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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

Attention: Stop Loss Comments

American Fidelity Assurance Company respectfully submits the following comments in response to CMS-9967-NC, [Request for Information Regarding Stop Loss Insurance \(RFI\)](#). We appreciate the opportunity to provide information to the Agencies on this important subject. American Fidelity Assurance Company is an active participant in the stop loss market, authorized to operate in 49 states and writing over \$160 million in annual stop loss premium. Our clientele include a wide range of employer and association groups in the private, not-for-profit and government sectors. We have been successfully supporting our employer policyholders with stop loss products since 1991.

Summary

The following key points illustrate the tangible elements and effective nature of current stop loss business practices in serving policyholders of all sizes.

- I. Employee health benefit self-funding, and the related purchase of stop loss insurance, is a viable option for a wide range of employer sizes; the decision to self-fund is made in consideration of many factors in addition to the availability of stop loss insurance.
- II. The most important factors in an employer's decision to self-fund are their risk tolerance for the variability of cash flows and willingness to accept the complex legal and administrative responsibilities of managing a self-funded Plan.
- III. Stop loss insurance is a risk management tool that indemnifies the policyholder, typically an employer or other health Plan sponsor, for certain expenses they have incurred in the operation of their health Plan. Stop loss is not first dollar insurance that reimburses employees or providers for medical services.

- IV. Stop loss insurers will continue to respond (subject to state regulatory oversight) to market incentives and offer desired products to health Plan Sponsors.
- V. Speculation that full implementation of the Affordable Care Act (ACA) with Exchanges will stimulate a meaningful shift to self-funding by small employers is not supported by the history of small group reform, stop loss insurer business practices or identified empirical survey evidence. Limiting stop loss options available to smaller employers by imposing minimum attachment points may not improve the success of Exchanges, and may increase the number of small health Plans that become insolvent.
- VI. We anticipate that employers will continue to evaluate self-funding with stop loss insurance as an option to finance benefit obligations in response to the cost of traditional insurance and to recognize the other values offered by self-funding.

The Market for Stop Loss Insurance Reflects the Prevalence of Self-funding

It is important to recognize that the use of stop loss is a consequence of the use of self-funding by employers, unions and others to finance the delivery of health benefits. There are various estimates of the number entities using self-funding to meet their benefit obligations. The Kaiser Family Foundation Employer Health Benefits 2011 Annual Survey, a respected source, reported that 60% of all employees in comprehensive medical Plans are in self-funded Plans. The adoption of self-funding has driven the availability and use of stop loss.

One strong indicator of the prevalence of self-funding is that the majority of the companies identified as large health insurers provide their service to far more self-insured employees than they do to fully insured certificate holders. Measured on the basis of “covered lives”, these insurers would be more properly described as third party administrators. For example, in Aetna’s most recently stated required annual financial statement (2011 Financial Report to Shareholders) they describe their total population of commercial benefit members to be 16,626,000; of these 11,868,000, or 71.4%, were in employer self-funded Plans, not covered by health insurance.

There are very few rules of thumb or consistent patterns regarding purchasing habits for stop loss coverage. Risk tolerance is in the eye of the beholder. Many smaller firms will self-insure with stop loss that has high attachment points, and certain larger firms will self-fund with low, conservative attachment points. These variances are determined by many factors, such as strength of the Plan Sponsor’s balance sheet, access to and cost of cash to fund short term adverse claim experience, and market pricing of stop-loss. Without regard to Plan size, the purchase of stop loss does not make a Plan “partially” self-funded, irrespective the generosity of the stop loss reimbursement terms. While Plan Sponsors use stop loss to manage risk they cannot transfer their primary and direct liability to pay the claims of their beneficiaries. ***The essence of self-funding is not the level of risk retained by the Plan Sponsor but rather that the Plan Sponsor has accepted and is legally liable for the direct payment of benefit claims generated by their employees and participants, with or without the benefit of stop loss insurance.***

It is important to note that while the ACA does not directly mandate specific coverage provisions of stop loss insurance, the stop loss market has quickly responded to health Plans' obligations under the ACA. All of the early health Plan requirements of federal health care reform have been quickly and efficiently accommodated by the stop loss industry. For example, the Independent Review requirements present the possibility that a claim, determined to be payable after the fact by an IRO, would not be reimbursed under traditional stop loss policy language. This potential gap was quickly addressed by endorsement and coverage memorandums to assure policyholders that they would not have a gap in coverage. Stop loss policies typically have evolved as a "following form" of excess insurance. This means that the coverage provided by the underlying Plan, as designed by the employer Plan Sponsor, generally determines claims payable and binds the stop loss insurer to indemnify the policyholder. As such, stop loss policy language rarely needs to be customized. Each carrier may have a few coverage terms and limitations that supersede the underlying Plan, but these can often be amended by endorsement for a consideration in the premium.

