

STOP LOSS COVERAGE WHITE PAPER:

Maximizing Benefits, Limiting Risk

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Employer-provided health care continues to undergo turbulent change in the US marketplace. In 2010, almost six in 10 participating employees were covered by self-funded employer plans—up from about four in 10 in 1999.¹

Employers must balance the potential rewards of self-funding with risks of unexpected large claims. Stop loss insurance in a self-funded plan can help limit financial exposure of employer assets as a result of these unexpected claims. This white paper evaluates types of stop loss insurance, avoiding pitfalls in coverage gaps and strategies to balance the risk/reward relationship found in self-funded plans.

WHAT IS SELF-FUNDING?

Self-funding is a method of funding whereby an employer assumes financial responsibility to provide benefits to their employees. Self-funding provides many advantages:

- Customized plan choices
- Expedited cash flow
- Lower premiums for certain employee groups
- Exempt from federal or state fees
- Exempt from certain state insurance premium taxes (1%–2.5% of premiums paid)²

Employers who self-fund their employee health care also purchase stop loss insurance, which caps liability at a selected level. In the event of cancer, premature births or even a widespread flu epidemic, liability will stop at the amount that each employer has predetermined.

3 OUT OF 5

COVERED WORKERS ARE IN A SELF-FUNDED HEALTH PLAN.¹

The MedCost underwriting team recommends stop loss policies that provide consistency between the policy and the employer's Summary Plan Description (SPD). This consistency is vital to ensure that there are no gaps in coverage. MedCost works extensively with consultants and employers to strategically design plans that control both known and unknown costs. Effectively managing health care dollars, especially during long-term employee claims, can be a source of significant savings for employers.

TWO TYPES OF STOP LOSS INSURANCE

Specific (or individual) stop loss insurance limits the self-funded employer's liability to a predetermined dollar amount (specific deductible) for each employee covered under the health plan. The specific deductible per employee is determined by group size and risk tolerance.

Example:

Jane Smith suffers from renal failure and undergoes kidney dialysis. Her claims total \$300,000. Jane's employer is self-funded and has purchased **specific stop loss** with a \$75,000 deductible.

Total Claim	\$300,000
Employer Deductible	\$75,000
Amount Reimbursed by Stop Loss Carrier	\$225,000

Aggregate stop loss insurance limits the self-funded employer's *overall* liability. Maximum liability is determined by projecting expected claims plus a margin (typically 25%). If paid claims exceed 125%, the stop loss carrier reimburses the amount above the maximum liability. Individual claims that exceed the specific deductible do not accumulate toward the aggregate. Only claims *up to* the specific deductible apply to the aggregate deductible.

Example:

- Includes claims paid that do not exceed the specific deductible.
- When underwritten appropriately, expenses should approach amount of **expected claims** (\$4 million), rather than maximum liability (\$5 million).

Expected Claims	\$4,000,000
25% Margin	\$1,000,000
Maximum Claims Liability	\$5,000,000

¹2013 Employer Health Benefits Survey, Kaiser Family Foundation, August 20, 2013, <http://kff.org/report-section/ehbs-2013-section-10/>

²Michael J. Brien, PhD and Constantijn W. A. Panis, PhD, "Self-Insured Health Benefit Plans," U.S. Department of Labor contract, March 23, 2011, <https://www.dol.gov/ebsa/pdf/ACASelfFundedHealthPlansReport032811.pdf>

STOP LOSS INSURANCE CARRIERS: THE MEDCOST PHILOSOPHY

A.M. Best is the oldest and most commonly used rating agency. A.M. Best ratings provide an independent opinion of the stop loss carrier's financial strength and ability to pay claims. The top ratings are AA++ and A+. Both ratings are awarded the distinction of Superior. MedCost partners with carriers rated A- (Excellent) to A++ (Superior).



HOW TO CHOOSE THE BEST STOP LOSS PARTNER

Who Offers Stop Loss Insurance?

