National Association of Insurance Commissioners
The Center for Insurance Policy and Research

MEMORANDUM

TO: ERISA Working Group

FROM: Christina Goe, Chair ERISA Working Group

DATE: August 8, 2012

SUBJECT: For discussion at the Summer National Meeting: Responses to comments received on the 7-2-12 draft guideline amendments to the Stop Loss Insurance Model Act (#92)

The ERISA Working Group posted draft guideline amendments to the Stop Loss Insurance Model Act (#92) for public comment on July 9, 2012. Comments were submitted by various interested parties raising a number of questions and concerns. The intent of this memo is to respond to and resolve many of the questions and concerns raised in the comment letters so that future discussions of the draft guideline amendments can be as productive as possible for regulators and interested parties both.

1. Why are the revisions being proposed as guideline amendments?

In 2007, the NAIC membership changed the NAIC process for model law development. The new process required that a proposed model law or amendments to an existing model law must meet model law criteria by 2/3 vote: 1) the subject of the model law necessitates a uniform national standard; and 2) NAIC members are committed to devoting significant resources to promote the adoption of the model in their state. If a proposed model meets those 2 criteria, a 2/3 majority vote of the NAIC Membership is required for adoption. In recognition of the fact that there may be items of importance that do not meet the model law criteria, the membership saw fit to retain a process for the adoption of new "guidelines" or "guideline amendments" to existing models. Guidelines continue to use the process that existed at the time this stop loss model was created—adoption by a majority of the NAIC membership. Updating the Stop Loss Insurance Model Act is an example of a proposal that does not meet the model law criteria, because there is no current commitment to adopting it in a uniform manner in the states, but it addresses an issue of recognized importance.

Other NAIC Model laws under the jurisdiction of the Health Insurance and Managed Care (B) Committee that have guideline amendments include: Uniform Health Carrier External review Model Act (Model #76); Prepaid Limited Health Services Organization Model Act (Model #68); and Third Party Administrator Model Act (Model #90). There are many other guideline amendments to existing model laws involving other lines of insurance as well.

2. Why is the NAIC updating a model so few states have adopted?

Although only a small number of states have adopted the Stop Loss Insurance Model Act in substantially similar form as legislation, the attachment points are used by many states in other ways, such as in bulletins or in form reviews of stop loss policy forms. Other states are considering legislation or regulatory measures to address issues in their stop loss market, and seek consistency with NAIC standards. This is why the NAIC has established a guideline process.

3. **What is the timing for public comment?**

The NAIC is committed to an open and transparent process for all adopted materials, from models, to guidelines to white papers. However, the NAIC does not require a set amount of days to pass before anything, including a model, is adopted. Rather, the NAIC focuses on ensuring that all interested parties have an opportunity to be heard before adopting any work product. This is true for guidelines as well as model laws. The charge to revise the Stop Loss Model Act attachment points resides with the ERISA (B) Working Group. The ERISA Working Group enlisted the assistance of the Health Actuarial Task Force, which created a Subgroup to commission the report from Milliman to provide the information the ERISA Working Group sought. From a process perspective, the ERISA Working Group is the appropriate place to raise concerns and questions about the proposed revisions to the Stop Loss Insurance Model Act and it looks forward to continuing dialogue.

4. **Is the intent of the revisions to make stop loss insurance out of reach for small employers?**

No. The NAIC, in 2005, voted to retain the Stop Loss Insurance Model Act in the official list of NAIC *Model Laws, Regulations and Guidelines* because it continued to serve a useful purpose. Section 1. Purpose and Intent of the Stop Loss Insurance Model Act states "[t]he purpose of this Act is to establish criteria for the issuance of stop loss insurance policies. Nothing in this act shall be construed as imposing any requirement or duty on any person other than an insurer or as treating any stop-loss policy as a direct policy of health insurance." This continues to be the purpose of the model act. The working group does not intend to establish unreasonably high attachment point levels or to prohibit employers with under 51 employees from self-funding.

It is important to recognize that there are inherent differences between small-group and large-group risk that have given rise to significant differences between regulatory frameworks for those markets. These differences make it inherently riskier for small employers to self-insure, and are not caused by insurance regulation.

The attachment points in the Stop Loss Insurance Model Act have not been revised since the model was adopted in 1994. The charge before the ERISA Working Group is to revise the attachment points so that they are in keeping with medical inflation and changes in the typical underlying health plan design. This issue has been around since before 1995 and continues to exist today, even if the ACA had not been enacted. The Working Group believes that, as a threshold matter, it is reasonable to update dollar amounts that are over 17 years old.

