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Self-insurance

10 compelling reasons to remain fully insured

Excerpted and condensed from AASCIF News, published by the American Association of State Compensation Insurance Funds

There is always a place in the market for well-managed self-insured groups of businesses that share a keen interest in loss prevention and risk management.

However, employers must be educated to make informed decisions. Fully insured plans are a better choice for most businesses than self-insured trusts.

1. Guaranteed asset protection

Guaranteed asset protection is the single most important reason businesses purchase insurance. A key component is choosing the proper workers' compensation insurance. Fully insured plans include coverage for employers' liability and legal defense costs.

Bottom line: The assets of a business are tied to the success of the self-insured trust.

2. Reinsurance

A trust is likely to purchase two types of reinsurance: Specific stop loss limits the liability on an individual occurrence. Aggregate stop loss limits the liability on the total of all claims for a specified period of time.

Buyers need to determine whether the limits of the insurance will cover all losses and future loss development above the initial contribution. Often prospects are told that reinsurance provides coverage when the group has a 100 percent loss ratio; consequently, there will never be the need for future contributions. Stop loss insurance will not relieve the group from having to pay the fixed expenses of the trust that may run 30 to 40 percent. Reinsurance only applies to claims.

Insolvency of a reinsurer can mean future liability to trust members. Ratings by A.M. Best and Standard & Poor's are measures of ability to meet their financial obligations.

3. Joint and several liability

Every member of the trust is liable for the claims and expenses of the group by virtue of joint and several liability. This may not become an issue until losses begin to fully develop.

If contributions are not enough to cover loss development and expenses, funds must be raised by increasing future cost or imposing an additional contribution on all who participated for the year in question.

4. Premium versus contributions

Trusts do not charge premium; insurance carriers do. Trusts require contributions from all members to cover the cost of reinsurance, current claims and future claims development, as well as the fixed administrative expenses of the trust.

Fully insured plans cap liability at premium. In alternative plans, the final cost is never known until all expenses of the trust are paid and all claims are closed and retired; assessments are issued to cover any additional payments.

5. Future loss development

Self-insured trusts may tout savings over fully insured plans. However, many have only been doing business for three or four years. The claims that trust participants have generated may not be fully developed, and they will demand additional contributions if fully developed losses are higher than anticipated.

6. Controlling your destiny

An astute businessperson actively manages the business and has the ability to control losses. As the trust grows, selection for trust membership becomes more difficult to control, and critical decisions for controlling losses will be out of the hands of the businessperson.

Safety group participants also share the experience of other businesses in the group; however, in a safety group, liability is capped by the premium paid.

7. Ability to shop a changing market

Market conditions change continually. Committing to an alternative plan will preclude a business's ability to shop the open market. Most trusts have multi-year commitments and penalties for premature withdrawal.

In some states, once a business becomes self-insured, no experience modification is promulgated by the rating organization. What happens if the business sustains a major loss? How may this affect your membership in the trust? Even more critical, the business may sustain no losses yet other participants may be incurring significant losses.

8. Liability of trust agreement

Who will decide who may join? If a member is unfortunate and incurs high losses, will it be removed from the group? If a member is asked to leave the trust, who will meet the obligations of loss development on the claims left behind?

The trust agreement details how contributions from each member will be determined and how decisions regarding who may join the trust will be made. Make sure the businessperson takes a close look at this document.

9. Carrier as partner in risk

Make sure your fund is marketing proactive claims management, elimination of fraud, and targeted loss control. These services are recognized as the most important in driving down the cost of workers' compensation.

However, consider that third-party administrators charge according to the number of lost-time and minor medical claims processed. The more claims filed, the more money they make. In fully insured plans, the insurance carrier has a stake in reducing losses and managing claims proactively.

Insurance carriers share risk; trust managers and service providers hired by the trust don't share in the risk.

10. Administrative expenses

In most instances, the administrative costs of the trust are considerably higher than those of a fully insured carrier. Trust expenses including the cost of reinsurance may average 30 to 40 percent. That means only 60 cents of every dollar of the member's contribution is left to pay claims and any projected dividend. It is impossible to predict the future cost or availability of stop loss insurance, a key component of trust expenses.

The ultimate expenses of the trust will include fully developed losses, administrative expenses, the cost of reinsurance and assessments. If they have not collected enough in contributions or have returned too high a dividend, they simply will bill the participants in the plan to make up the shortfall.

Risk versus reward

In the beginning, most trusts are established with a group of similar-size risks with similar loss ratios. As a trust grows, new participants come on board. Make sure the businessperson asks the key questions:

- Who will be admitted as the trust grows?
- How much am I likely to save in the first year?
- How long am I committed to the plan?
- Is there a penalty for withdrawal?
- Who is providing reinsurance?
- Will reinsurance continue to be available and affordable?
- Do I really want to assume liability for someone else's losses?
- Does the potential gain outweigh the risk?
- Ultimately the decision has to be made: Do I really want to risk the assets of my business, or is it prudent to remain insured?

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SFM Companies
3500 American Blvd. West, Suite 700
Bloomington, Minnesota 55431-4434