

Let's Talk Comp

**An Increase in PEOs Utilizing Large Deductible Plans
for Workers' Compensation Has Become More Evident
as a Risk Financing Mechanism.**

Here Are Some Parameters You Will Need to Know.

BY ROBERT G. BARROW, JR.

The popularity of large deductible plans for workers' compensation has blossomed dramatically in the past ten years. The past four years has shown a significant increase in the number of PEO's utilizing this risk financing mechanism. It has proved itself in an insurance marketplace that was not quite as soft as it is at present. It also works extremely well if the PEO has a strong loss control program and claims administration program. Let's look at the large deductible and it's parameters.

Presently, there are forty states that allow some form of large deductible plan. Of these, twenty three states have no restrictions as far as the minimum premium or the minimum deductible. Seventeen states have some form of restriction, whether it be in the form of a premium or deductible level regulation. Large deductible programs, filed with the states by insurers, tend to vary less from state-to-state than the small deductible plans. However, because they are developed by each individual carrier, the structure of the plans tend to vary considerably from carrier to carrier. The carrier issues the standard workers' compensation policy, to which is attached an endorsement, which stipulates the terms of the deductible. The carrier retains the responsibilities of all its regular duties to administer the policy such as filings and reinsurance over the retention amount. One of the more interesting features of the plan is that the carrier is responsible for payment of all claims, even if the insured fails to reimburse the carrier for the losses within the deductible layer.

Essentially, the carrier will charge the policyholder a premium, which is a fraction of manual premium, by applying a deductible credit. For example, the range of a deductible credit on a deductible of \$250,000 can range from 85% to 65% of manual premium, thus the policyholders' basic insurance charge would be 15% to 35% of

manual premium. After negotiating this, it comes down to satisfying the usual necessary collateral, to secure the unfunded claims. Typically, the carrier will request an amount of at least the anticipated claims, called a "loss pick." This can be funded with paid-in-monthly cash or a letter of credit; the possibility of a required deposit also exists.

Now let's take a look at the progression of how the large deductible plan has integrated with the PEO industry over the years: When the insurance marketplace was still fairly hard, the PEO could still get its price on workers compensation. With the ever softening of the market and traditional carriers doing "market share underwriting" it's become increasingly difficult to compete on the workers' compensation pricing structure; the reduction of workers' compensation up-front pricing is now cutting into the dollars that should be reserved for claims, thereby escalating the problem. There are several mergers and acquisitions taking place today because PEO's that have been on large deductible programs have not underwritten their books of business, implemented day to day loss control procedures or pursued an active claims administration program. These PEO's can now no longer afford their monthly claims reimbursement funds; nor are they competitive on their workers' compensation programs, because they have given away claims-funding in order to competitively price their business. It is inevitable, when large deductible plans are stacked year-upon-year, that the time must come "to pay the piper."

Although this plan is not for the faint of heart, when planned and implemented prudently it contains the seeds for inordinate success. Loss control, claims administration and the ability to walk away from a bad risk are the basics for success.

Let's look at the advantages and disadvantages of the large deductible program:

Advantages to the Policyholder

- 3n May self insure without having to obtain regulatory approval, especially when crossing state lines.
- 3n The properties of a self insurance program without the start up costs.
- 3n Significant cash flow.
- 3n Reasonably easy entry and exit with regard to getting into and out of the program.
- 3n The ability, in some states, to improve experience modification.
- 3n The ability to maintain the full services of a carrier.
- 3n The opportunity to become a significant profit center.

Disadvantages to the Policyholder

- 5n Risk of large losses, especially in the beginning of the policy, could adversely affect cash flow.
- 5n Financial collateral is a requirement.
- 5n Implementation of a strong loss control program.
- 5n Must stay on top of all claims.
- 5n Necessity to actively underwrite all prospects and clients.
- 5n The unpredictability in the timing of the reimbursements to the carrier for the deductible.
- 5n After a couple of years, the open claims begin to stack on top of each other requiring more and more collateral.
- 5n Risk of serious financial consequence, if there is no aggregate limit, to the maximum amount of claims.

Advantages to Carrier

- 3n Competitive tool to gain market share.
- 3n Policyholder has strong motivation to implement loss control.
- 3n Policyholder has motivation to control claims.
- 3n Policyholder has strong motivation to write quality business.
- 3n Most of the risk has been transferred to the policyholder.

Disadvantages to Carrier

- 5n Underwriting the credit worthiness of the policyholder is paramount.
- 5n Loss of the use of funds for investment income while waiting for reimbursement from the policyholder.
- 5n If policyholder doesn't manage the program optimally, resulting in the inability to pay, and defaults, the carrier would have to drop down to first dollar coverage, I.E., paying the first claim, without the benefit of the deductible being in place; and later attempting to collect from the policyholder.

The large deductible can work remarkably well if all parties pay particular attention to the details of loss control, claims management and subscriber underwriting. If not, the PEO will find itself in a very unfavorable cash flow position with their workers' compensation carrier. This, coupled with the ever softening workers' compensation market with traditional insurers, could be the reason why we're seeing a return to the more traditional fully-funded plans or guaranteed-cost programs.

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