Managing general underwriters (MGUs) are often hired to underwrite stop loss policies for carriers that pay the claims. In the late 1990s, many MGUs and carriers wrote such large volumes of stop loss policies that some yielded poor underwriting results, causing carriers to terminate relationships with many MGUs. Today, about one-third of the sources from the '90s sell stop loss insurance.

The MedCost underwriting team typically recommends a direct writer or carrier, removing the third-party MGU from the process. This direct connection with the stop loss carrier can lessen the possibility of denied claims or inconsistencies in the policy written. There are, however, quality MGU firms. MedCost thoroughly vets each underwriting firm, including carriers, before making a recommendation. Below are just a few of the criteria that are reviewed.

1. Who Assumes Risk?

The big question here is: Does the MGU assume any risk? If an MGU assumes little or no financial risk, it may lack incentives to properly underwrite. In addition, MGUs assuming little risk typically do not have authority to settle claims, increasing turnaround time.

2. How Quickly Are Claims Reimbursed?

Since specific stop loss contracts protect against catastrophic claims, quick turnaround by the carrier or MGU is vital for employers to avoid financial strain. A strong carrier or MGU will reimburse the employer in 5–8 days for specific stop loss claims and 30–45 days for aggregate claims.

3. Why Are Claims Delayed?

Incomplete information can hinder claims processing, sometimes by over 30 days. A competent third party administrator (TPA) can submit or confirm information to avoid payment delays.

4. Who Actually Reimburses Claims?

Many MGUs rely on premiums to fund stop loss claims. This can dramatically influence a claim's turnaround time. Some MGUs do not receive adequate premiums to properly fund claims or must request funds from their respective insurance companies.

Most stop loss insurance policies today include simultaneous or advance reimbursement provisions. This provision allows the employer to submit claim amounts that exceed the specific deductible for reimbursement prior to actually paying the claims. Otherwise, exorbitant claims can severely impact an employer's cash flow.

BE SURE YOUR POLICY MIRRORS YOUR PLAN

Stop loss insurance has multiple variables to consider beyond price. Many stop loss carriers have policies with exclusions or definitions that may conflict with the employer's Summary Plan Description. The stop loss carrier's policies can dramatically impact how or if a claim is covered under the policy.

Ultimately, the employer remains responsible if the stop loss insurer fails to perform or denies a claim based on contract terms. And inconsistencies between the stop loss policy and the employer's Summary Plan Description can result in gaps in coverage.

THE IDEAL POLICY WILL HAVE LIMITED EXCLUSIONS AND RELY ON THE PLAN'S DEFINITIONS TO DETERMINE COVERAGE.

An example is a stop loss carrier's definition of experimental treatment—a common health plan and stop loss policy exclusion. If the plan and the stop loss policy's definition of experimental treatment conflict, the stop loss policy will most often dictate whether claims may be reimbursed. The plan must pay in accordance with the SPD, while the stop loss carrier must reimburse in accordance with the stop loss policy.

However, the self-funded employer is still responsible for reimbursing expenses as defined by the plan. A stop loss denial for experimental treatment can result in an unexpected exclusion. *For this reason, the MedCost underwriting team reviews all policies for gaps in coverage before making stop loss carrier recommendations. MedCost provides this standard service when we are the stop loss agent of record.*

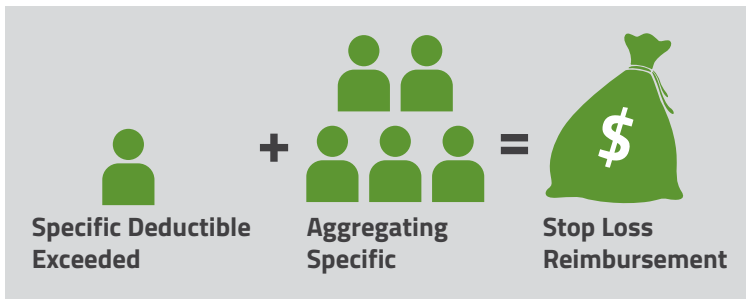
The ideal stop loss policy will have limited exclusions and rely on the plan's definitions to determine coverage—or better yet, mirror the employer's plan.

