<u>How to Determine Which Insurance Structure Is Right For You</u>

<u>Introduction: (5 minutes – 2:05 pm)</u>

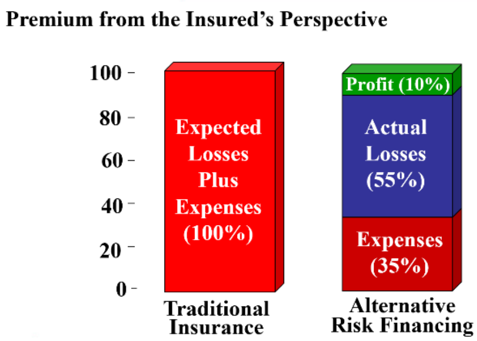
- Welcome to WC Mastery training
    - Insurance Structure is fundamental platform to maximize ROI of injury management best practices
- Introduce 3 Major Points
    - Spectrum of Risk Financing
    - Choosing the Right Option for You (or your client)
    - Practical Steps to Get Started

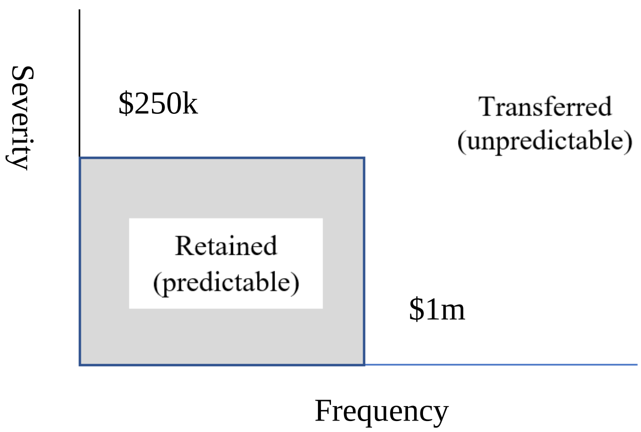
<u>Main Point #1: Spectrum of Risk Financing – (25-30 minutes)</u>

- 4 Cornerstones of Insurance Structures:
    - Risk Tolerance
        - Degree of variability willing to withstand
        - Comparison to Guaranteed Cost
        - Risk/Reward
    - Risk Predictability
        - Law of large numbers
            - Small number of claims vs large
        - 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

- 



- 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.
  - 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 / Penalty / Control**
    - Need to be Familiar with Various Options When Making Decision
        - Don’t be a one-trick pony
    - Guaranteed Cost
        - Dividend
    - Retrospective Rating
    - Captives
        - Group
        - Rent-a-Captive
        - Single Parent
    - Deductible
        - Small
        - Intermediate
        - Large
    - 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
            - **Opportunity: Insurance brokers in market (18%)**
    - $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: $500,000
  - 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: $625,000

Standard: $500,000

Minimum: $210,000 (basic x tax multiplier)

6 Months Post Policy Reconciliation

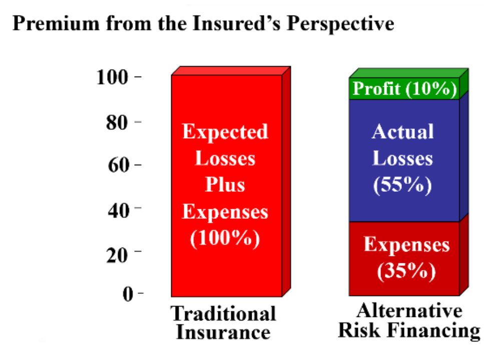
Paid & Reserved Losses = $150,000

[Basic Premium ($210k) + Converted Losses ($165k)] x Tax Multiplier (1.05) = Premium ($393,750)

Returned Premium = $500,000 - $393,750 = $106,250

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



Acme Company

GC

Travelers

(carrier)

Acme Insurance Company

HD Policy

Profit & Losses

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

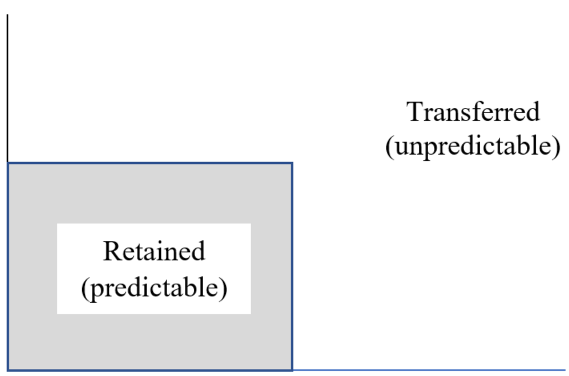
        - Medicare Set-Aside
        - Attorneys Etc.
- Much potential for employer control & broker service, often underutilized by both parties
    - Premium ($150,000) + Claim Cost ($100,000) + Expenses ($50,000) + Surcharges ($10,000) = $310,000

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
- Biggest difference between High Deductible is Financial Back-Stop

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 – BE A PROFESSIONAL
    - **EVERY STURCTURE BEYOND GUARANTEED COST CAN RETAIN AND TRANSFER RISK**



  - **FIGURE OUT NEEDS OF ORGANIZATION FIRST**
- Measuring Risk Tolerance:
  - Assess options & cost of transferring risk
    - Use Guaranteed Cost as a Benchmark
    - How much risk over guaranteed cost are you willing to take for a reward?
    - Increase risk predictability with tools
      - Loss projections
      - Actuarial forecasting
      - Combine with others
    - Can you mitigate the cost of worst-case by sharing risk/reward with others?
    - Have you made RM improvements?
    - Do you want access to profit margin and ability to control expenses?
- Considerations:
  - 1) Investment Income
    - Insurance company or Employer?
    - Who holds the cash to invest?
  - 2) Collateral
    - Future payments of losses
    - Secure ability to pay losses in future (mortgage)
    - Captive vs Deductible vs Self-Insurance
  - 3) Tax Implications
    - GC Premiums deducted all in one year vs over time
    - Difference between structures
  - 4) Mitigate Losses
    - Loss Control
    - Who handling claims
      - Bundled vs unbundled claim costs
        - Bundled – same company (Travelers)
        - Unbundled – use 3rd party service providers

Guiderails Based on Standard Premium

- $0 - $300,000: Guaranteed Cost/Small Deductible
- $100k - $1.5m - Retro
- $200k - $1.5k – Captive
- $750k+ - Large deductible
- $750k+ - Self Insurance (subject to state rules of minimums)

<u>Main Point #3: Practical Steps to Get Started (5-7 mins)</u>

- 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