Five Best Practice Strategies for Maintaining Excellence in Workers' Compensation Self-Insured Groups

Safety National is the market leader for providing excess workers' compensation coverage for self-insured groups and writes almost 300 groups nationwide. As a provider of this coverage for almost 70 years, Safety National has first-hand knowledge of successful strategies that build financially solid groups. Self-insured groups around the country have a great story to tell regarding the economic and financial benefits self-insurance provides for private businesses and public entities.

The following document identifies five best practice strategies that will help every self-insured group stay successful and make a positive contribution to their community.

A best practices strategy is a list of guidelines designed to promote a successful business outcome. These strategies are based upon common-sense business principles, and can help lead a self-insured group to a desired and profitable result. A best practice strategy takes time to create, perform, and document, and requires the commitment of all group members and service providers to be successful.

There are many best practice strategies groups can select. Here are five best practice strategies every group can incorporate into their own program:

I. FIVE BEST PRACTICES RECOMMENDATIONS FOR SELF-INSURED GROUPS

1. MAINTAIN A STRONG FOUNDATION THROUGH A PROACTIVE AND DETAILED PLAN OF OPERATION

   Every well built house starts with a strong foundation. It is no different with a self-insured group. Self-insurance continues to be a successful and cost effective business option for employers when funding their insurance needs. Self-insured groups exist in the marketplace to help members control the cost of insurance by reducing accidents through better risk control and by providing better claims services than those provided by traditional carriers. Profitable groups, upon the approval of the regulators, can return surplus or dividends back to members which can then be reinvested in local communities.

   Groups should consider annually evaluating the plan of operation to ensure it still meets the positive reasons and purposes for which it was created. Changes may have occurred in the workers' compensation environment compared to when the association application was first proposed to the regulators. This evaluation could answer the following questions:

a. Does the group's original feasibility study still make sense in today's economic climate, or are modifications necessary? Have economic circumstances negatively changed the need for a group to continue operating?

b. Does the group continue to attract new members that can meet the group's underwriting criteria, or should underwriting modifications be made and proposed to the regulators? In other words, is the underwriting philosophy still consistent with the group's original underwriting guidelines?

c. Are the service providers still acceptable to the founding members, the board of trustees, existing membership, and regulators?

d. Are the goals and standards within the plan of operation clearly expressed and communicated to all service providers, members, the board of trustees and other representatives of the group?

e. Does the current plan of operation include:

- An updated list of all members and the number of employees for each member;
- An updated list of the board of trustees for the group and how they may be contacted;
- An updated copy of the bylaws;
- An updated agreement between the group and its service providers;
- A current indemnity agreement that jointly and severally binds the group with each member to pay all compensation due in the event of the group's insolvency;
- An indemnity agreement that is consistent with state statutes or regulations and recent court or administrative rulings;
- A current copy of the group's financial statements;
- Evidence that the financial statements of the group's members have been reviewed;
- Evidence of any excess insurance policies for the group;
- Although not required by every state, evidence that the claims account for the group has been established in a federally insured financial institution within the group's state;
- A current actuarial report and a copy of the current rating plan, along with any recommendations made by an approved actuary;
- A listing of classification codes, rates, and current modification factors for each member;
- A copy of the group's plan for payment of the annual assessment by members of the group;
- A copy of the group's underwriting plan and guidelines for accepting new members;

- A copy of the group's board of trustees-approved plan for distributing dividends for review by the regulators;
- A copy of each member's loss history with their present program or contract of insurance;
- The name and date of the incorporation of the trade association which the group and its members are affiliated if required under state regulation;
- Evidence of each member's affiliation.

Every group should consider establishing an overall governance policy as part of its plan of operation. This governance policy can include standards related to transparency, accountability, responsibility, claw backs, and timely disclosure of material operational issues, internal audits and compliance with legal and regulatory requirements.

The above is a sample listing of what a group plan of operation might contain. A self-insured group will be expected by regulatory authorities to maintain current information on many or all of the above topics. The relevant criteria for groups will vary by state, but an updated list like the one above is a great first step to assuring the regulators that the group is operating successfully.

2. HOLD SERVICE PROVIDERS TO HIGH STANDARDS AND RESULTS

When groups select service providers, appropriate standards of experience and performance need to be developed and implemented. In some jurisdictions, service providers must first be approved by the regulators before a group can contract with that service provider. As such, it is important for groups to think about the standards of operation and service offered by a service provider when making decisions as to which vendors to use.

