Stop loss insurance helps employers mitigate risks related to self-insurance, such as the loss of revenue owing to the impact of the ACA.
Since the implementation of the ACA, more employers have shifted towards self-insurance for both cost savings capabilities and overall flexibility. Unlike most traditional group insurance plans, self-funded insurance plans do not have to provide all of the benefits mandated by the ACA, nor are they subject to its health insurer fees or minimum loss ratio requirements. As a result, self-funded insurance has become a more attractive option for a growing number of employers. This rise in demand has resulted in a major ACA-related shift in the commercial health insurance market, affecting the largest and historically profitable market segment: employer-sponsored groups. The commercial group market had been shrinking for a number of years owing to a higher unemployment rate after the financial crisis, resulting in less membership. However, group membership has not seen any meaningful increase even though the unemployment rate has steadily declined, owing to companies’ transition from hiring at-will employees to contracting employees who do not qualify as full time and therefore do not receive the benefits that full time employees do. With the advent of the ACA, more employers shifted to self-insurance and purchased stop-loss coverage.

The transition has adversely affected the top-line revenue and profitability of the commercial group market, leading to rising demand for stop-loss solutions. Employers with capacity began to assume more risk—as well as the likelihood of claims that could result in financial hardships for their firms. The frequency and severity of these claims could go far beyond the norm of the general insured population and is very difficult to predict and absorb—another reason a growing number of employers began using stop-loss insurance to supplement their self-insurance efforts, to mitigate these risks. In addition, the removal of the lifetime max by the ACA significantly increased the potential for catastrophic losses.

This shift has led to steady stop-loss premium growth for several years, with net premiums earned (NPE) more than doubling from $9.2 billion in 2013, to $18.6 billion in 2018 (Exhibit 2). The revenue growth in the stop-loss segment also reflects higher rates due to additional risk related to unlimited maximum exposure. Although scale plays a role, stop-loss growth continues to grow at a rate that greatly exceeds that of the traditional group health market. Further, companies that wrote at least $10 million in stop-loss premium in 2018 saw the line grow 102%, while reporting a decline of almost 11% in group commercial NPE since 2013.

The Finer Points – Group Size

The types of employers that continue to self-fund and purchase stop-loss are an important factor in the product’s overall risk profile as well as each company’s book of business. According to the Medical Expenditure Panel Survey, the rate of self-insurance among
employers with more than 500 employees declined from 80.4% in 2015 to 78.7% in 2018. Rates also dropped for firms with 100-499 employees during the period, from 30.1% to 29.0%. Rates also decreased for firms with fewer than 100 employees, from 14.2% to 13.2%. Although AM Best has not observed widespread moves by smaller employers resorting back to becoming fully insured, we believe the declines in the number of smaller employers that self-insure is partially attributable to the advent of level funding products. These are ASO (administrative services only) products with integrated stop loss coverage offered by insurance companies, brokers, and third-party administrators.

Historically, the self-insurance segment has traditionally been used by larger employers—those with more than 1,000 employees. Smaller companies with fewer employees tend to be more volatile, as one or a handful of employees may have severe claims, resulting in much more volatile experience owing to swings and spikes in health care costs. Some states have thus discussed or enacted legislation that could dampen the growth of self- and stop-loss insurance somewhat but improve the risk profile. Some of these discussions relate to potential restrictions on the lowest attachment point available through stop-loss insurance, indicating a need for a lower attachment point for more volatile small groups. Several states now require minimum attachment points as an alternative, just to distinguish between fully and self-insured plans with stop-loss coverage. Other states have or are enacting legislation that restricts employers with fewer than 100 employees from self-insuring.

However, smaller employers continue to move towards self-insurance plans, partly as the result of the reduction of age bands that must obtain a community rating through the ACA. In an effort to ensure that younger and healthier employer groups subsidize older and less healthy ones, the number of age bands was cut from either five or seven to three. Employers with younger and healthier employee populations can opt out by self-insuring, thereby taking advantage of favorable demographics. However, doing so adversely affects the demographics of the former community rating pool and makes it more expensive to insure. Although some states have concerns that inadequate regulation of stop-loss could exacerbate adverse selection, they must be balanced by the reality that rising health care costs will cause some small employers to exit the ACA small group market entirely.

The size of the employer group can heavily influence an insurer’s success. Small insurers are often reluctant to write stop-loss business for small employers, owing to their more volatile claim patterns. As a result, some smaller companies are focusing on more medium-sized to large employer accounts, which forces them to compete with other insurers with more scale or expertise, or exit the stop-loss market. Small employers tend to prefer a better overall customer service experience, which tends to be an advantage of smaller insurers.