5. **What search criteria were given to Milliman and why?**

The Self-Insurance Subgroup had a narrowly defined task: to update the attachment points in the current Stop Loss Insurance Model Act (#92). The two criteria given to Milliman—1) to examine attachment points at which the ceding company's and reinsurer's expected claims amounts would be equal; and 2) to examine attachment points where the standard deviation of the ceding company's expected claims would be equal to that of the reinsurer's—were used to be consistent with the original Cooper's & Lybrand's study. Given that the Subgroup's charge did not include rewriting the underlying Model Act, the Subgroup was of the general opinion that the most compelling item in the Milliman Report was Table 7, which is contained in the section labeled "Comparison to Previous Study."

6. **Does the report broaden the scope of the proposed guideline to include employers with up to 100 employees, rather than the NAIC definition of a small employer (50 employees or less)?**

No. The proposed Guideline does not change the provisions of the Model Act that establish different standards for "groups of fifty (50) or fewer" employees and "groups of fifty-one (51) or more" employees. Although the ACA will require the group size threshold to 100 no later than 2016, that issue is not being addressed in the current proposal. The Milliman study, like the Coopers & Lybrand study, used 100 covered lives to model a group with 50 employees and 50 dependents.

7. Did the Self-Insurance Subgroup consider alternatives to updating the attachment points or consider the alternative measures of risk provided in the Milliman Report?

The Self-Insurance Subgroup's task was limited to suggesting updated numbers based on the information in the Milliman Report. While Milliman did provide additional measures, they were not asked to do so. However, having been provided, the Subgroup did give them their due consideration. The Subgroup concluded that because it was not charged with addressing issues with the underlying Model Act, such alternative measures were simply outside the scope of their work.

8. Has the ERISA Working Group done an analysis of the impact of the updated attachment points on employers?

As the organization of the chief regulators of state departments of insurance, we do not have access to employer data or information.

9. Does self-insuring small employers really result in adverse risk selection or "cherry-picking" because self-funded health plans cannot exclude employees on the basis of health status?

The ERISA working group understands that self-funded employers are subject to federal law regarding nondiscrimination on the basis of health status. However, stop loss insurers are not subject to those laws. Most employers, especially smaller ones, cannot self-fund their risk without purchasing stop loss insurance, which covers a share, and in some cases most, of the health claims for that group.

Stop loss insurance policies are not subject to nondiscrimination laws regarding rating, underwriting or guaranteed renewability. They are free to reject less healthy employer groups. Stop loss insurance policies will not be subject to the new laws regarding unreasonable rate increases, community rating with restricted age bands or minimum loss ratios. The less healthy groups will face the following dilemmas: stop loss insurers may either refuse to insure their risk, raise the rates to unacceptable levels or refuse to renew a group if the claims are too high. Those groups will then end up in the fully-insured, community-rated risk pool or they will drop coverage and their employees will go to the individual market exchange.

If this trend continues over time, the community-rated risk pools may end up absorbing most of the higher risk employees and their dependents and the healthier groups will migrate to the self-funded risk pools where the rates may be lower—at least until the health risk of that group deteriorates. The health claims in a very small group can be extremely volatile because of the inability to spread the risk among more employees. If the health insurers are unable to attract healthier risks because their rates cannot compete with rates from stop loss insurers who are not subject to the same regulations, risk distribution in the community rated risk pools will be unfavorably skewed.

10. How do you answer the assertion that small employers need more affordable options and self-funding provides that?

The proposal for the guidelines does not prohibit small employers from self-funding. It merely raises the stop loss attachment points from the levels that were set in 1995 to the 2012 equivalent for those levels. Any employer who fully understands the legal burden of acting as a health plan fiduciary and has the financial ability to afford the risk associated with funding healthcare for their employees should be allowed to accept that challenge.

The ACA included mechanisms intended to make premiums more affordable: minimum loss ratio, adjusted community rating, restrictions on unreasonable rate increases, additional rate review for exchange products, and risk adjustment and risk corridors. It remains the subject of considerable debate as to whether these mechanisms will achieve the intended savings. However, if health insurers are adversely selected against to an unreasonable degree at the outset of those reforms, the opportunity to see if these mechanisms can successfully control the inflation of health insurance premiums will be lost.