The following are some basic standards of performance a group's internal assessment or audit committee may consider to determine if the service provider's performance has been or will be satisfactory:

a. All service providers should maintain a sense of urgency when interacting and performing group business with group members, the board of trustees, and state regulators;

b. During a group formation, all service providers should demonstrate that they have the necessary values, successful experience, and attention to quality and detail that will allow the group to achieve its stated purpose and daily goals;

c. Each service provider should demonstrate that they know, follow, and are in compliance with the state statutes and regulations under which the group operates. Service providers should also show a willingness to undergo either an annual board of trustee assessment of their contributions toward the group's success or some other reasonable measure of evaluation and benchmarking that evaluates a service provider's capabilities;

d. When analyzing the benefits of a service provider, the group should focus in detail on:

- *Quality Performance*: Can the service provider deliver important customer service and operational tasks necessary to benefit the group? For example, is the group administrator's depth of experience adequate to manage the resources necessary to conduct the business of the group, work with other service providers and/or develop a rapport with group members in order to grow the group?

- *Good Value*: Does the group get good value from its service providers? For example, does a service provider offer all the necessary risk control functions group members should expect, and are those services offered at a reasonable fee?

- *Core Competencies*: Does the group's auditor, actuary, broker, third party administrator ("TPA"), or attorney have the necessary self-insurance skill set required to explain complex workers' compensation issues regarding group solvency, the reasoning for the particular self-insured retention, the specifics related to a complex claim, any loss reserve projections or trends, and any legal or regulatory issues to the board of trustees and/or group members? Can the service provider effectively work with relevant regulatory authorities? The group may consider requiring its vendor to provide an annual stewardship report outlining the vendor's accomplishments and self-assessment.

- *Conflicts of Interest*: How was the service provider selected? Is the service provider owned by another service provider or member of the group? Would the group's retention of a service provider create an appearance of impropriety?

All of the service providers selected by a self-insured group need to perform at a high standard and demonstrate to the board of trustees, and current members, that they have the ability and skill-set to help the group stay competitive and successful when compared with the traditional market.

3. REGULATORY RELATIONSHIPS MAKE A DIFFERENCE

Everyone has heard the old saying: "Dig your well before you're thirsty." This certainly applies to the relationship between the self-insured group and the regulator.

A self-insured group may be faced with future regulatory oversight matters such as a dividend assessment, a loss portfolio transfer, a consumer complaint, the dissolution of the group, a merger with another group or issues related to a market conduct or financial examination. Consumer complaints regarding claims handling or the pricing of new and renewal business can easily generate a market conduct exam by the regulators. In fact, it is this area that regulators pay particular attention to when assessing how a self-insured group functions on a daily basis.

Because regulatory issues are diverse in scope and may seriously impact the function of a group, it is important that self-insured groups foster a relationship with appropriate regulatory authorities as soon as possible after formation. When the group has established a professional business relationship with a regulatory authority, a better, more thoughtful and open dialogue may be developed. Just one meeting a year with the regulator at their office is generally not enough to establish an effective relationship.

The self-insured group should consider finding other means to interact with their regulators. This can include more involvement with the state self-insurance association, attending a self-insurance conference, sitting on a regulatory subcommittee for self-insurance or simply being prepared to make a public comment upon a proposed state statute or regulation that affects self-insurance. Working with a state legislator to sponsor a statute related to a safety practice for members in a group is a great way to distinguish the group.

It is more important than ever that a self-insured group always be prepared to tell their story in a positive way every time they interact with regulators or legislators.

4. ESTABLISHING BEST PRACTICES DISTINGUISHES THE GROUP

By establishing best practice strategies and standards, a self-insured group can distinguish itself in a positive way in the workers' compensation marketplace. And isn't that the point of everyone's hard work?

A self-insured group distinguishes itself from the traditional marketplace and successfully grows by setting a strong foundation from which a group will operate, holding service providers to high standards of performance, and establishing positive relationships with the regulators and legislators.

Regulators generally have a good idea who the better self-insured groups are within their state. But if they don't know, the self-insured group that follows defined and articulated best practices strategies and standards has a great story to tell the regulators when they interact. In addition, groups that follow best practices generally deliver quality service to members and can earn the loyalty of their membership.

It is very important for the group to plan for positive ways to distinguish itself from the many workers' compensation writers in its state. Best practices strategies and standards can help create a brand that represents quality, loyalty, and success for a self-insured group.

5. FINANCIAL SOLVENCY IS THE KEY TO LONG TERM SUCCESS

Regulators are not only concerned with the daily operations of the group and the quality of those operations, but also the financial solvency of the group. The financial solvency of a group is determined through a financial examination. As a general rule, regulatory financial examinations for groups are conducted every three years and are based upon the annual financial reports turned in to the regulators.

A group's first step is to meet the capital requirements found in the self-insurance legislation of each state. Once minimum capital requirements have been met, a group can assess ongoing expenses and estimated losses for the membership. The group should consider utilizing an actuary very experienced in group self-insurance operations to provide not only an estimate of outstanding liabilities for a reporting year, but also to estimate ongoing funding needs required to cover those liabilities.

