MILLIMAN WHITE PAPER

Observations on the employer stop-loss market

2019 survey

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Introduction

In March 2019, Milliman sent survey participation requests to approximately 30 employer stop-loss carriers. Of those carriers receiving a request, 25 provided survey responses. The subset of carriers responding included:

- Third-party or direct carriers (15)
- Administrative services only (ASO)/health plans offering stop-loss products (9)
- Carriers that offer coverage through managing general underwriter (MGU) channels (1)
- Several of the 10 largest carriers by 2017 premium[1] (7)
- Some of the carriers ranked 11th to 20th largest by 2017 premium (6)
- Carriers for whom stop-loss is a core business, defined as 15% or more of total premium (9) and those for whom it is not (15), with one carrier that did not respond to this question.

The survey asked questions about various topics, including:

- Portfolio characteristics, such as employer size and types of coverage purchased
- Underwriting measures, such as persistency and discretionary limits
- Pricing measures, such as a carrier's average discretionary discount and target loss ratios
- Historical results, both loss ratio and growth
- Product terms offered

This survey is an update to Milliman's initial survey, published in June 2017.

Background

Stop-loss coverage is purchased by self-insured employers looking for coverage from catastrophic medical and pharmacy claims. Based on the most recent data available from S&P Global Intelligence, we believe the stop-loss market stands at approximately $20 billion in premium.

[1] From "MyHealthGuide News for the Self-Funded Community" (April 1, 2019).

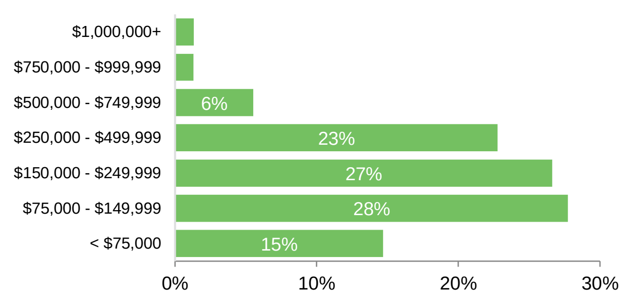
Employers generally purchase stop-loss coverage from one of two sources. If the employer uses a health plan as its third-party administrator (TPA), the employer may be able to purchase stop loss directly from the health plan acting as TPA. If the employer doesn't purchase coverage from its administrator, it can purchase coverage from a direct stop loss carrier. We believe the market is split nearly evenly, with health plans representing slightly more than half of reported stop-loss premium.

Portfolio characteristics

DISTRIBUTION OF PREMIUM BY STOP-LOSS DEDUCTIBLE

Employers can purchase specific (or individual) stop-loss policies with deductibles as low as $25,000 (even lower in some states) to as high as $1,000,000 (occasionally even higher). Figure 1 shows the share of premium attributable to various ranges of specific stop-loss deductibles.

FIGURE 1: DISTRIBUTION OF PREMIUM BY DEDUCTIBLE

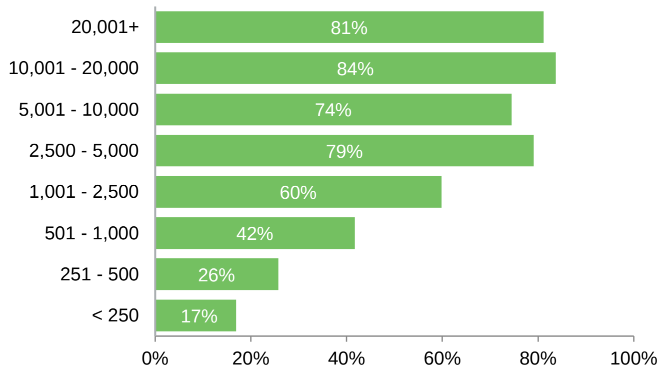


From this graph we see that, while premium is relatively evenly spread across deductibles ranging from $75,000 to $500,000, a significant number of policies are sold with deductibles below $75,000, and some with deductibles as high as $1 million.

PREVALANCE OF SPECIFIC-ONLY COVERAGE

While many self-funded employers purchase policies that include both specific stop-loss and aggregate stop-loss (coverage for high total medical spend), some will purchase policies that include specific stop-loss only. Figure 2 shows the share of total policies purchased that include only specific coverage, summarized by employer size, where employer size is measured by count of covered employees.

