

# *Self-Insured Workers' Compensation and Employee Benefit Programs*

# Do They Make Sense for Your PEO?

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Although there are some very moving arguments to self-insure either the health and/or workers' compensation exposures of a PEO, the decision must be evaluated vigilantly. With the insurance marketplace tightening up, many PEO owners face the option of self-insuring their employee occupational and non-occupational health exposure.

## Defining Self-Insurance

Self-insurance can take many different forms. For the purpose of this article, self-insurance refers to an individual, partnership, or corporation that bears the ultimate financial responsibility for losses under an insurance program in accordance with applicable state regulations.

## Requirements for Self-Insurance

The ability to self-insure is state-specific, but generally focuses on the potential self-insurer's financial stability. The capacity to properly accrue and ultimately pay for losses sustained under either a workers' compensation or health insurance program

is in question. General indications of a firm's financial solvency are audited financial statements, the ability to post a bond guaranteeing some portion of future loss liabilities with the state, and a minimum asset worth requirement. An actuarial study to project future liabilities is typically necessary so state regulators can analyze whether the PEO is capable of meeting current and future liabilities as a self-insured entity. Each state also requires the PEO to purchase some form of excess insurance coverage and hire a state-approved third party administrator (TPA) to pay claims and manage the medical networks.

Unfortunately, each state has its own requirements for being self-insured, and therefore a multi-state PEO would have to apply for self-insured status in each state where it does business. Some PEOs become self-insured in their governing states and buy a separate fully insured insurance policy for the others. This can be

cumbersome due to separate underwriting restrictions, TPAs, managed care entities, etc.

## Statutory or Legal Compliance

The vast majority of states allow employers to maintain a self-insured plan for workers' compensation or group health. However, licensing requirements or other statutes relating specifically to the industry may further restrict PEOs. For example, in Florida, PEO licensing statute 468.529 states, in brief: "...no licensed employee leasing company shall sponsor a plan of self-insurance for health benefits..." A PEO should carefully review not only insurance statutes, but also other statutes that may specifically address a PEO's ability to sponsor a self-insurance plan. Table 1 reviews statutes regarding self-insure in a sample of states.

## Self-Insurance Advantages

Flexibility, flexibility, and flexibility! Self-insurance allows the PEO to control almost every facet of its risk management program. No longer will the insurance carrier dictate the TPA to use, the managed care network, or how loss control is used. The excess insurance provider furnishes the PEO with its exclusion list and allows the PEO's underwriting department to use its own judgment in adding clients. Unless a single occurrence has the potential to pierce the specific insurance layer within

the excess program, or the aggregate insurance is threatened by the culmination of all claims, the PEO owner has very little oversight by its excess insurance carrier. The ability to contract with vendors who are most suitable to your business philosophy and geographical spread can also be of great value for those who choose to self-insure. Quite often, PEOs purchase employee health programs based on maximum costs or marketability rather than focusing on quality of services rendered and measurable outcomes. Because of the increase in risk retention inherent in any self-insurance arrangement, the focus should shift to controlling loss.

From an employee benefits standpoint, a self-insured PEO no longer has to underwrite client companies based on employer contribution or employee participation, but only on the underwriting standards agreed upon up front with the excess insurance provider. The PEO is also able to choose TPAs and networks locally or regionally, thereby providing the best quality providers within every jurisdiction. This freedom allows the PEO a significant marketing advantage, as it is able to customize solutions for its client companies rather than be limited to one company option.

## Self-Insurance Pitfalls

Volatility, volatility, and volatility! The soft market of the 1990s allowed many PEOs the luxury of booking very low maximum costs on their financial statements by buying cash-funded guaranteed cost programs. While these programs may still be available to PEO owners who controlled losses, others are finding insurance carriers are no longer willing to “cash-flow underwrite.” Self-insurance can be quite a wake up call to those not familiar with historical loss payment patterns, loss development, and loss accrual.

To give an example in the workers’ compensation arena, many PEOs previously obtained guaranteed cost programs

at about 50 percent of manual rates. If we assume the fixed costs of a self-insured program represent 10 percent of manual rates, and the applicable National Council on Compensation Insurance (NCCI) development factor at 12 months is 1.529, the PEO owner would need to achieve a loss history no greater than 26 percent (40 percent/1.529) in order to book the same maximum (50 percent) on their

financial statements.

