Article from:

Health Section News

September 2001– Issue No. 41

Current Issues In Stop Loss Market

by Daniel L. Wolak

The stop loss insurance market is emerging through a period of unprecedented losses. What are the current trends and issues facing the market as it regains profitability? The panel of Ray Marra of The Hartford, Mike McLean of Medical Risk Managers (MRM), and Jerry Winkelstein, who is an independent consultant, moderated by Dan Wolak of GeneralCologne Re, discussed their views at the SOA 2001 Spring Meeting in Dallas.

The major focus currently for the insurers and reinsurers in the marketplace is in improving loss ratios to the point of meeting their profit targets. The panel generally feels that many companies are moving in the right direction, but many others are still falling short.

Claim Experience

Mike McLean presented two surveys of loss ratios from a sample of direct insurance writers. In his study from 1999, loss ratios increased by 16% from 1996 to 1998 underwriting years. In a recent survey of five carriers, the projected loss ratio peaked in 1999, and is expected to decline for the 2000 underwriting year. It is still too early too tell how the loss ratio for the 2001 underwriting year will develop. The panel predicted that there is a reasonable chance that well disciplined programs will be profitable for the 2001 underwriting year. Of course, actual emerging trend is key.

The Trend in Trend

With the recent history of poor results from the product, the panel next discussed average rate increases in the marketplace. Based on the panel's and the audience's feedback, a "normal" rate increase at renewal for a program is currently in the area of 40% or more. A good portion of the rate increase is to cover trend; the rest to improve the financial results for the product line. The panel was split on their views of current trend on a $50,000 specific deductible. Jerry Winkelstein shared that for his clients, which are large MGUs, large claim management programs and centers of excellence are limiting leverage trend to the range of 18% to 20%. Mike McLean and Ray Marra, who both are on the stop loss carrier side, believe that leveraged trend is in the 25% to 30% range.

The annual increase in cost for stop loss is impacted, naturally, by underlying trend on the first dollar medical plans, by leveraging, and also by type of fee arrangements with HMO or PPO networks.

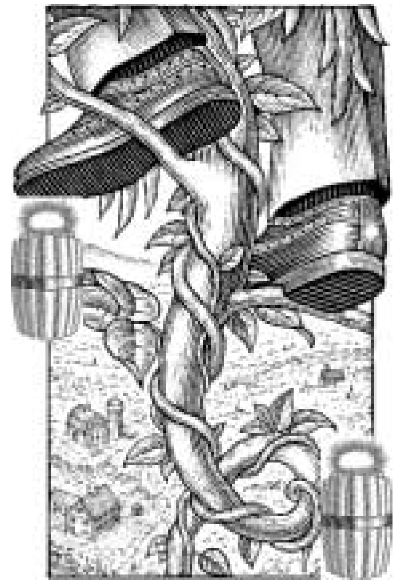
With the successive years of losses for the stop loss product line, the panel explored the role that reserving, or in this case under-reserving, played. Generally, few companies' actuaries have recognized the under-priced, high emerging loss ratios in reserves until claim patterns were fully developed. Ray Marra presented also the need to vary the lag factor by level of deductible. For example, for a lower specific deductible, 68% of ultimate claims are paid within 12 months of the anniversary date. For a high deductible, only 44% may be paid at that point in time.

Once you seen one PPO, you have seen....

Jerry Winkelstein discussed the issue regarding how different one PPO is from another. The concern is that the data available to analyze a PPO may be limited or confidential. In addition, available data is retrospective and may not be a good indicator of how prospective cost will develop for a future point in time. The issue is: how should the "PPO effect" be taken into account in the premium development? If manual rates reflect past experience, wouldn't the "PPO effect" already be in the manual?

Outlier Fee Schedule Impact On Stop Loss

Hospital costs are rising; hospitals are negotiating significant fee increases, updating per diems that have been frozen for a number of years. In addition, stop



loss carriers and underwriters are challenged to correctly factor in the impact of a given PPO network when setting the stop loss rates.