In that actuarial assumptions are an important component in establishing loss funding estimates at the group level, the actuary should provide the group's history year by year and the factors that influenced the group results before selecting any outstanding liabilities or target loss rates or loss ratios. Because actuarial analysis is such an important component of assessing the financial health of self-insured groups, it would be to the benefit of the board of trustees to understand the exhibits that should be a part of every actuarial report. The board of trustees and regulators need to be aware that averages can be inadequate based on recent workers' compensation trends, changes in the group's mix of business and given today's business climate. The board of trustees, administrator and regulators need to know and understand what transpired in the past in relation to liabilities and funding in order to help the group better plan for future success.

Additionally, it is common practice for an actuary to provide only net losses or those losses for which the group is responsible. This can lead to unintended camouflaging of the group's true experience, trends and loss drivers. Net analysis deprives the group of identifying concerns and the opportunity to address issues while fresh and ripe for resolution. As a best practice, the group should consider reviewing both gross and net losses to gain a better understanding of loss projections in total and those that impact the group.

When a group sets expected losses without a risk margin, losses become an estimate with a 50/50 chance of accuracy. It is recommended as a best practice that all groups at least evaluate risk margins or confidence levels for projected losses before determining liabilities for outstanding losses and funding**.** Understanding the factors used to determine group liabilities will help the board of trustees and regulators test the adequacy and strength of group surplus.

Although the practice can vary by state standards and requirements, the discounting of losses, while generally acceptable, requires that investment returns are added back to loss funding to preserve funding adequacy. Recording liabilities for losses at a discounted expected value can be a cause for future rate increases if the losses turn out to be more than expected or investment returns are less than expected.

A very important aspect of financial solvency is taking the group's selected funding model based upon agreed assumptions, utilizing the final loss ratio, development factors, premium rates and rating factors for the group and applying those factors to each member so all members are priced within these parameters. This method provides control on member pricing and ensures existing and new members are priced consistently. It is not uncommon for actuarial information to be used only for regulatory reporting, and not for daily operations, including member acceptance and premium determination. Only the rating factors contemplated in the funding analysis should be used in determining an individual member's premium.

The board of trustees as well as regulators should also understand the expenses of operating a group and the base used to determine charges made to members. If the total expense ratio is greater than 35 percent, a review and assessment may be warranted. It is not unreasonable to compare actual cost of services (salaries, benefits, overhead, travel, etc.) to the actual dollar amount received for these services. Everyone is entitled to make a profit, but not at the expense of the group's performance and solvency.

Finally, as nothing is more important to a self-insured group than financial solvency, it is important that the group keep a firm grasp on its financial stability. Thus, a self-insured group should consider performing a thorough annual internal audit as part of its governance policy, including a financial assessment of its own bottom-line numbers, as part of its best practices strategies and standards.

The above is a basic analysis a group can perform regarding its expenses, claim liabilities, expected losses and the premium for future funding. The group that rigorously follows a conservative solvency analysis is better positioned to be successful for the long term.

II. ROLE OF SELF-INSURANCE REGULATORS

Of course, an analysis of best practices for self-insured groups would not be complete without taking a look from the other side of the fence and listing what regulators could do to improve and strengthen the group marketplace. The role of the self-insurance regulator is a very important component for the success of self-insured groups. Below are three areas where regulators can improve regulatory oversight and, as a result, benefit members of groups and injured workers.

1. IMPROVE INSTITUTIONAL KNOWLEDGE

Regulators should develop and maintain their knowledge and understanding of alternative risk transfer and insurance principles. Regulators that are educated in the areas they regulate can make an immediate and positive impact on the self-insurance industry.

There are many insurance courses regulators can take to develop their knowledge. The Associate in Risk Management; the Associate in Risk Management for Public Entities; and the Associate in Risk Pool Management represent a few designations that cover alternative risk and self-insurance topics.

2. REGULATORY UPDATES TO STATE SELF-INSURANCE STATUTES AND REGULATIONS

   Self-insurance statutes and regulations are, in some circumstances and in some jurisdictions, decades old and in need of an update due to changing market conditions. Self-insurance regulators, with the assistance of the self-insurance industry, need to consider crafting more self-insurance model laws to address areas of transparency that can protect group members and injured workers.

3. REGULATORS NEED TO EXERCISE A SENSE OF URGENCY

   Regulators need to be cognizant of the public trust placed in them and take appropriate and timely corrective action against non-performing groups to protect not only group members and injured workers, but also the reputation of other groups that do perform well and are well-operated.

   Regulators need to be fully engaged in reviewing group financial statements, actuarial reports, loss information, board of trustee minutes, and TPA or claims files in order to measure the health and well being of a group. Regulators should be aware of inadequate actuarial reports and loss reserves submitted by a group, and be prepared to test the assumptions and information the reports are based upon.

III. SUMMARY

As stated at the outset, it takes time and determination for groups to implement these best practices. In the long run, these strategies represent added value that every group can take with them into the marketplace when competing for customers. These five best practices certainly are neither the only strategies a group can use nor will these best practices work under every circumstance. It is hoped that by presenting these strategies, groups can face the unknown future with more confidence and ability to demonstrate to regulators that group self-insurance is and always will be a successful business option for private businesses and public entities funding their insurance needs.