11. Does the Milliman study support regulatory action?

The NAIC is proposing to raise the minimum threshold of attachment points in the existing model law so that employers will cede the same amount risk as they did under the 1995 model act. The Milliman study provides information sufficient to accomplish that goal. (See answer to question 15.)

12. While developing their interpretation of the Milliman report, did the Self-Insurance Subgroup consider the 50/50 rule?

In the course of interpreting the Milliman report, the Subgroup did consider the 50/50 rule. The Subgroup came to the general conclusion that the 50/50 rule was arbitrary and has no actuarial or mathematical basis.

It is important to note that this rule was also taken into consideration during the 1994 analysis and a similar conclusion was reached (i.e., the final conclusions of the 1994 study were not based on the 50/50 rule). A percentile approach would be more appropriate (e.g., comparing the probability that the value of a specific claim exceeds a particular value).

13. The Subgroup appears to have ignored the comparisons to Sample 2 of the original study; is this appropriate?

Sample 1 of the original study was comprised of claims generated from more basic benefit packages (i.e., it is representative of a "lean plan"); Sample 2 was comprised of claims generated from more rich benefit packages. Therefore, the Subgroup did consider Sample 2; however, given that small groups tend to have leaner benefits, it is more appropriate to consider comparisons made between Sample 1 from the original study and the bronze (or even silver) plan in the Milliman study, as opposed to any comparisons based on Sample 2.

14. Table 1A of the Milliman report indicates that the probability of a claim exceeding 20,000 is only 3.34 % whereas this probability was only 2.43% in the 1994 study. Does this mean that 20,000 is still the appropriate value for the specific attachment point?

No. As stated on page 4 of the Milliman report, according to the 1994 study, the probability of a claim exceeding 20,000 was 0.85% for the lean plan. Today, the corresponding value would be 60,000 (or slightly higher) as the probability of a claim exceeding 60,000 is approximately 0.98% for the silver plan. As noted above, it is appropriate to compare the lean plan from 1994 to what would be considered bronze or silver today. The 2.43% referenced in the question is based on a comparison using the rich plan; which for reasons mentioned above, is not the appropriate basis for comparison (i.e., the original parameters were established based on the 0.85% corresponding to Sample 1; not the 2.43% corresponding to Sample 2). Therefore, the 3.34% has no relevance whatsoever with regard to this point.

15. Table 1 of the Milliman report seems to indicate that there should be no difference between small and large groups with regard to the amounts being transferred; is this correct?

The numbers look very similar because when the number of individuals becomes sufficiently large, the experience of the pool of such individuals will begin to converge (i.e., the Law of Large Numbers will begin to apply). However, it is important to keep in mind that the common element between small and large groups is that all of the members had to be actively at work in order to qualify for benefits. Therefore, it does not matter if we are talking about 500 groups of 25 individuals or 25 groups of 500 individuals; all other things being equal, their pooled results should look fairly similar. The bottom line is that comparisons made between small and large groups in Table 1 provide little or no value. This is because the main difference between the claim experience of small and large groups is volatility, and because the numbers used to derive the values in Table 1 were sufficiently large, the higher volatility of small groups was masked.

16. Stop-loss coverage is intended to kick-in when losses reach catastrophic levels. Given that volatility is important, doesn't it make sense for small groups to have lower attachment points because higher volatility will result in small groups having a greater number of catastrophic losses?

While on the surface, this may appear to be the case, the reality is that large groups have a certain amount of stability due to their size which means that catastrophic losses are truly catastrophic. One or two claims may appear to be catastrophic for a small group simply because they do not have the law of large numbers on their side. However, when the attachment point becomes too low, stop-loss coverage begins to resemble direct insurance. Therefore, a balance needs to be struck. The original parameters in the Model Act which are based on the 1994 Coopers and Lybrand study struck this balance with a specific attachment point of 20,000. As pointed out on page 12 of the Milliman report, the probability of a claim being greater than 20,000 in 1994 was approximately 0.85%; whereas today that same probably would translate to a specific attachment point that is somewhere between 50,000 and 75,000.

It is important to highlight the fact that this is a comparison between a lean plan from the 1994 study and a bronze plan in the Milliman report; which as noted above, is the appropriate comparison. The bottom line is that moving from 20,000 to 60,000 today results in a specific attachment point that is consistent with what was established in the original Model Act nearly twenty years ago.