

Understanding Self-Insurance

What is Self-Insurance?

When a company self-insures, it takes responsibility for paying its own claims rather than purchasing workers' compensation coverage from an insurance company.

Companies that self-insure establish a claims fund with dollars they would otherwise pay for insurance premiums.

When you self-insure, you are paying the bills. You have more control over the workers' compensation process. This additional control translates into significant savings.

Ask yourself this question: Who has the ability to exercise the most effective control of your workers' compensation process and the related costs, you or an insurance company?

Obviously, you do.

Employers that purchase guaranteed cost workers' compensation coverage (also known as first dollar programs or primary workers' compensation) have a tendency to abdicate control to the insurance company. The insurance company decides worker pay. They choose how much to pay, how often, and which healthcare professionals to use. Insurance companies are basically "claim factories" with a one size fits all philosophy.

Insurance companies also provide safety or loss prevention programs to their clients. The results are similar; it's a one size fits all approach for these types of programs.

Since insurance companies pass any increased costs back to their customers by raising rates or through the experience modification, they have less incentive to drive costs down than you do.

When you self-insure, you take control of this process.

You tailor the workers' compensation claims and loss prevention process to the unique characteristics of your company. The savings can be huge!

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Who is a Candidate?

Industry Type

Employers from virtually all industries are candidates for self-insurance, including: healthcare, government, education, transportation, retail, financial, and manufacturing all benefit from self-insurance.

Employer Size

Usually, when an employer is paying \$500,000 to \$750,000 annually in workers' compensation premium in a single state, self-insurance becomes a realistic option for them.

Employers that have their premium spread across several states must reach the \$500,000 to \$750,000 threshold in each state for self-insurance to be an option.

Note: If your company is too small to self-insure individually, you may wish to consider group self-insurance.

Employer Characteristics

- Employers who experience better than average losses year after year.
- Employers who have historically experienced worse than average losses, but who are newly committed to controlling their workers' compensation costs.

Guaranteed Cost Workers' Compensation Policy Vs. Self-Insurance

Self-insurance eliminates overhead and profit charges of the insurance company.

In this example, self-insurance saves \$187,500, eliminating the overhead and profit charge of the insurance company. Typically, 10% to 20% savings is achieved by reducing the expense component.

Why Self-Insure?

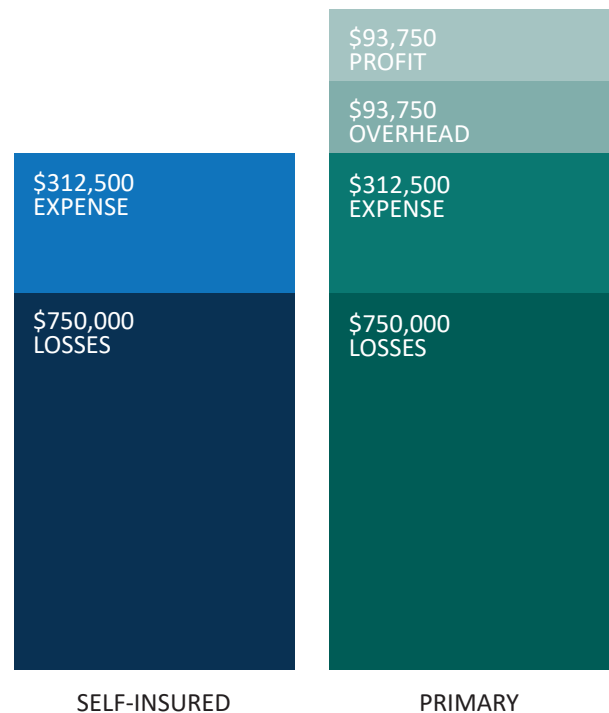
An ever-increasing competitive environment, greater demands on productivity and escalating costs continue to make workers' compensation a high-priority issue for businesses.

Many employers are turning to self-insurance as a cost-effective alternative to rising insurance prices - and as a way to gain greater control of their workers' compensation claims experience.

Companies choose to self-insure to:

1. Lower their overall workers' compensation costs.
2. Improve their cash flow.

Employers find that in addition to these basic financial benefits, they also enjoy improved employee morale and greater productivity as a result of their decision to self-insure.



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The Benefits of Self-Insurance

Savings Generated from Lowering Your Losses

Let's say an employer recognizes their workers' compensation losses can be reduced. They see back injuries in one department cost them \$100,000 per year. They identify a machine costing \$20,000 that will eliminate all the back injuries, so they make the investment.

If this employer has guaranteed cost/primary insurance, the employer's decision to spend \$20,000 increases the insurance company's profit by \$100,000.

If self-insured, the employer's profit increases by \$80,000 recognizing a 4:1 net return on the \$20,000 investment.

Greater Control

Self-insured companies become better risks.

Employers who are self-insured:

- Become more aware of workers' compensation costs and their drivers
- Take control of the claim process by focusing on proactive return to work for injured workers, arranging discounts from medical providers, etc.
- Look to invest more in safety-related programs and activities
- Establish their own thresholds for fraud
- Create a safety culture among employees

Limiting a Self-Insured's Financial Risk

Self-insured employers are prudent risk takers. They do not expose their companies to potential financial ruin. They are self-insured, not uninsured!

They limit the amount of financial risk they have by purchasing **excess insurance**.

Workers' compensation claims for employers large enough to self-insure are relatively predictable. In a self-insured program, the employer retains the predictable components of losses.

Serious and catastrophic injuries that can cost hundreds of thousands of dollars, or even millions, do occur in the workplace. When excess coverage is purchased the insurance carrier covers the cost of unpredictable components of loss.

