



Buying and Selling Employer Stop-loss Is Simple ... Or Is It?

By Dave Nelson, Keith Passwater and Luis Prieto

Any prudent organization that is obligated to cover health claims will consider the risk that those medical claims vastly exceed expectations. This is true for an employer self-funding employee health benefits, a health system contracted with two-way risk (e.g., accountable care organizations [ACOs]), and a small or midsize health insurance company. Without protection, these risk bearers can incur ruinous losses.

Interestingly, the forms of insurance sold to cover such large medical claims, although quite similar, sometimes go by different names depending on the buyer. The three main categories are as follows:

- **Employer stop-loss (ESL).** Self-funded employers who want protection against large unanticipated claims.
- **Provider excess (PXS).** At-risk health systems that have taken delegated risk from a public or private payer and desire protection against large unanticipated claims.
- **Medical excess/HMO reinsurance (HMO Re).** Health insurers (including HMOs) that desire protection against large unanticipated claims.

The concepts we discuss in this article apply to all three categories of large claim risk. They also apply somewhat to stop-loss sold through level-funded premium insurance policies (LFP), although LFP sold to employers with fewer than 50 employees is a topic for a separate article, which we might attempt to write if the 2020 golf season is shortened.



AGGREGATE STOP-LOSS

Aggregate stop-loss (agg) is, for many people, the most intuitive form of medical excess claim coverage. Agg policies reimburse the insured organization when total claims during a stated period, usually 12 months, exceed a stated threshold (also known as the agg attachment point). For technical reasons, the agg attachment point is derived as a percentage of expected underlying risk claims, with 120 percent and 125 percent being common attachment points. And, although the agg attachment point will be written in dollars in the policy coverage forms, writers of agg, buyers and their brokers frequently discuss a particular agg policy in terms of percent of expected claims, rather than a dollar amount.

As an example, if a large employer buying ESL has 500 covered employees and dependents with an expected claim cost of \$400 per person per month, the agg attachment point might be 120 percent of $500 \times 12 \times \$400$, or \$2.88 million (M) over one year. Effectively, the ESL customer pays the claims up to the expected value ($\$2.4M = 500 \times 12 \times \400) *plus* a deductible for claims between expected claims and the agg attachment point ($\$0.48M = 20\% \times \$2.4M$). As a result, agg claims rarely occur, which is reflected in the relatively modest pricing. In fact, when an underwriter has a case that experiences an agg claim, the level of scrutiny that follows reinforces the desire to never have another agg claim. Given the infrequent payout associated with an agg policy, the bulk of this article examines the specific stop-loss product as described next.

Table 1
ESL Buyer’s Average Results

Specific Stop-loss Attachment Point	Typical Annual Premium	Chance of Gain	Average Annual Top 10 Gains out of 100 Trials
\$75,000	\$213,681	28%	\$357,819
\$150,000	\$110,893	22%	\$279,107

SPECIFIC STOP-LOSS

In contrast to agg stop-loss, specific stop-loss (or spec) covers high claims on an individual in a covered group of patients (or members, as health insurance beneficiaries are termed). So, a spec policy might state that any claims on an individual in a year in excess of \$100,000 (the spec attachment point) are covered by stop-loss. Spec attachments are available in a very wide range. As a result, spec rates range from less than a dollar per member per month (pmpm) to \$200-plus pmpm based on the spec attachment, as well as other factors, including area, case size, provider network, and plan provision. We discuss these factors in the paragraphs that follow.

Specific Stop-loss Value Varies by Business Type

We have done considerable Monte Carlo modeling (see [Appendix](#)), which shows that spec purchasers pay more in premium than they receive in claims 70 to 80 percent of the time. But most at-risk organizations are still prudent to buy stop-loss to protect financial results. So, we recommend choosing an attachment point that is at the high end of the organization’s risk tolerance. In fact, buying the right amount of spec is, in many ways, more important than getting the lowest price. To that point, population size is a critical variable in choosing the right spec attachment point:

At small population/case/group sizes (under 150 covered lives), stop-loss coverage expenses are typically quite high. But small groups need to buy this coverage, since our modeling suggests that the chance of a few large claims generating high losses is significant. If the prospective stop-loss ESL buyer has adequate retained earnings and management is comfortable with some annual earnings fluctuations, they can save money long term if they choose what might be considered higher attachment points at their size (between \$50,000 and \$200,000).

- **At very large case sizes (over 100,000 members), stop-loss expenses are lower as a percentage of stop-loss premium, but the chances of the group’s claims being dramatically higher than average are low.** For that reason, very large groups should usually pick a spec attachment above \$1M (or go without coverage).
- **In between, groups would probably benefit from some of the modeling shown in the [Appendix](#).** Absent case-

specific modeling, it is good to remember that stop-loss premiums usually exceed stop-loss claims. Therefore, customers should choose a higher attachment point if some earnings fluctuation is tolerable.

Some brokers use 5 percent of expected plan cost as a conservative spec target and 10 percent as a more aggressive spec target. Assuming \$5,000 per member and 2 members per employee, a firm with 150 employees generates \$1.5M in expected cost. Using this rule of thumb, a conservative spec attachment would be \$75,000 and a more aggressive spec attachment would be \$150,000.