FIGURE 2: PREVALANCE OF SPECIFIC-ONLY COVERAGE BY EMPLOYER SIZE

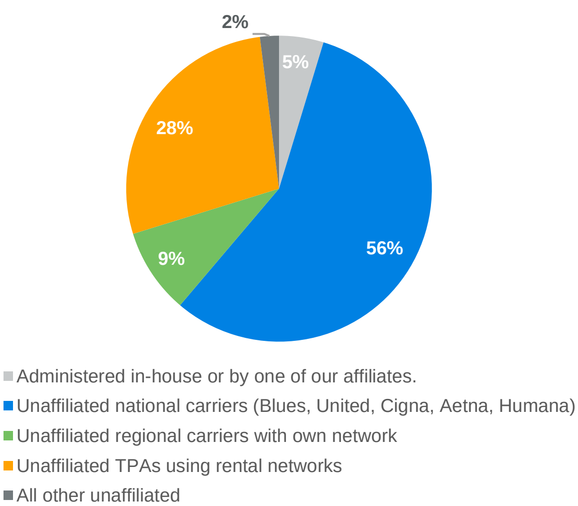


From this graph, we see that a majority of employers with 1,000 or more employees choose to purchase specific stop-loss coverage without aggregate protection. The prevalence of this practice begins to drop significantly as the employee count falls below 2,500.

CLAIMS ADMINISTRATORS

Employers that purchase coverage from third-party carriers could have their underlying medical claims processed and paid by several different types of administrators. Figure 3 shows the overall breakdown of the third-party carriers that responded by administrator type. Note that we did not include ASO/health plan respondents in this graph as, by definition, virtually all of their business would be administered in-house or by an affiliate. From this graph we see that nearly two-thirds of employers purchasing stop-loss coverage from third-party carriers purchase administration services from health plans, while TPAs not affiliated with health plans represent just over one-quarter of the market for administrative services.

FIGURE 3: ADMINISTRATOR TYPE

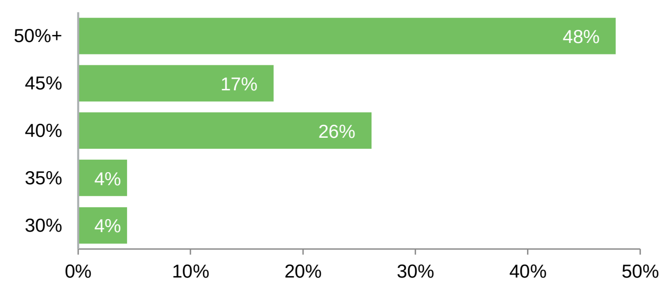


Recent product innovations

RATE INCREASE GUARANTEES

Over the last several years, some stop-loss carriers have begun offering maximum rate increase guarantees with their stop-loss policies. Figure 4 shows the distribution of each respondent's most commonly offered maximum rate increase.

FIGURE 4: MOST COMMON RATE GUARANTEE



From this graph, we see that the most common renewal rate guarantee offered is 50% or higher, and that the most common guarantee for almost all carriers is at least 40%.

REFERENCE-BASED PRICING

Recently, some stop-loss carriers have begun offering specific stop-loss policies where stop-loss reimbursement is based on a fixed percentage of Medicare's fee schedule. This approach is often referred to as "reference-based pricing" (RBP).

- We learned that 60% of all respondents currently offer RBP policies.
- Of those respondents that have an RBP offering, RBP policies represent a small share of total premium. Over 90% of responses indicated that RBP was 10% or less of total premium.

> While a majority of stop-loss carriers offer policies with a reference-based pricing approach, they represent a small share of these carriers' total premium.

COVERAGE OF CAPTIVES

The use of captives in medical stop-loss coverage has increased in the last few years. Some stop-loss carriers will provide high-dollar coverage to these captives. For example, an employer might purchase a specific stop-loss policy with a $100,000 deductible from its own captive. The captive might then purchase a policy from a stop-loss carrier to cover all claimants with more than $500,000 in claims.

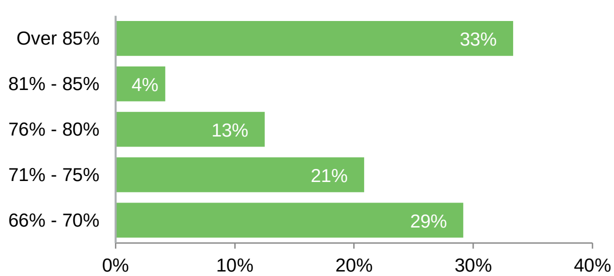
- We found that approximately one-third of our respondents currently offer coverage to captives.
- For all those that offer coverage to captives, total premium for captive coverage is less than 10% of total stop-loss premium.

