FUNDAMENTALS OF SELF-FUNDING

STOP LOSS COVERAGE:

Regardless of the type of underlying benefit plan, most self-funded employers choose to purchase some form of insurance to limit their overall liability to adverse claims frequency and severity. Only the largest self-funded employers with stable and predictable loss profiles can operate a plan without the use of such "stop loss" insurance to protect them from the effect of a large loss or an adverse increase in claim frequency.

This "stop loss" coverage is essentially an insurance policy with a large deductible. The policy may be purchased by the trust, in a trusteed program, or by the employer in a non-trusted plan, such as a "general asset" plan. According to the terms of the insurance contract, it will pay for all claims presented over an annual maximum limit (the "annual aggregate").

AGGREGATE LIMIT:

The term "aggregate limit" refers to the threshold at which covered claims become payable from the assets of the stop loss carrier for the remainder of the policy year. Aggregate stop loss coverage protects the employer from an unexpectedly high number of small claims. For example, the insurance company may agree to indemnify the employer for all covered claims exceeding $1 million incurred and paid during the policy year, up to the limits of coverage under the policy for that year. Under those circumstances, the "aggregate limit" for the policy would be $1 million.

In setting the aggregate limit for stop loss coverage, plan sponsors or fiduciaries select amounts representing the risks they are able and willing to assume. This aggregate limit is established at or near the start of the stop loss policy year. The plan sponsors or plan fiduciaries must decide how much to spend on the stop loss coverage and which levels of coverage to buy. Because stop loss coverage usually must be paid in advance the payment of stop loss coverage premiums may have an adverse effect on the cash flow of the employer. Cash flow consequences are one of several factors an employer must consider in determining how much and what level of stop loss, if any, are a prudent use of plan assets and a reasonable expense of administering the plan. Additionally, although the cost of various stop loss options may vary significantly depending on the stop loss carrier's experience with the plan, the range of options available to a plan may vary with experience but may remain relatively restricted by factors such as the employer contribution as well as the number of employees covered by the plan.

AGGREATE STOP LOSS COVERAGE:

Under aggregate stop loss coverage, no payments are made until the sum of all claims paid within the plan year exceeds a predetermined limit known as the aggregate attachment point. The stop loss carrier sets this loss limit after a careful evaluation.

The attachment point is usually set at 125% of the expected claims, but both lower and higher attachment points are possible.

Based upon paid claims, the attachment point will be recalculated each year, and it may increase or decrease. Each year the employer is guaranteed that the cost of the claims portion of the program will not exceed a predetermined amount. However, if the program exceeds the stop loss, the attachment point will probably rise if the stop loss carrier chooses to renew the coverage.

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