Our modeling suggests that a 150-employee (300-member) ESL buyer would generate the average results presented in Table 1.

The 5 to 10 percent rule of thumb seems to generate a good starting point when determining a reasonable attachment point, since the exceptional covered claim is large (see annual top 10 gains in Table 1) in relation to the premium. And if the employer can stand the loss that may happen at the higher attachment point, they can benefit from a known reduction in premium of similar average size (roughly \$100,000 in the example shown).

Spec Price Varies by Coverage

Spec coverage and operational features have significant impacts on stop-loss prices. Coverage features like run-in and run-out provisions and aggregating specific coverage can each generate 20 percent price impacts (see [full Appendix](#) for a summary of pricing differentials).

Run-in and Run-out Provisions

Customers need to read the fine print when choosing so-called run-in and run-out provisions. What will happen if a claim occurs during the policy’s first effective dates but is not billed until the second policy year? Without proper planning, customers could be left with no coverage for some large claims.

To solve coverage problems, several options are available. Essentially customers need to create some overlap between the old and new contract years to cover any claims incurred in the few months surrounding the contract change date. This is especially true if the customer is switching insurance carriers.

Samples of common contract coverage periods follow¹:

Table 2
Example of Aggregating Specific

Claimant	Total Claim Amount	Specific Stop-loss Attachment Point	Amount in Excess of Attachment Point	Application of Aggregate Specific Deductible	Stop-loss Coverage Reimbursement
#1	\$250,000	(\$200,000)	\$50,000	(\$50,000)	\$0
#2	\$255,000	(\$200,000)	\$55,000	(\$10,000)	\$45,000
#3	\$235,000	(\$200,000)	\$35,000	\$0	\$35,000
Total	\$740,000	(\$600,000)	\$140,000	(\$60,000)	\$80,000

- 12/12 is the lowest-priced option.** Claims are covered only when the services are incurred and the claims are processed within the policy year. This is a common contract length for the first year when an ESL buyer moves from fully insured to self-funding. A terminal liability option (TLO) is sometimes sold alongside 12/12 coverage. TLO coverage allows the ESL buyer to purchase “run-out” coverage later in the year.
- 12/15 or run-out policy.** With this form, claims are covered when services are incurred within the policy year and paid within three months after the end of the policy year. Other common run-out periods are six months for a 12/18 policy and 12 months for a 12/24 policy. ESL buyers pay an additional premium for any of these run-out options.
- 24/12 or run-in policy.** Claims are covered when services are incurred 12 months before the policy start date. Typically, a company that bought 12/12 in the first year buys 24/12 in the second year to make sure they don’t end up with a coverage gap. Not surprisingly, this feature costs more than the others described here.

Aggregating Specific Coverage

As mentioned previously, an aggregating specific feature can also impact premiums significantly. Customers can lower their premium by 20 percent or more if they accept additional risk when a claim or claims exceed the spec attachment point. With aggregating specific, the amount exceeding the spec attachment point is first applied to the aggregating specific deductible before the stop-loss carrier pays claims. The concept is analogous to a medical plan in which a copay applies first and then a deductible applies.

Table 2 illustrates the concept. Assuming three claimants and a spec attachment point of \$200,000, an aggregating specific deductible of \$60,000 would function as shown in Table 2.

Typically, the cost of the spec coverage is lowered dollar for dollar by the size of the aggregating specific deductible. This works well for the carrier if the group is large enough (over 250 members) and the spec attachment point is low enough

(below \$200,000) that enough claims will exceed the spec attachment point.

Stop-loss writers can learn quite a bit about the viability of a dollar-for-dollar premium reduction by modeling expected claims. In the full [Appendix](#) to this note, we show two examples. In the first example, we model a 251-member (126-employee) group with a spec attachment point of \$50,000. Here the stop-loss carrier can offer a dollar-for-dollar premium reduction, since it is likely that the aggregating specific deductible will be recouped from two or three claims, commission reductions and premium tax reductions. In the second example, a 150-member (75-employee) group with a spec attachment point of \$100,000, the expected number of claims is too low to support a dollar-for-dollar premium reduction. The buyer, however, may still have some interest in aggregating specific if the seller offers a premium reduction that is greater than the expected aggregate claims charge (see full [Appendix](#) for the math on this point).

Specific Stop-loss Price Varies by Operational Features

Operational features like underwriting and lasers, network payment rates, large case claims management and expense and profit margins can generate 10 to 30 percent price impacts. In fact, stop-loss carriers typically need to be proficient in two or three of these areas to have a competitive product.

Underwriting and Lasers

Individuals having serious ongoing medical conditions present material **known** risks that impact stop-loss rating of the risk. Stop-loss insured groups with fewer than 1,000 lives are frequently assigned higher spec attachment points for these higher-risk people. Isolating particular high-risk individuals for a higher stop-loss attachment point is known as **lasering** and is a common practice.