Although underwriting has become stricter and the product has become more expensive after product repricing (owing to higher than initially anticipated claims and costs), many smaller insurers remain in the stop-loss segment by more extensive use of reinsurance (than larger companies) to mitigate loss volatility by stop-loss carriers. Reinsurers are also looking for additional areas for growth, and greater use of reinsurance can provide further diversification as the stop-loss market continues to expand and develop. Other companies with a lack of know-how in stop-loss products have made investments into actuarial and underwriting expertise and are taking a cautious approach to stop-loss marketing and sales, with careful evaluation of potential client risk profiles.

AM Best believes the market as a whole should be stable over the next few years, with persistently tight pricing and stable margins, albeit lower than before 2010.
Favorable Medical Loss Ratios

Medical loss ratios have been consistently lower for stop-loss than for group commercial coverage but have been creeping up owing to some initial mispricing and a few years of higher or more frequent shock claims (Exhibit 3). However, the segment’s highest reported loss ratio of 78.7 in 2018 is still below the loss ratio of the commercial group in its best performing year, when it hovered in the low to mid-80s.

Along with growth prospects and fewer reserving requirements, the relatively low and stable stop-loss product medical loss ratio has been one of the reasons that carriers have turned their focus to this product, despite the marginal uptick. The primary driver of the increase in the loss ratios has been the increase in frequency of large claims. According to Sun Life Financial’s 2019 stop loss research report, the number of claims over $1 million has been rising. Most of these claims are in the range of $1 million-$1.5 million and $1.5-$2 million, but there have also been a steady number of claims in the $2.5 million-$3 million and $3.0 million-plus ranges—these $1 million-plus claims accounted for 21% of all stop-loss claims in 2018. Age mix also plays a role, as older people tend to have higher first-dollar claims, while younger people and children have higher aggregate claims.

One of the changes instituted by the ACA was the elimination of both the annual and lifetime maximums on medical treatment and the cap on an individual’s out-of-pocket costs. Initially, medical carriers estimated that such a change might not lead to a spike in costs since many policies already had limits up to several million, and there was no clear indication that new ACA rules would bring in more high-dollar claims. However, as new and more expensive treatment protocols developed and the provider community embraced the concept of financially unlimited medical policies, stop-loss carriers saw a substantial, broad-based rise in high-cost claims. The current structure of medical coverage doesn’t provide any incentive for an individual to limit the cost of treatment once it exceeds the out-of-pocket maximum. To help mitigate the rise in loss ratios, stop-loss writers implemented rate increases and more stringent underwriting guidelines, and started relying more on reinsurance.
In addition, data suggests that the medical loss ratio variances depend on the group size. When stop-loss issuers are broken into groups based on the number of lives covered per policy (LCPP) over a five-year period, results are much more volatile. One would think that, given the larger pool of risk for companies with a higher number of LCPP, the stop-loss insurer’s loss ratios and volatility of losses would have declined, but our data indicate otherwise. One NAIC white paper notes that, as “employers get smaller, self-funded health plans … tend to become more standardized.” More policy customization could be causing greater fluctuations in the loss ratio results of firms with higher LCPP, owing to shock claims from additional risks assumed as part of the stop-loss contract with larger employers. However, insurers with the highest LCPP also have the most favorable average loss ratio, indicating that risk is generally being appropriately distributed among this sample group (Exhibit 4). By comparison, for smaller firms with more standardized contracts, the frequency of low-cost claims may be
Market Segment Report

Stop Loss

Exhibit 6
Top Blue Cross Blue Shield Stop-Loss Writers

<table>
<thead>
<tr>
<th>Company Name</th>
<th>NPE ($ billions)</th>
<th>2018 BCBS Share (%)</th>
<th>Growth (%)</th>
<th>Since 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2016</td>
<td>2017</td>
<td>2018</td>
<td>YoY</td>
</tr>
<tr>
<td>Health Care Service Corp. Mut Legal Reserve</td>
<td>614.3</td>
<td>636.2</td>
<td>806.0</td>
<td>23.1</td>
</tr>
<tr>
<td>Blue Cross Blue Shield of MI Mut Ins. Co.</td>
<td>311.7</td>
<td>326.1</td>
<td>345.5</td>
<td>9.9</td>
</tr>
<tr>
<td>Anthem Insurance Companies Inc.</td>
<td>265.6</td>
<td>278.2</td>
<td>307.2</td>
<td>8.8</td>
</tr>
<tr>
<td>Community Insurance Co.</td>
<td>194.7</td>
<td>193.2</td>
<td>213.4</td>
<td>6.1</td>
</tr>
<tr>
<td>Wellmark Inc.</td>
<td>163.0</td>
<td>179.4</td>
<td>200.8</td>
<td>5.8</td>
</tr>
<tr>
<td>BCBSM, Inc.</td>
<td>175.4</td>
<td>183.2</td>
<td>185.9</td>
<td>5.3</td>
</tr>
<tr>
<td>Anthem Health Plans of Virginia, Inc.</td>
<td>150.4</td>
<td>144.6</td>
<td>151.8</td>
<td>4.4</td>
</tr>
<tr>
<td>Blue Cross and Blue Shield of MA</td>
<td>102.9</td>
<td>116.0</td>
<td>140.2</td>
<td>4.0</td>
</tr>
<tr>
<td>Blue Cross &amp; Blue Shield of NC</td>
<td>88.6</td>
<td>99.4</td>
<td>122.6</td>
<td>3.5</td>
</tr>
<tr>
<td>Blue Cross Blue Shield of North Dakota</td>
<td>120.9</td>
<td>117.6</td>
<td>117.4</td>
<td>3.4</td>
</tr>
<tr>
<td>Top 10 BCBS</td>
<td>2,066.7</td>
<td>2,156.3</td>
<td>2,473.3</td>
<td>74.3</td>
</tr>
<tr>
<td>Total BCBS</td>
<td>2,955.7</td>
<td>3,068.0</td>
<td>3,487.1</td>
<td>13.7</td>
</tr>
</tbody>
</table>

