**How to Determine Which**

**Insurance Structure Is Right For You**

**Introduction: (5 minutes)**

* Welcome to WC Mastery training
  + Insurance Structure is fundamental platform to maximize ROI of injury management best practices
* Introduce 3 Major Points
  + Spectrum of Risk Financing
  + Choosing the Right Option for You (or your client)
  + Practical Steps to Get Started

**Main Point #1: Spectrum of Risk Financing – (25-30 minutes)**

* 4 Cornerstones of Insurance Structures:
  + Risk Tolerance
    - Degree of variability willing to withstand
  + Risk Predictability
    - Law of large numbers
    - Taking on risk by removing risk
    - Acceptable predictability can be accomplished through different structures and programs
  + WC Management Best Practices
    - How well employer preventing & managing injuries
    - Poor WC Management can’t be saved by insurance structure
    - Need to commit to preventing & managing losses
  + Financial Impact
    - Increasing retentions/deductibles allow for greater financial reward (getting access to carrier profits) but increase potential cost (if losses are greater than expected)
* Economics of Transferring Risk
  + A screenshot of a cell phone

    Description automatically generated
  + A screenshot of a social media post

    Description automatically generated
  + Frequency on horizonal access; Severity on Vertical access
    - Per claim on severity side, aggragate on frequency
  + Transfer of Risk
    - Where are your losses predictable? Capping losses at various retentions can help with that assessment.
      * Single claim cap, never had a big loss, going to take a $500k deductible; want profit margin on all losses on everything over $100k; single $500k claim is going to swing volatility. Can use historical experience to figure out based on retention what layer is predictiable; what is tolerable from a volitiltiy standpoint based on capping mechanism.
    - If your losses are not predictable on a stand alone basis, can you aggregate your losses with other companies with similar attributes to get critical mass to create predictable losses?
* Spectrum of Risk Financing
  + Definition of Insurance is ‘transfer of risk’
    - Risk / Reward / Control
  + Need to be Familiar with Various Options When Making Decision
    - Don’t be a one-trick pony
  + Guaranteed Cost
    - Dividend
  + Retrospective Rating
  + Deductible
    - Small
    - Intermediate
    - Large
  + Captives
    - Group
    - Rent-a-Captive
    - Single Parent
  + Self-Insured
* RIMS Benchmark Survey
  + Guaranteed Cost
    - 82% of companies < $100m in revenue
    - 18% choosing some deductible up to $250,000
    - 23% of total companies
  + $100,000 - $500,000 Deductible
    - 37% of total companies
    - Bell curve of deductible amount
      * $1,000 - $5m+

**Guaranteed Cost**

* Most common insurance structure in smaller companies
* Fixed Premium charged Prospective (before policy period)
  + Not changed by loss experience during period
  + Experience Mod
  + Risk Profile for carrier credits
* Easy to budget insurance costs
* Should be used as Benchmark for small to medium size companies
* Premium Includes:
  + Expected Losses
  + Buffer for Expected Losses
  + Expenses
  + Insurance Company Profit
* Dividend Program
  + Based on performance can receive return dividend (10%-20%)
  + Ask premium with and without a dividend
* Payroll x Rate x Exp Mod x Adjustments = Premium
  + Exp. $500,000 premium

**Retrospective Rating**

* Retrospective Rating
  + Starts similar to guaranteed cost with premium payment except:
    - Final premium retrospectively determined based on losses
    - No premium size discount
  + Minimum & Maximum Premium
  + Incurred vs Paid
    - Paid – better cash flow, collateral requirements
* Exp. $500,000
  + Standard Premium: $550,000
  + Basic Premium Factor (minimum): .40
    - Includes expenses & ins co profit
  + Maximum Premium Factor: 1.25
  + Loss Conversion Factor (ins comp buffer): 1.10
  + Tax Multiplier: 1.05

Maximum: $687,500

Standard: $550,000

Minimum: $231,000 (basic x tax multiplier)