Determining Attachment Points and the Appropriate Level of Risk Retention

The inquiries regarding attachment points in the Request for Information (RFI), along with certain public commentary and recent activities of the NAIC suggest that there is a standard methodology used by carriers and employers to calculate the attachment levels used by the parties to a stop loss policy. A perception held by some stakeholders is that there is precise stop loss attachment level that can be empirically calculated for any Plan Sponsor that defines whether or not the Plan Sponsor is fully insured or self-funded. We estimate that under current industry practices stop loss policyholders typically retain 75% of total Plan claim liabilities and costs. In the long run, after accounting for claim reimbursement proceeds from stop loss insurance, a typical Plan will have retained 90% or more of all claim and administrative expenses. By any measure, and in consideration of the fact that the Plan has retained 100% of the legally enforceable liability to pay claims, this does not approach fully-insured status.

The wide variety of attachment points selected for both individual participant risk and aggregate risk is a defining characteristic of stop loss purchasing. Each purchaser can accept policy terms that best fit their risk retention tolerance. Individual attachments typically range from as low as \$20,000 to as much as a \$1,000,000 per person, and occasionally even higher. While the smaller Plans generally use lower attachment points, there is not an industry "rule of thumb." Plans will purchase both individual and aggregate stop loss coverage; however it is also common to purchase only individual coverage, particularly as employer size increases. During the underwriting process insurers will evaluate the selected attachment points for consistency with the group's characteristics.

The percentage of total claim cost eventually retained by employer Plan Sponsors can vary greatly from one period to the next, as the Plan's catastrophic claim experience changes. When a Plan purchases both specific and aggregate coverages, the Plan Sponsor is protected against the retained claims cost exceeding a pre-determined percentage of the total predicted claim costs. For a given year the percentage of total cost retained could be much lower because of an above average frequency of

catastrophic claims that are reimbursed under the individual stop loss coverage. Over time the Plan Sponsors will eventually retain at least 75% of anticipated claims, with that percentage approaching 100% for larger groups.

Small Groups, Self-funding Trends and Stop Loss

Some commentators have suggested that we are poised for a rapid expansion of self-funding in the small group markets, possibly selecting against fully insured Exchange-based coverage. We think that this hypothetical trend is not likely to materialize. Stop loss utilization will increase in correlation with any change in the use of self-funding by Plan Sponsors, without regard to employer size.

The existing small group reforms that have been implemented over the last 20 years have already influenced the behavior of small employers in selecting a benefit funding method. It would not make sense for a small group that has a young healthy population to move from insurance to self-funding just because of the deployment of the Exchange and related reforms. If such an entity has the risk tolerance for the responsibility of self-funding, they likely would already be using that approach. We believe that access to the ACA Exchanges will not shift those dynamics in a meaningful way. The idea offered by some as noted in the RFI is that the potential for cost-avoidance will drive self-funded plans to move to standardized fully insured coverage at fully insured rates when experience deteriorates. Rational benefit Plan sponsors won't move away from the funding concept that they have embraced solely in response to Exchange influence, particularly if stop loss insurers can continue to offer products demanded by the market.

Small employer use of self-funding is not subject to frequent shifts in funding strategy. Plan sponsors who have chosen a self-funded strategy, and the stop loss insurers that support them, are committed to self-funding as a long term solution. Stop loss underwriting processes include a thorough review of the group's history. Plans with frequent shifts in insurers or funding concepts are subject to increased stop loss rates and possibly limited coverage availability. A small group that repeatedly attempts to move back and forth between self-funding and insurance from an Exchange eventually will not be able to access quality stop loss coverage. In this respect stop loss industry underwriting practice and the interests of Exchange insurers are aligned. Also the non-insurance costs of changing health Plans, such as enrollment and education meetings, fulfilling new business quote information requirements, and concern for employee uncertainty favor stability. History has demonstrated that employers are unlikely to change funding methods or insurers unless there are meaningful long-term advantages. For small employers this stable tendency may become more probable as we anticipate they will have less agent decision support resulting from declining agent revenue opportunities.

Stop Loss Insurers and the Current Regulation of Stop Loss Insurance

Stop loss coverage is sold by a wide range of insuring entities, from multi-billion dollar publicly traded U.S. and international companies, to medium size regional insurers. Small entities, as defined in the RFI, do not have a meaningful presence in the U.S. stop loss markets. Insurers issuing stop loss coverage are subject to the same capital and licensing requirements as all other insurers in the governing state.

As with all insurance regulatory authority each state has varying requirements. The NAIC has promulgated a Model Stop Loss Act, which defines certain stop loss contract requirements based on the size of the group purchasing coverage. At the present time only three states have adopted the Model Act. About 20 other states have adopted laws that regulate stop loss policy terms. These rules are typically similar to the Model Act.

The markets and products available to deliver stop loss coverage to employers and other buyers are financially sound, competitive and vibrant. Policyholders have a wide range of companies and products from which to choose. State regulation has worked well and there have been no significant insolvency issues involving legitimate regulated entities for over 20 years. Almost all current insurers offering stop loss coverage are rated by A. M. Best A- or better. Current industry practices combined with the regulatory framework have resulted in a strong record of delivering secure and innovative risk management options for self-funded Plan Sponsors.

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Again we appreciate the opportunity to provide our comments. If you would like any additional information please feel free to contact me. I may be reached directly at 405-523-5315 or by e-mail to marc.marion@af-group.com.

Respectfully,

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