WHEN SHOULD YOU EXPLORE WORKERS' COMPENSATION OPTIONS?

BY ROBERT G. BARROW, JR., CIC, DWCA, CBWA

In the early days, insurance companies that provided workers' compensation programs to the PEO industry had only two options for risk financing: assigned risk/state funds and large-deductible plans (only one carrier wrote this option).

Although it was a bleak time for the marketplace during the late 1980s and early 1990s, there were still a couple dozen early PEOs in existence. As the marketplace learned and understood, albeit slowly, the true nature of PEOs and how they functioned, new insurance carriers became attracted to the industry. A couple of carriers entered the field in 1994, and by 1996 there were at least six carriers fiercely competing for PEO market share. Perhaps a few of those early carriers competed too well—they are no longer in existence.

The insurance industry has adapted to innovate and create. In response to the advent of the PEO industry, the increase in workers' compensation product was rapid. By 2000, guaranteed-cost programs, small- and large-deductible plans, retrospective rated plans, and captives (both group and protected cell) were available.

TIME TO CHANGE?

How do you know when it's time to explore a plan other than a guaranteed-cost plan, which is what almost all PEOs start with? The main criterion is risk appetite. Risk appetite is the amount and type of risk an organization is prepared to pursue, retain, or take. To put it into practice within a PEO, you must link risk appetite to business decisions and then collect the proper data to measure it.

There are four items to study in establishing the company's risk appetite:

- **Risk capacity.** How much risk can the PEO absorb?
- **Risk profile.** What are the leading risks and the PEO's controls to mitigate them?
- **Quantitative analysis.** What types of analyses create the boundaries in which the PEO can operate? and
- **Qualitative risk assessment.** Are you able to rank and categorize the company's risk by measuring the controls that are in place and the risk versus reward that is present?

Once these evaluations have been made, you will be in a better position to understand which workers' compensation plan might work best for your PEO.

Figure 1 presents an analysis of the seven most popular workers' compensation plans

UNUSUAL WORKERS' COMPENSATION CASES

One of a PEOs' most important services to its client companies is risk management and worksite safety. Here are a few unusual workers' comp claims, listed on the Ortwerth Law website, that might challenge any employer's ability to predict:

- A 90-year-old man broke his hip on a vending machine while trying to shake loose a bag of chips for a co-worker;
- A fast-food employee accidentally drank from a cup of lye in the break room;
- Bending and twisting to catch a bag of fries before it hit the floor, a fast-food manager injured her neck;
- Taking a break from construction work in an air-conditioned truck, an employee was tricked out of his spot by a co-worker who told him he needed to speak to someone across the worksite; when he realized the joke, he ran back, jumped over a trench, and broke his leg upon landing; and
- A department store decorator tripped over her dog in her own garage when retrieving fabric samples, breaking her wrist.

for the PEO industry. It addresses various aspects of risk appetite. It will help you determine what might best work for your PEO to take either a conservative or an aggressive approach to your risk financing.

Matrix Characteristics

- **Usual premium range.** This describes the range of premium typically found in various workers' compensation financing options.
- **Loss sensitivity.** This provides a point of reference regarding the impact losses will have and the speed with which the losses affect the total cost of the workers' compensation program. For example, a guaranteed-cost program responds quite slowly to losses, via the experience modification factor, whereas a large-deductible plan responds as claims are incurred.
- **Upside risk.** This reflects the maximum total cost compared to standard premium.
- **Need to forecast loss.** The necessity to actuarially project losses and develop a loss pick varies by plan, with it becoming more important with a higher degree of self-funding and loss sensitivity.
- **Internal administration.** This addresses the amount of time and attention needed by you and your staff to properly administer the plan.
- **Required security.** The amount of security or collateral varies with the loss-sensitivity of a plan. It is to protect the upside potential of loss. The collateral could be in the form of cash, letter of credit, or in some cases, a bond.
- **Cash flow.** This is a measure of cash going out. A guaranteed-cost plan is paid completely within the first year. A loss-sensitive plan usually incurs fixed-cost payments and claims as they are incurred, thus stretching out cash payments.
- **Early tax deductions.** Taxes are treated differently across the spectrum of risk financing plans. For example, a guaranteed-cost program has an immediate tax deduction treatment of paid-in premium, whereas a self-insurance plan allows deductibility for paid losses, fixed costs, and excess insurance.
- **Accounting treatment as insurance.** This category illustrates how a specific plan affects your financial statements and earnings. For example, the total costs of a guaranteed-cost plan are expensed the first year. A large-deductible plan may have open claims for several years that are in reserves but not yet paid. It would be expensed over future years until all claims are paid and closed.
- **Documentation.** This shows the degree of paperwork required of you and the carrier. It includes claims administration, financial information, and state filings. ■

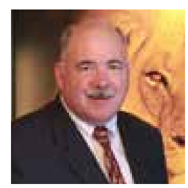

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FIGURE 1. AN ANALYSIS OF THE SEVEN MOST POPULAR WORKERS' COMPENSATION PLANS FOR THE PEO INDUSTRY.

Characteristics	Guaranteed-Cost	Small-Deductible	Retrospective Rating Plan	Group Captive	Protected Cell Captive	Large-Deductible	Self-Insurance
Usual Premium Range	0 to 1 million	50,000 to 1.5 million	500,000+	500,000+	500,000+	750,000+	3 million +
Loss Sensitivity	Low	Low to Medium	High	Medium	High	High	High
Upside Risk	Low	Medium	Low to High	Medium	Medium to High	High	High
Need to Forecast Loss	Low	Medium	Medium	Medium to High	High	High	High
Internal Administration	Low	Low to Medium	Low to Medium	Medium	Medium to High	Medium to High	High
Required Security (Collateral)	Low (Deposit Premium)	Low to Medium	Low to Medium	High	High	High	High
Cash Flow	Low	Low to Medium	Low	Medium	Medium to High	High	High
Early Tax Deduction	Yes	Yes	Limited	Yes	Limited	Low to High	Limited
Accounting Treatment as Insurance	Yes	Yes	Limited	Yes	Yes	Limited	Limited
Documentation	Low	Low	Medium	Medium	High	High	High