Mike McLean discussed that many PPO fee scales provide incentives that adversely impact stop loss results. Mike has found that many contracts have had per diems that provide less than the needed revenue to a hospital but also provide an outlier that applies at a relatively low-level claim amount. Though carriers may receive "20% or more" off of "billed charges" for large claims, this translates into an area of significant profits for the hospitals. The concern and fear is that stop loss carriers have paid at a fee level much higher than average hospital cost per day because of the existence of outliers.

Mike provided an example of a low outlier in a negotiated contract with a low per diem payable up to the outlier. For the sample case, negotiated savings resulted in a 60% discount on claims under $30,000, and 30% savings on claims over $30,000. The lower discount on high claims is very "stop loss unfriendly."

He discussed examining $1 billion of claims from a major carrier over a 10-year period. He said that the average reimbursement for claims subject to a discount off of billed charges increased at the rate of 10% a year. For claims subject to a per diem, the average reimbursement increased only 2% a year. Yes, hospital costs increased by 6% a year, but the high claims shared in a disproportionate amount of the increase. Mike recommends that network contracts be renegotiated to level the amount paid between low claims and high claims.

Jerry Winkelstein asked if such a change would really help the employer. The change is revenue neutral to hospitals and to employers' claim payments. Are employers willing to make such a change with little direct benefit to them? The panel had a lively discussion on this issue.

The solution outlined by Mike is:

1. Partner with select PPOs and eliminate the outlier provision in network hospital contracts.
2. Raise the per diem to remain revenue neutral for the hospital.
3. Steer employers towards these PPOs.

Can Claims Manage the Billing Practices of Providers?

Ray Marra discussed the need to monitor the effectiveness of inside claims departments as well as TPAs. Ray provided several examples of how a review of submitted stop loss claims resulted in requiring the TPA to request a repricing from a hospital. In one case, a one-day hospitalization charge resulted in a $96,000 bill. Most of the cost was associated with a medical device, which the hospital had marked up their cost of $18,000 to a billable charge of $75,000! The most gross situation of over-billing was a $97,000 charge for a gel foam sponge, an item which costs the hospital only $10!

Reinsurance Capacity... Is the Glass Half Empty??

The panel discussed the current situation with reinsurers. Mike McLean noted that virtually all of his contacts in the '90s from reinsurers are no longer there, primarily due to the former major players having dropped out of the market. Dan Wolak discussed that today, unlike the late '90s, the reinsurance risk taker is now requiring greater control. In the past, reinsurers had little control on rating and underwriting. Because of the poor results incurred by reinsurers over the past several years, reinsurance capacity for a new program currently is difficult to find. There is what is called "naïve" capacity in the stop loss market place which refers to new reinsurers with little knowledge of the product. The "naïve" capacity has been able to enter since there are few barriers for a new reinsurer to enter the market. Mike McLean noted that reinsurers who are "naïve" and add no value, have been a major problem with the underpricing in the marketplace.

Because of the above, there are fewer reinsurers today than there were three years ago. This change makes it difficult for new programs to find reinsurers when the direct writer desires to keep a minimum amount of risk.

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Plans Laid for Academy's Life and Health Qualifications Seminar

Emphasizing real-world professional needs, the American Academy of Actuaries will again offer its seminar on life and health annual statement certifications in Washington, DC on November 12–15, 2001.

The seminar gives life and health actuaries the opportunity to demonstrate by examination that they have obtained the necessary basic education to function as valuation actuaries under the Qualification Standards for Prescribed Statements of Actuarial Opinion.

Building on participants' knowledge of financial statements, actuarial mathematics, life insurance valuation, insurance finance and investments, and life, health, and annuity products, the 3½ day seminar will cover such topics as valuation and non-forfeiture requirements, statutory accounting, and expense analysis.

The primary purpose of the seminar is to provide state-specific and country-specific basic education for actuaries who did not fully meet the basic education requirements as part of their SOA examination process. However, actuaries seeking to refresh their basic education or add to their continuing education will find the seminar useful. Additionally, candidates for fellowship in the SOA may earn 15 units of professional development credit for attending.

There will be an examination on the final day for those seeking to meet qualification standards or professional development credit.

For more information on the seminar, contact the Academy's legal assistant, Rita Winkel, either by phone at 202-223-8196, or e-mail at *winkel@actuary.org.*, or visit the Academy's Web site, *www.actuary.org/seminar/index.htm.*