Source: AM Best data and research

consistently higher than what the insurer might have expected, but tail risk from shock claims is more limited, likely owing to greater use of reinsurance.

Market Concentration and Provider Challenges

Several notable acquisitions have affected the stop-loss industry, but M&A has slowed over the last two years and many of the top writers of stop-loss continue to dominate the industry. In 2018, the top ten writers of stop-loss insurance accounted for 74% of the NPE across the industry, a percentage that has been fairly constant over the last three years. Cigna remains the dominant market share holder—at almost 18%, it’s the only company with a double-digit market share and just over double the number two market share holder (Exhibit 5). Eight of the top 10 writers reported NPE growth in 2018, the two exceptions being Voya Financial and Highmark. CVS Health Corporation (formerly Aetna) posted the largest increase in stop-loss business in 2018, nearly doubling its NPE to more than $1.6 billion.

In all, the Blue Cross Blue Shield plans still hold the largest market share, at almost 19%, although this is down from 22.6% in 2014, even as its premium rose by more than 33%. BCBS’s market share is heavily driven by Health Care Service Corp., which commands nearly a quarter of BCBS premium (Exhibit 6) and remains in the top ten stop loss providers by market share. Roughly 80% of the BCBS companies that write stop-loss reported year-over-year premium growth in 2018, while average growth since 2014 has been over 33%, and nearly 40% for the top 10. BCBS carriers are mindful of the higher level of risk exposure of the stop-loss product, especially its potential volatility for the small group segment. Therefore, although these companies have ample capital to support the added risk, many have increased their reinsurance protection to adjust for stop-loss product volatility.

Furthermore, since BCBS companies have a large amount of historical data on millions of claims, the group has an in-depth level of claims information that may be beneficial in the overall underwriting process, especially as some of these companies have been writing stop-loss for many years.

Although stop-loss itself is not a form of health insurance, health insurers may be more likely to enter the stop-loss market as a means of recouping some of the revenue lost to self-funded plans owing to the impact of the ACA. Health insurers are usually in a better position...
to manage medical costs and maintain more favorable contracts with providers. These factors can be a competitive advantage and contribute to better profitability.

Given that most of the M&A in the industry occurred a few years ago and has slowed since, and some smaller writers have opted to exit the market, the number of stop-loss writers is lower than it was a few years ago (Exhibit 7). Although the stop-loss market is dominated by ten writers, AM Best believes there is potential for more small and medium-sized insurers to enter the market or gain share, owing to higher demand from small or medium-sized employer groups. Further, the product’s short-term nature means minimal reserve requirements, leaving fewer barriers to entry.

With premiums rising steadily over the last few years and earnings varying somewhat, the performance of the top stop-loss writers has been relatively consistent. However, accurate pricing and stable underwriting results will remain a priority, especially if new entrants focus on smaller employers. Additionally, companies with their own administrative platforms have gained traction because of lower expenses.

Although in aggregate the stop-loss segment has performed favorably, roughly one quarter of the rating units writing stop-loss have incurred an underwriting loss each of the last three years, further emphasizing the market’s competitiveness and the importance of more stringent underwriting. Nevertheless, despite the decline in overall underwriting gains from 2015 to 2017, there was improvement in 2018. As insurers view opportunities in the small and medium-sized employer market, underwriting will need to be closely monitored to preserve surplus base. The top providers of stop-loss are unlikely to lose their market-leading positions anytime soon, but small and medium-sized employer group providers are likely to continue to make inroads.
Market Segment Report

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MARKET SEGMENT REPORT

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