6 Months Post Policy Reconciliation

Paid & Reserved Losses = $150,000

[Basic Premium ($220k) + Converted Losses ($165k)] x Tax Multiplier (1.05) = Premium ($404,250)

Returned Premium = $550,000 - $404,250 = $145,750

**Deductibles:**

* First dollar responsibility per claim shifts to Employer up to deductible amount (carrier pays first dollar & employer reimburses)
  + Per claim: $1k, $5k, $25k, $50k, $100k, $250k, $500k, $1m, $5m, $10m
  + Aggregate (optional) – 125 to 500% of actuarial expected losses within the deductible
    - Exp. $250,000 per claim, $1.5m aggregate
  + Carrier evaluates based on Underwriting & Credit Risk
    - Need for Collateral
* Payment Structure:
  + Premium + Claim Costs + Expenses + Surcharges = Total Cost
  + Premium:
    - 60% or 70% discount off standard
    - Lots of flexibility and carrier discretion
    - Could Use Single Rate
  + Expenses become Unbundled:
    - Unallocated & Allocated
    - Unallocated = carrier / TPA fixed expenses
      * Overhead, Phones, lights, rent, salaries, etc.
      * Per claim fee example:
        + $300 / medical only
        + $1,500 / lost time
    - Allocated = costs per individual claim
      * NCM
      * Surveillance
      * Peer Review
      * Bill Review
      * Medicare Set-Aside
      * Attorneys Etc.
* Much potential for employer control & broker service, often underutilized by both parties
  + Premium ($150,000) + Claim Cost ($100,000) + Expenses ($50,000) + Surcharges ($10,000) = $310,000

**Captives**

* Separate legal entity created as an insurance company. Owned and operated by members for the benefit of the members.
  + Company asset on balance sheet to manage risk.
  + Full control over decision making and management of company.
  + Participate in underwriting and investment profit
    - Startup Costs
    - Capital Requirements
* Example:
  + Acme company paying premiums to Travelers for High Deductible plan VS
  + Acme company paying premiums to Acme Captive Ins. Company.
    - Purchase guaranteed cost policy
    - Act as re-insurer for claims under the per-claim and aggregate limit.
* Different Captive Designs
  + - Group
    - Rent-a-Captive
    - Single Parent

**Self-Insurance**

* Self-Insure up to Retention level, purchase excess policy
* Must file and receive approval from state insurance department
  + Regulatory burden
* Claims handled through TPA or Self-Administered
* Lowest cost structure & possibility for lowest-risk

**Main Point #2: Choosing the Right Option for You (or your client) (30-35 mins)**

* Decision Tree to determine of needs assessment and how going to make a decision;
* Once understand options, what are guideposts of decision making
  + Don’t be a one-trick pony
* Measuring Risk Tolerance:
  + Assess options & cost of transferring risk
    - What is cost of transferring everything?
    - What is cost and opportunity of retaining?
    - What are best- and worst-case scenarios?
    - How confident are you in projections?
    - **Can you mitigate the cost of worst-case by sharing risk/reward with others?**
    - Have you made RM improvements not accounted for by Underwriters?
    - Do you want access to profit margin and ability to control expenses?
* Considerations:
  + Risk tolerance
  + Financial stability
  + Projected Cash Flow
  + Income Statement
  + Balance Sheet
  + Tax Implications
  + **Access to Investment Income**
  + **Does the structure/carrier/group give you access to claims, loss control or best practice resources?**
  + Amount and Type of Losses
    - Placing risk in wrong structure too early can have disastrous effects
    - Good outcomes lower costs, bad outcomes increase costs
  + **Attached needs directly to the insurance structures**
    - Bundled / unbundled conversation; claims, how much control?
    - Financing retained losses with cash or Letter of Credit?
    - Tolerance relative to guaranteed cost in knowing your total cost of risk;
    - How strongly do you feel about sharing risk with others?
    - Flexibility in Structure
      * What are your goals?
      * As move up retained risk have a lot of flexity in terms of how to handle and plan expenses, structures, and how fund structures; captives give you a lot of flexibity in those areas.
* Use of an Actuary
  + Credibility of loss projections
  + Experience Mod Worksheet – Weighting Value
* Engage in Conversation & Educate
  + Share pros and cons of each option
  + Run what if scenarios
  + Opportunity to improve WC management in Loss Sensitive plans