Underwriting results

PERSISTENCY RATIO

Generally, the stop-loss industry defines "persistency" as the percentage of premium in year *x* that was successfully renewed in year *x+1*. Figure 5 summarizes each respondent's persistency during 2018. From this graph, we see that there appears to be a split in the market, with most carriers experiencing persistency rates of either between 65% and 75% or of 85% and above.

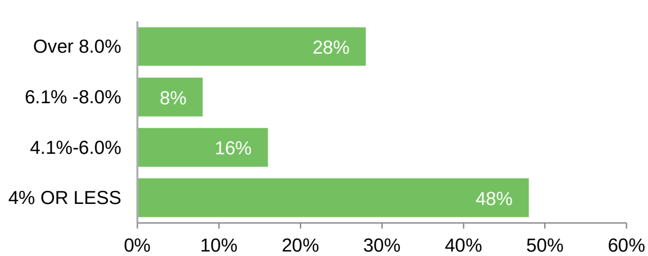
FIGURE 5: PERSISTENCY RATIO



CLOSE RATIO

"Close ratio" is defined as the percentage of stop-loss rate quotes on prospective business that turn into issued policies. Figure 6 summarizes each respondent's close ratio during 2018.

FIGURE 6: CLOSE RATIO

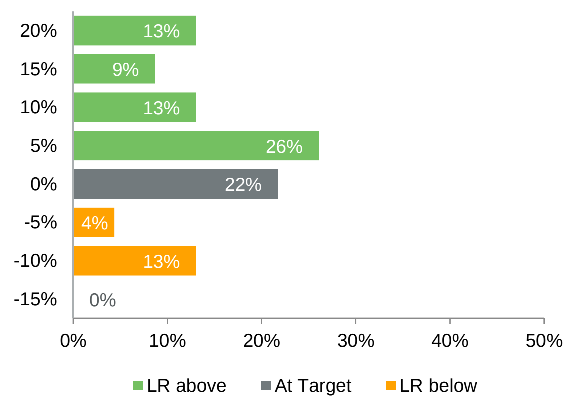


From this graph, we see that a near-majority of carriers experience close ratios of 4% or less, although some reported close ratios above 8%.

PROFITABILITY

The survey asked each respondent for its target, or desired, loss ratio for specific stop-loss coverage and the actual loss ratios for 2018 policies. Figure 7 summarizes the difference between target and actual loss ratios. In this graph, positive numbers indicate an actual loss ratio above target. Negative numbers indicate a loss ratio below the target.

FIGURE 7: ACTUAL VS TARGET LOSS RATIO



This graph shows that a majority of carriers experienced loss ratios in 2018 that were higher than target. However, it is also true that slightly more than half of carriers reported loss ratios that were within approximately 5% of target loss ratios.

It should be noted that, because both the target loss ratio and the actual loss ratio were reported as ranges, the differences reported above are only an approximation. For example, a carrier whose target and actual loss ratios were reported to be in the same range (e.g., 75%-80%) could have experienced a loss ratio that was as much as 5% higher or lower than its target.

> In 2018, a majority of survey respondents experienced loss ratios that exceeded target loss ratios.

Assumptions and methodology

This white paper is intended to summarize the findings from Milliman's 2019 stop-loss survey. This information may not be appropriate, and should not be used, for other purposes.

In preparing our white paper we relied upon data collected from survey participants and estimated certain statistics, such as persistency, carrier premium, and loss ratios, based on the ranges submitted by participants. Survey data was collected, without audit, though we did review for reasonability. Results will vary based on actual carrier performance.

To limit confidentiality concerns, numeric responses generally required ranges rather than precise values. As a result, certain market-wide values cited in this report are estimated rather than calculated.

Survey inquiries

The carriers who participated in this survey will receive a detailed report including responses to all survey questions. Many of the questions will be summarized separately for third-party and health plan carriers and, in some cases, by carriers for whom stop-loss is (or is not) a "core" business. For more information or to participate in the next update to Milliman's Stop-Loss Survey please contact Rob Bachler at 206 504 5946 or rob.bachler@milliman.com.

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