STOP LOSS INSURANCE STRATEGIES

Within the stop loss marketplace, there are optional features that allow employers to choose from varying levels of risk:

1. Aggregating Specific (or Split Funding)

Split funding can save employers money on upfront premium payments. This feature, also known as the aggregating specific, exchanges premium savings for employers' assumed liability for a set dollar amount. When an individual claim or combination of individual claims exceeds the specific deductible, this amount is applied to the aggregating specific, instead of the individual receiving reimbursement. When total excess claims (exceeding the specific deductible) equal the aggregating specific, the additional amount is reimbursed by the stop loss carrier.



2. Participating Contracts

Participating contracts allow employers to share in net profits earned on the stop loss policy. The cost of 3%–5% added to the base premium can result in thousands of dollars refunded. In 2014, MedCost clients with participating contracts received over \$1 million in refunds.

The participating contract should only be considered by an employer committed to a long-term partnership with a single stop loss carrier. This contract is a tangible benefit for employers who can successfully manage their exposure to large claims by using disease management, wellness and other health management programs that target avoidable health issues such as those associated with obesity.

IN 2014, MEDCOST CLIENTS WITH PARTICIPATING CONTRACTS RECEIVED OVER \$1 MILLION IN REFUNDED STOP LOSS PREMIUMS.

3. Captives

Captives are a more complex alternative to traditional stop loss insurance that allows the employer to share in risk and profit along with other employers. The captive (essentially the insurance company) transfers risk above the captive layer to a stop loss carrier. Captives are often created by an employee benefits advisor (consultant) or a third party administrator.

How does it work? Each employer in the captive chooses an individual specific stop loss deductible. The captive then assumes a set amount of risk above each individual employer’s specific deductible. Note that the captive layer is the same over each specific deductible.

Approximately 50%–70% of each employer’s stop loss premium is retained by the captive to fund the captive layer for claims that exceed the group’s specific deductible but are below the captive’s stop loss deductible (see graphic below). The remaining premium is used to pay the captive’s administrative expenses and purchase stop loss for claims that exceed the captive layer. Captive employers are also required to provide collateral (often as a letter of credit) if the captive’s premium reserve is exhausted.

Any premium amounts remaining in the captive after all claims and expenses are paid are distributed to the employers (net of taxes). Profit returns may be delayed if various employers within the same captive have different renewal dates. Captives typically require a multiyear commitment from each employer in order to see a financial return.

4. Planning for the Unexpected

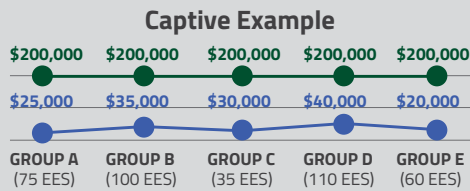
What if one of an employer’s covered members develops a critical disease such as cancer? Several options are available to help an employer offset financial exposure to this type of risk.

The stop loss underwriter may increase the quoted premium to offset the known risk. For example, during the renewal process, a new cancer diagnosis is discovered and the planned treatment is expected to be \$200,000. The group has a \$50,000 specific deductible. This results in \$150,000 of known risk (amount exceeding the specific deductible) that must be underwritten. In this example, the underwriter would simply load the specific premium plus \$150,000 to offset the known risk. This same technique is typically used in the fully-insured underwriting model.

Another option an underwriter may propose is a laser. With a **laser**, the employer pays a higher specific deductible for the known claimant (the employee with cancer) before stop loss reimbursements are made. The underwriter would request a \$200,000 laser, the anticipated cost of treatment.

LASER: A HIGHER SPECIFIC DEDUCTIBLE ON AN INDIVIDUAL WITH A KNOWN RISK.