**Guiderails Based on Standard Premium**

* $0 - $300,000: Guaranteed Cost/Small Deductible
* Association Group Program/Self-Insured Group – pay guaranteed cost. Risk/reward based on only group’s performance
* $100k - $1.5m - Retro
* $200k - $1.5k – Group Captive
* $750k+ – Rent-a-Captive Captive
* $750k+ - Large deductible
* $2m+ - Single Parent Captive
* $500k+ - Self Insurance (subject to state rules of minimums)

**Guaranteed Cost**

* Most common insurance structure in smaller companies
* Fallback consideration and baseline for decision making

**Retrospective Rating**

* Most common structure which is ***incorrectly*** chosen
  + Lower initial cost, better cash flow seen as attractive
  + Poor WC Management leads to surprise costs
    - *exp*. Washington Mutual Option ARMs in housing boom
* Readily available options in marketplace
* Consideration:
  + Ensure stakeholders familiar with elements of plan (no surprises)
  + **Some flexible and customizable** 
    - Upper middle market may be more flexibe to be in large deductibe. Vs retro
  + Incurred vs Paid
    - Collateral requirements
    - Cash Flow
  + **Lack of control over claim handling and potentially how it is priced**
  + Understand all elements of retro contract
* **Review Guaranteed Cost Pricing**
  + What loss amount would be lower/higher than GC
  + Decide based on odds to beat this number

**Deductibles:**

* Considerations:
  + **Unbundled Claims Handling Expenses – Allocated vs Unallocated**
    - Options for insurance carrier and TPA to be separate entities
    - Better control of fee arrangement for Allocated Expenses
  + Deductible & Premium Options
    - Choose specific retention based on predictable losses, the cost to transfer risk, and risk tolerance
    - Choose Aggregate limit or Not
    - Leverage Independent Actuary
  + Collateral requirements can be significant and build each year
    - **Understanding multi-year collateral obligations can be tricky**
    - Leverage Independent Actuary
  + Financial stability of employer
    - Cash flow
    - Collateral requirements
    - Income Statement / Balance Sheet
  + Financial stability of carrier
    - Are collateral requirements too low?
  + WC Management systems and management commitment
  + Partnership with claims handler
  + Regulatory burden on insurance carrier
  + Lots of flexibility in plan design

**Captives**

* Employer will own and operate an insurance company
  + Additional time requirement and resources for decision making
  + Regulatory requirements
* **Broader Coverage/Flexibility to add coverage**
  + Availability of coverage in commercial insurance market
  + Price of coverage in commercial insurance market
* Increased Control
* Collateral requirements
  + Capital requirements
* Financial Stability
  + Proforma Cash Flow/Profits
  + Tax impact
* Domicile
* **If Group: how are members determined, does size of group create leverage on cost, how is risk shared**
* Engage Actuary - Captive Feasibility Study
  + Control
    - Risk management control
  + Cost
    - Short term
    - Long-term
    - Tax implications
  + Capacity
    - How captive builds retention capacity

**Main Point #3: Practical Steps to Get Started (5-7 mins)**

* The decision for the right insurance structure is not made alone!
  + Not a short process not about markets, its about needs;
* Further Educate Yourself:
  + Talk with more experienced brokers & advisors
  + Ask questions to confirm or add perspective to what’s been discussed
* When making decision bring in stakeholders to discuss options:
  + Employer
  + Broker
  + Risk Advisor
  + Accountant
  + Attorney
  + Actuary