Spec buyers need to be aware of lasers in current and future years. Often it is reasonable to request a rate that guarantees no new lasers with a maximum rate increase in the next year. Of note, one alternative to a laser is loading the spec premium to accommodate the higher risk.

Network Payment Rates

Provider payment rates can vary tremendously by carrier. To demonstrate the impact of these differences on stop-loss rates, let’s consider the impact of differences on a spec attachment point of \$200,000.

- In the first instance, the provider submits a claim of \$400,000 to carrier A, which applies its network rate and pays \$100,000 to cover the amount over the \$200,000 attachment point.
- In the second instance, the same provider submits the same claim of \$400,000 to carrier B, which applies its network rate and pays \$50,000 to cover the amount over the \$200,000 attachment point (Table 3).

Table 3
Comparing Network Payment Rates

	Carrier A	Carrier B
Claim	\$400,000	\$400,000
Provider discount	(\$100,000)	(\$150,000)
Net provider charge	\$300,000	\$250,000
Specific attachment point	(\$200,000)	(\$200,000)
Stop-loss claim	\$100,000	\$50,000

Not every claim will substantiate a 50 percent stop-loss claim differential, but one can see that provider payment rates (and particularly payments for high-cost outlier claims) can have a huge impact on stop-loss rates.

Large Case Management

Complexity and fragmentation of the medical system makes opportunities for improvement in the care possible—especially for complicated cases like transplants or services outside the carrier’s primary service area. Effective stop-loss carriers take steps to make sure that the right care is delivered at the right location at the right price. Most ESL, PXS and HMO Re stop-loss contracts require advance reporting of claims likely to exceed the spec attachment point. When stop-loss buyers comply, potentially costly care is identified early so that nurses and network management people can help patients and families understand what their options mean in terms of cost, quality, convenience and comfort.

Frequently, case management is performed by the stop-loss carrier’s third-party administrator (TPA) partner and is often governed by a preferred provider agreement that limits large case management activities. If case management is done well, stop-loss prices can be reduced materially (recall the earlier

example that shows how small differences in total costs can drive a big difference in amounts in excess of the attachment point).

Expense and Profit Margins

Expense and profit loads can be very significant in the sale of stop-loss because the coverage is risky and expenses can be quite high. Rates for a 100-life ESL group typically include fees for agents and underwriters, whereas stop-loss fees are infrequent on 1,000-plus employee groups where a benefits consultant is usually paid a flat fee. In addition, the TPA will often be compensated by the stop-loss carrier from the stop-loss premium. And at case sizes of less than 150 employees, it is often easier for the TPA to sell a higher stop-loss rate (bearing some TPA revenue) than a higher administrative services only (ASO) fee. Spec loads can vary from 35 percent on small case size to 20 percent on a larger case.

Timing

Our final note about the purchase of spec concerns timing. In the first year, customers often take less risk by choosing a lower attachment point as they switch from fully insured to self-funding. In future years, customers often buy down renewal increases by switching to a higher attachment point or agreeing to a separate aggregating specific deductible. Customers taking more risk at renewal makes sense for two reasons:

- in renewal years the customer has more experience with self-funding, and
- stop-loss renewal increases are often high on account of deductible leveraging.

Table 4 shows how a 5 percent overall trend can turn into a 15 percent stop-loss trend.

Table 4
Stop-loss Renewal Increases

	Year 1	Claims Trend	Year 2
Claim	\$400,000	5.0%	\$420,000
Provider discount	(\$100,000)	5.0%	(\$105,000)
Net provider charge	\$300,000	5.0%	\$315,000
Specific attachment point	(\$200,000)		(\$200,000)
Stop-loss claim	\$100,000	15.0%	\$115,000

CONCLUSION

Although it is somewhat difficult to generalize about the best way to purchase spec, it is safe to say that one should be aware

of the nuances of the product and pricing structures in the stop-loss market. Buyers wishing to purchase the optimal stop-loss insurance value for their organizations can often benefit from expert outside counsel to evaluate both their true risk needs and the competitor stop-loss offerings available.

APPENDIX

To accommodate *Health Watch* size limits, the Appendix to this paper is being made available at www.pascoadvisers.com/soa. The authors encourage readers to at least scan the Appendix as a way to understand the rationale for the observations made in this paper. In addition, the visualizations and tables in the Appendix help summarize the content in a succinct manner. This is especially helpful for students hoping to get a good feel for how stop-loss needs vary by case size and how an aggregating specific deductible impacts costs.

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Dave Nelson, FSA, MAAA, is senior adviser at PascoAdvisers. He can be reached at dave.nelson.111@gmail.com.



Keith Passwater, FSA, FCA, MAAA, is managing director at Pasco Advisers. He can be reached at keith@pascoadvisers.com.



Luis Prieto, ASA, MAAA, is senior pricing analyst at Cross Country Home Services. He can be reached at luis.prieto.info@gmail.com.

ENDNOTE

- 1 Doyle, D. Illuminating Industry Jargon. *Stop-loss Insurance Brokers*. November 30, 2015, www.stoplossins.com/contract-periods-run-in-and-run-out-provisions/ (accessed April 17, 2020).

RECOMMENDED READING

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