of stop-loss insurance:

- **Catastrophic risk volatility.** A sponsor may not have a large claim event for two years, and then have several in the third year. To combat this volatility, stop-loss insurers typically “pool” their entire book of business. If the pool warrants an increase, it will be passed along to all plan sponsors in the pool, regardless of the claims history of a particular plan sponsor.

### Table: Net Cost Comparison

<table>
<thead>
<tr>
<th></th>
<th>No Stop-Loss</th>
<th>Stop-Loss Deductible</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$200,000</td>
<td>$300,000</td>
</tr>
<tr>
<td>Estimated annual premium</td>
<td>$0</td>
<td>$480,000</td>
</tr>
<tr>
<td>Sponsor claims paid</td>
<td>$1,500,000</td>
<td>$600,000</td>
</tr>
<tr>
<td>Stop-loss carrier claims paid</td>
<td>$0</td>
<td>$900,000</td>
</tr>
<tr>
<td>Net cost to sponsor</td>
<td>$1,500,000</td>
<td>$1,080,000</td>
</tr>
<tr>
<td>Net reduction in cost due to stop-loss protection</td>
<td>$420,000</td>
<td>$300,000</td>
</tr>
</tbody>
</table>

*Includes the full cost of claimant A’s and C’s events, which include claims under the $500,000 deductible.

Source: The Segal Company.
higher for specific stop-loss insurance than overall medical inflation, due to stop-loss policies’ high deductibles. This higher trend is primarily driven by the erosion of the leverage that a fixed high deductible has over time as new and expensive treatments become more common.

• **Improvements in medical technology.** The U.S. health care system offers some of the world’s most progressive (and expensive) technologies, and uses them more frequently.

• **Unlimited benefits.** In the past, it was not uncommon for stop-loss insurance to have annual or lifetime limits. With the ACA’s prohibition of lifetime dollar maximums on essential benefits, stop-loss carriers are now offering unlimited plans. As a result, insurance companies are raising their base premium for this additional risk.

Here are some strategies for controlling the cost of stop-loss coverage:

• **Request rates related to experience.** Plans that have better-than-average experience, including lower overall trend, should ask carriers to consider those factors in their premiums for renewals and bids. If the market cycle is “soft,” carriers may be amenable to reducing their quotes.

• **Review and negotiate discounts for effective networks.** Traditionally, stop-loss carriers have discounted their premiums if there is a strong provider network in place. They will focus on how networks reimburse the “outlier” claims within their contracts. For example, a network may have a fixed fee in place for a certain procedure up to $50,000 and a less favorable “discount off charges” for claims in excess of $50,000. (Charges in excess of $50,000 are considered the “outlier” portion of the claim.) In general, the higher the outlier, the more favorable the contract. Many carriers may provide premium discounts if they think solid reimbursement arrangements exist for large claims.

• **Consider cost-containment programs.** Stop-loss carriers will sometimes offer discounts on their premiums if the sponsor has contracted with vendors providing large case management, centers of excellence and disease-management programs. These discounts depend on the quality and effectiveness of the programs. In addition, many stop-loss carriers have affiliations or preferred agreements with entities that provide these services.

• **Look into dividend-eligible contracts.** These contracts typically require a longer term commitment and perhaps a predetermined renewal increase. At the end of the period being evaluated, the stop-loss carrier may return a portion of the premiums paid if the loss ratio was below a predefined level.

• **Request high-deductible policies.** Some stop-loss carriers offer policies with annual deductibles set at $1 million or more. These are designed primarily for the largest plan sponsors which have adequate reserves, probably have not purchased stop-loss insurance before and are seeking minimal protection against additional risk.

**Conclusion**

It is timely for health plan sponsors that self-insure their benefits to either consider or revisit their current stop-loss insurance. If they decide to add coverage or confirm that coverage is still needed, this is just the first step. Then it is important to manage stop-loss insurance through timely and expert negotiations with carriers.