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Risk Management

Book Portfolio Analysis

The Rice Krispie® Secret

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Statistics and trends are prevalent everywhere in society: sports, weather, health, war, and business. They're everywhere! Depending on what you do for a living, or what's important to you, we all know some sort of statistic very well and we constantly count on it and track it. Stats and trends provide us our gauge, our barometer, our measuring stick. What we learn from them helps us to make wiser decisions, hopefully. What's probable is most likely to happen unless some factor alters the norm.

PEOs and workers' compensation insurance professionals deal with many, many factors. *(Webster): a quantity by which a given quantity is multiplied or divided in order to indicate a difference in measurement.* You can get lost in all the factors. Loss development factors, loss cost factors, experience mod factors, frequency/severity ratios. We have factors up the wazoo!!

Now that I have thrown out all the buzzwords, I ask you to ponder these questions. What workers' compensation statistics, trends, probabilities, and factors are important to the PEO industry and the insurance carriers who assume risk? Do you know and understand the trends/results of your co-employers? What class codes on your book drive the best workers' compensation results? Do you know what factors change expected loss rates by class code? What is the probability that today's results will continue? Are PEOs out-performing "traditional" workers' compensation insureds? What are your data sources and can you rely on them? Which of these factors can you control, have some control over, or have very little control over?

Data is King

It's the difference between the experienced poker player and a rookie. It enables teams with less skill and talent to outsmart the competition and bring in the win. In our fiefdom of PEO and WC insurance, without performance measurements, you are shooting in the dark. There are many moving parts in a PEO business model, and lots to measure. With workers' compensation being a necessary evil, it behooves us to know how the risk bearer—the insurance carrier—measures you up.

The carrier's appetite will vary by state, industry group, and class code. Price factors include state benefit structures, managed care, litigation, regulatory climate, premium taxes, surcharges, special disability trust funds (if any), bureau advisory or assigned rates, loss cost multipliers, relativities, and pricing algorithms (allowable credits/debits).

Here are some typical book analysis carrier targets:

- Pure loss ratio-30 to 35 percent;
- Developed (ultimate) loss ratio-55 to 60 percent;
- Combined ratio (developed losses plus expenses)-90 to 95 percent;
- Frequency rate-a ratio of 2.5 to 3.5 claims to every $1 million in payroll;
- Severity rate-total loss time claims against all claims at less than 15 to 20 percent;
- 75 to 85 percent of claims reported within three days of the date of the accident;
- Average cost per claim (medical only and lost time)-less than $20,000 to $25,000 per claim.

Sounds easy right? Maybe so on an aggregate basis. The truth is, most carrier legacy systems are seven to 10 years behind today's technology. Most policy and claims management systems were built for the multi-state, multi-line traditional insured. They were not built for PEO (multi-tier) insured. Rarely will I find a loss run or book portfolio analysis that drills down to the client company or class code level. To add to the complexity, many PEOs today also have multi-carrier relationships and therefore multi-policies. States such as California now mandate multiple coordinated policies (MCPs) and if the National Council on Compensation Insurance (NCCI) has its way, MCPs will be prevalent in most states. Add to the mix client-based policies or carve-outs, guaranteed cost coverages, and loss sensitive coverages, and the tracking of data is not so simple. How slick is your system for data tracking?

It's Not All Doom and Gloom

PEOs already control half of the data puzzle. The very payroll systems you use to cut paychecks contain some very critical data that insurance carriers would love to have direct access to. Payroll systems contain scores of information carriers and reinsurers call for when performing book analysis, conducting audits, or managing a claim: client company, FEIN, location number, address, zip code, employee name, gross wages, total WC wages, age, sex, class code, hire date, SSN, DOB, etc. Because we know you have the marshmallows (payroll records) and the carrier has the Rice Krispies® (loss records), how can/do you now merge the two? Unfortunately, nothing off the shelf at Best Buy exists that can do this for you-I've checked. I can tell you from experience, however, that your carrier(s) would be more than happy to collaborate with you to "share" data.[1]

The most cumbersome, archaic, and manual route would be via a data dump into Excel or Access. While these are great tools and are cost-effective because everybody has them, formatting after a data dump is nightmarish and extremely easy to corrupt with the stroke of key, not to mention, these softwares have size limitations and version controls. Workers' compensation has an average 10-year tail, so over time you will max out Excel's capacity. XML or Sequel data transfer is the next step up. You can look into building a proprietary system or even a Web-based system, but be prepared for sticker shock, a long wait, and consumption of your valuable resources. While this may be the slickest and most reliable answer, you will find yourself starting from scratch if you change carriers or deal with multiple carriers. I've learned that "system integration" is a bad word in the world of information technology and doing so lends the question of "who owns" the data.

This is just my opinion, but I believe the best path to take is with a build-out of a data warehouse. With all the complex WC policy scenarios described above and multi-

carrier relationships, I think you will have a higher success rate of having your insurance carrier conform/collaborate with the business requirements it takes to provide loss data in a consistent format for database purposes. The end result: you and the carrier(s) of record can benefit from the outcome.

Why Jump Through all the Hoops?

Every business goal is to be profitable. B.C. Forbes said: "Any business arrangement that is not profitable to the other person will in the end prove unprofitable for you. The bargain that yields mutual satisfaction is the only one that is apt to be repeated." Profitability of a client company should not be based solely on PEO bundled pricing. Your carrier partner(s) are making both objective and subjective decisions regarding your renewal pricing every year. Because workers' compensation is vital to a PEO's health, WC results should be segregated and evaluated on their own. In addition, PEOs have a unique ability to control their loss ratios more so than carriers with the same broad spectrum of risks. In most states, carriers are bound by statute to stay on a risk (good or bad) after 90 days of policy inception, regardless of the cooperation of the risk to implement needed loss controls and cost containment best practices. There are only a handful of qualifying events (these vary by state) for which an insurance carrier can cancel mid-term: non-payment of premium; change of ownership; or material misrepresentation of exposure. PEOs are not insurance carriers and therefore are not governed by these statutes. PEOs can exercise their rights to purge risks that cannot be rehabbed effectively via the client service agreement or risk transfer to another niche carrier willing to write the risk on a client-based policy.

It's Not Just Reactive

Book portfolio analysis at the client company level will also assist your sales, underwriting, and risk management teams to strategize for organic growth. It becomes quite an efficient tool to tell you what specific states or classes of business yield the highest profitability. Sales incentive programs can be centered around desired classes of business and retention of high performing clients. Underwriters will increase turnaround production of desired class submissions and will find that referral/exception class hit ratios will improve due to the carrier's confidence in data modeling. Risk engineers/loss control will have data necessary to proactively detect trends necessary to focus on client companies that are running temperatures on several key indicators. All these gained efficiencies will undoubtedly make your book of business more attractive to brokers, carriers, reinsurers, investors, and potential buyers.

Conclusion

When is enough data enough? An actuary will tell you never. Many factors such as an aging workforce and newly formed industries will continue to change how we look at risk. 9/11 alone sent us into an actuarial mind sweep. It now matters if you have 100 white-collar employees in a downtown Chicago office. It's not just a nice piece of trivia when you are in the business of risk. Active book portfolio analysis will help you make wiser decisions in risk selection and be a compelling influence to the naysayers. It should be your Rice Krispie® secret.

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1. Sharing data, of course, needs to take care to confirm with an increasing array of data privacy rules.