In 1997 alone, NCCI estimates employers saved billions in workers’ compensation tax and assessments through the purchase of high-deductible programs. As a self-insured entity, most states treat the PEO’s standard premium (premium after experience modification, but before NCCI premium discount) as the basis for tax and assessments. Consequently, if a PEO pur-

**Table 1. Licensing or registration in states that restrict self-insurance for PEOs.**

<u>State</u>	<u>Coverage</u>	<u>Licensing/Registration Statute</u>
Colorado	Health	As employing units or co-employers, employee leasing companies may aggregate all employees for the purpose of sponsoring and administering workers’ compensation plans pursuant to article 44 of this title and fully insured health coverage plans, as defined in section 10-16-102 (22.5), C.R.S., employee pension benefit plans, and provision of benefits pursuant to such plans.
Florida	Health	No licensed employee leasing company shall sponsor a plan of self-insurance for health benefits.
Nevada	WC and health	616.2545(3) An employee leasing company may not offer its employees any self-funded insurance program. An employee leasing company may not act as a self-insured employer pursuant to this chapter or chapter 617 of NRS or pursuant to Title 57 of NRS.
New Hampshire	Health	An employee leasing company that provides health insurance benefits to its leased employees shall only provide such benefits through a policy issued by an insurance carrier admitted to write such coverage in this state.
South Carolina	WC and health	No licensee may sponsor and maintain a plan of self-insurance for health benefits or workers’ compensation benefits after January 1, 1994.
Vermont	Health	An employee leasing company that provides health insurance benefits to its leased employees shall provide those benefits only pursuant to one of the following: (1) An insurance policy issued under chapter 107 of Title 8 by an insurer or entity authorized to do business by the commissioner of banking, insurance, and securities...

chases a high-deductible program, only the deductible premium is considered as the tax and assessment base. For example, if Hometown PEO has \$2 million in standard premium and the tax and assessment rate is 8.5 percent, their bill to the state would be \$170,000. If Hometown purchased a high-deductible program for \$350,000 in premium, their tax and assessment bill would be \$29,750, or 1.5 percent of standard premium versus 8.5 percent. With that said, this loophole is currently being examined by some state legislatures.

## Conclusion

For a PEO wanting to control its own destiny, self-insurance is a tempting proposition. The first task at hand is to consult with your legal department on any state regulation that prohibits self-insurance plans for employers and/or PEOs. You may also want to ask if there are any other implications of a PEO becoming a self-insurer (i.e. MEWA, ERISA). Second, evaluations of the PEO's risk management department by an unbiased source such as a consultant, broker, and/or actuary must be made. If the risk management department could not produce predictable, posi-

tive results under a fully insured program, it is doubtful there will be improvements in a shift to self-insurance. Lastly, scour the insurance market to see just how much risk your PEO will need to take in a self-insured arrangement. Never take on unneeded risk unless absolutely necessary. Table 2 summarizes some of the advantages and disadvantages of self-insurance. If you are deciding to take the plunge into self-insurance, please proceed with caution.

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**Table 2. Advantages and disadvantages of self-insurance.**

<u>Characteristic</u>	<u>Fully-Insured</u>	<u>Self-Insured</u>
Program Control	Varies based upon type of program. Generally, much less control over providers than self-insurance.	Ability to control all or most of insurance program (TPA, networks, underwriting)
Administrative Cost	Typically 50 percent more in states where tax loopholes do not exist.	Low fixed costs stem from ability to contract with chosen vendors and cost of excess insurance.
Legal	Generally satisfies all of PEO state licensing requirements.	Requirements vary among states. Some PEO licensing statutes may limit or prohibit self-insurance. This may result in fully funded and self-funded plans in various states for multi-state PEOs
Risk Transfer	Insurance company responsible for the "first dollar" of claims in some cases. Typically able to access lower maximum exposure.	PEO retains financial responsibility for all claims' "first dollar." Aggregate coverage is hard to access, and max exposure is typically higher.
Capital Requirements	Varies among different types of plans. Generally less stringent than self-insurance plans.	Can be highly burdensome depending upon state law.
Management Attention	Generally, less senior management attention is required.	Requires higher scrutiny by senior management due to potential financial impact to the PEO.