Excess Coverage

Just because a self-insured company is responsible for paying its own claims doesn't mean it carries all the risk. A self-insured company limits the amount it pays for a single claim, or even a year or more of heavy claims, by purchasing excess workers' compensation insurance.

Excess coverage protects companies from catastrophic losses, in the case of a single large claim, or an unusually large number of claims, during a given time.

There are three types of excess policies:

- Specific excess
- Aggregate excess
- Combination excess (Specific and Aggregate Combined)

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Specific Excess Insurance

Specific excess coverage is designed to protect a company from “unexpected” high-cost claims due to a single, serious or catastrophic accident. Such accidents usually involve serious injury and require intensive medical expense and long-term disability to the injured worker. Specific excess coverage reimburses the employer when a claim or claims resulting from a single occurrence exceeds the self-insured retention (SIR).

The SIR

The SIR is an amount negotiated by the employer and the excess insurance company. (The SIR is also sometimes referred to as the “specific retention.”) It acts as a deductible and is usually stated in increments of \$100,000, e.g. \$400,000, \$500,000, \$600,000, etc.

Specific Example

Assume:

- A company has an SIR of \$400,000
- An employee is involved in a serious accident with substantial medical care requirements
- Payments resulting from the accident total \$750,000
- In this case, the insurance company would reimburse the company \$350,000, or the amount by which the claim exceeds the SIR

\$350,000
Excess
Carriers
(Reimbursement
to Employer)

\$400,000
Self-Insured
Retention
(Employers
Portion of Loss)

SIR SPECIFIC
EXCESS AMOUNT

Specific excess limits apply to each individual accident, so a company never pays more than that specific, capped amount for claims resulting from a single occurrence.

Aggregate Excess Insurance

Aggregate excess coverage places a limit on the amount an employer pays for all claims incurred during a given time. So if a company has a year in which it experiences more than the anticipated level of claims activity, it is protected.

This situation could result from an unusually large number of claims, or from several claims that cost more than the usual. (Aggregate excess insurance is also sometimes called “stop loss.”)

When a policy for aggregate excess coverage is written, it specifies a “loss fund” amount and time period. The loss fund is the maximum amount the employer will pay for all claims during the policy term. If all claims that occur within the specified time period exceed the loss fund, the excess insurance company reimburses the employer the amount in excess of the loss fund.

While the typical aggregate term is one year, some smaller companies find it beneficial to purchase a two- or three-year aggregate term.

How Are Aggregate Loss Funds Set?

The aggregate loss fund is set at a level above the usual fluctuations. Methods of developing aggregate attachment points vary by company. This can involve formulae using Development and Trend factors, changes in the size of the risk, the loss ratio for the class plus actual loss history, and actuarial studies.

Aggregate Example

Assume:

- A company has a loss fund of \$1.25 million (The loss fund is the maximum amount the employer will pay during a given policy term)
- Claims for a given year total \$1.5 million
- In this case, the insurance company would reimburse the company \$250,000, or the amount by which the total claims experience exceeds the loss fund

\$250,000
Excess Carrier
Aggregate
(Excess Reimbursement
to Employer)

\$1,250,000
Employer
Aggregate
Loss Fund
(Employers
Responsibility)

LOSS FUND
AGGREGATE
EXCESS AMOUNT

Combination Excess Insurance

Many self-insureds opt for a combination of aggregate and specific excess coverage, to provide protection against both unusually high frequency and unexpected severity. Agents familiar with self-insurance can help you determine the appropriate excess coverage for your program.

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Steps to Self-Insuring

There are several steps that should be pursued when a company decides to self-insure, or when investigating the potential for self-insurance.

1 Contact Your Agent or Broker

First, contact your agent or broker to discuss the feasibility of self-insurance. If you need us to direct you to an agent that is well-versed in self-insurance contact us at www.MECasualty.com or 1.877.975.2667

2 Analyze Loss History

Analyze your company's loss history to determine appropriate risk retention levels for your self-insurance program.

Note: Your agent or consultant can help here.

3 Review State Regulations and Complete State Application

Self-insured status is considered a privilege and granted by your state only after careful review of your company's financials. You need to review the state requirements to see if your company can qualify.

Visit www.MECasualty.com to access state internet sites to download applications and review self-insurance requirements.

Note: Your agent or TPA can help you fill out the forms and take you through the process.

4 Determine and Satisfy Security Requirement

States typically require employers to post security with the state as a guarantee that payments will be made to injured workers should the employer become financially impaired. The "security" amount is set by the state. Most states require either cash or cash-equivalent instruments, Letters of Credit, or a self-insurer bond (also known as a surety bond).

Most employers post Letters of Credit or purchase self-insurer bonds.

Your agent can help you make the appropriate "security" decision.

5 Select a TPA (Third Party Administrators, also known as Service Companies) for Claims Administration and Safety Services

If the loss history analysis indicates that your company is a candidate for self-insurance, your agent or broker will assist you in moving to the next step, obtaining proposals from service companies to provide:

- claims administration
- loss prevention services
- data processing

If you need help identifying TPAs in your area contact us at www.MECasualty.com or 1.877.975.2667

6 Select an Excess Workers' Compensation Carrier

Your agent/broker will solicit proposals for excess coverage from carriers who specialize in providing excess workers' compensation protection.

To receive information on Midwest Employers Casualty's excess coverage and value added services visit www.MECasualty.com or call 1.877.975.2667

7 Assign Internal Management Responsibilities

At this point, you should designate individuals in your organization who will be responsible for activities such as claims administration oversight, loss reduction initiatives and aggregate tracking. You also need to alert your supervisors as to the change in insurance status and assign responsibility to them so they can begin to manage the process of controlling your workers' compensation costs.

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