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Extended Soft Market Continues To Challenge Medical Stop-Loss Writers

The medical stop-loss market, estimated at more than \$5 billion in premiums written, historically has undergone swings in premium revenue and earnings.

Today's soft stop-loss market is entering its sixth year, and most carriers remain challenged to generate appreciable organic revenue growth. When analyzing recent stop-loss data, A.M. Best notes that the carriers that grew premium revenue considerably during this time were larger and acquired blocks of business. Stop-loss writers that did not make acquisitions generally experienced only modest increases or modest decreases in premium revenue. From an earnings perspective, carriers generally demonstrated little or no growth in stop-loss net operating earnings.

A.M. Best believes that competition from the fully insured risk market, although reduced, is the primary reason for the continuing soft market. During the mid-2000s, national managed care insurers aggressively marketed fully insured medical benefit plans with attractive discounts, which induced many employers to fully insure their employee medical benefits. A number of these insurers, however, have experienced increased loss ratios in recent years, which has facilitated the implementation of higher premiums. These rate hikes may increase employer demand for less-expensive self-insured plans. The demand for stop-loss insurance, in turn, may increase as the majority of employers who self-insure also purchase some form of stop-loss coverage. Stop-loss premium rates and earnings could subsequently increase, thereby hardening the market.

The impact of the weak economy on employers also may accelerate the historical trend of employers switching to self-insured medical plans, and accordingly, seeking stop-loss coverage during economic downturns. Although the majority of growth in self-insured medical plans historically has been from small employers, in recent years mid-size and large employers have increasingly transitioned to self-insured plans due to ongoing medical inflation and increasing fully insured major medical premium rates. Any growth in stop-loss coverage for new self-insured

employers could be offset, to some extent, by declining payrolls.

The contraction in the carriers writing stop-loss coverage also may contribute to higher future premium rates, thereby hardening the market. Some smaller insurers that aggressively priced during the mid-2000s have curtailed their marketing activity or have exited the market due to high loss ratios. Since scale tends to drive more favorable operating results in the stop-loss market, larger writers including HCC Insurance Holdings Inc., Sun Life Financial, Munich Re Group, Humana Inc., and National Benefit Resources (a subsidiary of UnitedHealth Group), over the years have acquired blocks of stop-loss business from smaller carriers. Additionally, carriers such as HCC and Independence Holding Co. have acquired managing general underwriters that specialize in writing stop-loss. Due to disappointing operating results, reinsurers, now writing a minority of stop-loss business, have been less active in supporting new or aggressive players than they were in the mid-2000s. The limited role of reinsurers in this market also stems from the fact that large, better-capitalized carriers are less likely to reinsure their stop-loss business.

Current pricing dynamics suggest a competitive stop-loss market with generally modest growth in new premium revenue. Certain carriers, including some that aggressively offered low premiums in the mid-2000s, have more recently implemented moderate-to-high rate increases on employers with unfavorable specific stop-loss coverage experience. Most employers, however, have simply increased their deductibles in exchange for a lower rate increase rather than switch their coverage to a lower-priced carrier. Those employers with favorable specific stop-loss experience have generally received minor rate increases, or in some instances, no increases and, therefore, generally have not been induced to switch carriers to obtain a slightly lower rate. Additionally, relatively stable aggregate stop-loss premium rates in recent years have contributed to employers' overall reluctance to switch carriers.

Leading Medical Stop-Loss Insurance Carriers

(Based on data compiled by A.M. Best Co., listed alphabetically)

HCC Insurance Holdings Inc.

Highmark Blue Cross Blue Shield

ING Group

Sun Life Financial

Symetra Financial



A.M. Best is monitoring the medical stop-loss market to assess the impact of national health care reform, as this market has not been exempt from the proposed health care reform legislation. A tax on stop-loss premium income could be an easy adjustment for carriers as there is enough lead time to price for it. More troublesome for stop-loss writers is the lifting of annual and/or lifetime maximum benefits. A.M. Best still is trying to determine the full impact of health care reform on stop-loss writers.

A.M. Best also will be tracking any new entrants to the market as well as the future ownership of ING Group's stop-loss business given ING's recent announcement about divesting its U.S. insurance operations over the next few years. A.M. Best continues to hear rumblings of potential new entrants to this market. Nevertheless, there has not been a major play for market share made by a new entrant in quite some time.

Today, most stop-loss insurers continue to emphasize maintaining profitability via selective underwriting,

disciplined pricing and increases to specific stop-loss premium rates and deductibles. HCC, Sun Life, and Symetra Financial remain the three largest carriers in this market. For most carriers, A.M. Best anticipates a continuation of generally flat premium revenue and earnings through 2010. The stop-loss market could harden in the near future, however, if competition from the fully insured medical market decreases with a corresponding increase in demand for self-insured plans and stop-loss insurance; more mid-size to large employers elect to self-insure due to the economic recession and the contraction continues among stop-loss writers. Ratings are expected to remain relatively stable in the short term, as it will take some years to ascertain the extent to which health care reform affects this product line.

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