Self-funded employers may want to lessen the effect of potential catastrophic claims that extend to the next policy period. During the initial negotiation, a **rate cap option** is often available for a cost of 5%–9%. The rate cap would allow the employer to budget for a maximum specific stop loss increase of no more than 40%–55%, regardless of known risk. The rate cap would mean that no laser would be added at renewal.



EES = number of employees per group Blue = employer Green = captive

A properly managed captive may be an appropriate vehicle for smaller employers considering self-funding, since risk is shared by like-minded employers of a similar size. Captives should be considered a long-term strategy.

CONTRACTS

Stop loss insurance is contracted between the employer and a stop loss carrier. Different time periods may be contracted in order to cover expenses eligible for stop loss, from the time a claim is incurred to when the claim is paid.

Incurred & Paid Immature Contract: A 12/12 contract requires that eligible claims be incurred³ and paid within the 12-month contract year. A claim that has been incurred but not yet paid is called an *immature* claim. The renewal contract following the first year needs to cover claims incurred the previous year. This would be a paid (24/12) contract.

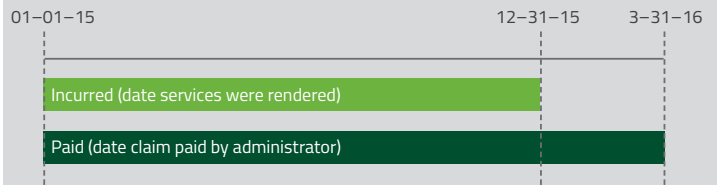
IMMATURE CLAIM: A CLAIM THAT HAS BEEN INCURRED BUT NOT YET PAID.

Paid Contract (24/12): The 24/12 contract extends eligibility for claims paid during the 12-month contract period as long as claims were incurred during either the 12-month contract period or the 12 months immediately preceding the current contract period.

For example, a contract becomes effective January 1, 2015. Claims incurred from January 2014 to December 2015 (24 months) and paid from January 2015 to December 2015 (12 months) will be covered by the stop loss contract. Most stop loss carriers will add an additional 12 months to the incurred dates at each renewal of a paid contract (first year 24/12, second year 36/12, third year 48/12, etc.).⁴

Incurred Contract (12/15, 12/18, 12/24): A 12/15 contract would include claims incurred during a 12-month period and paid within 15 months. Other variations are 12/18 or 12/24 contracts.⁵

12/15 CONTRACT



- Incurred in 12 and paid in 15 months (12/15 contract).
- Eligible claims must be incurred during the contract period and paid within the contract period or the three months immediately following.
- This is an abbreviated version of the true incurred contract.
- Variations include 12/18 and 12/24 contracts.

There are advantages and disadvantages to each of these types of contracts. Working with experienced consultants and third party administrators can eliminate confusion over contract terms and determine which type of contract best fits each employer.

WHICH PLAN WORKS BEST?

With all the changes in health care reform, are you exploring a self-funded strategy for your company's health care benefits? The MedCost team's evaluation of stop loss carriers, policies and contract provisions offers expert choices for consultants and employers. For more resources on self-funding, contact your benefits consultant or [Laura](#) at MedCost.

³ Claims that occurred on a date within the stop loss carrier's contract with the employer

⁴ Contracts such as 15/12, 24/12, etc., are also referred to as having a run-in period

⁵ Contracts such as 12/15, 12/18, etc., are also referred to as having a run-out period

ABOUT MEDCOST BENEFIT SERVICES

MedCost Benefit Services is an integrated benefits solutions company, offering customized programs to help employers lower their health plan costs and provide more affordable benefits for their employees. Based in Winston-Salem, North Carolina, we work with employers throughout North Carolina, South Carolina and Virginia who rely on our strategic benefit plan design, flexibility in benefits administration, best-in-class care management programs and customer-focused service. MedCost Benefit Services was formed in 1998 as a wholly owned subsidiary of MedCost LLC. MedCost LLC was founded in 1983 and is jointly owned by Carolinas HealthCare System and Wake Forest Baptist Health.

Learn more at www.MedCost.com.

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