STAFFING FIRMS EXPLORE ALTERNATIVES TO BETTER MANAGE RISKS AND CONTROL COSTS

KNOW YOUR RISK FINANCING OPTIONS WHEN SHOPPING FOR WORKERS’ COMPENSATION INSURANCE

STAFFING FIRMS EXPLORE ALTERNATIVES TO BETTER MANAGE RISKS AND CONTROL COSTS
Know Your Risk Financing Options When Shopping For Workers’ Compensation Insurance

The nature and needs of running a staffing firm demands that owners and risk managers address a number of unique liability exposures. This requires a delicate balance of controlling costs and transferring risk, which can be accomplished by clearly understanding where a business sits on the Risk Transfer Spectrum.

Furthermore, when experiencing change, growth, or a significant amount of workers’ compensation claims, a business should (or be required to) revisit its insurance coverage and carrier.

This eBook presents insurance options and important aspects that staffing business owners should consider when seeking to secure the right-fit workers’ compensations insurance, at the best price, based on risk transfer preferences.

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The Climate of Rising Costs

The rising cost of health care is a top risk that nearly all businesses fear, according to Risk & Insurance magazine. “U.S. health care costs rise faster than inflation,” notes Forbes, adding, “Rising health care inflation prompts insurance companies to raise premiums.”

This state of affairs puts many staffing companies, especially small and mid-sized independent firms, in a precarious position. The control of premium costs and administration of workers’ compensation insurance programs can be formidable challenges. Furthermore, the cost issue is compounded by the need to stay abreast of ever-changing rules, laws, and regulations, as well as adapting business practices to stay in compliance and understanding the related problems and penalties of noncompliance.

The complexity of your business and coverage needs will influence the type of insurance program that fits you best, as will your company’s capacity to retain any sizable element of risk or afford a program that allows you to shift risk.

Unfortunately, cost comparisons are not always simple. There is no “standard premium” because loss performance determines rates and every company is different. As a staffing business owner, it’s essential that you speak with your insurance broker and ask relevant questions including but not limited to:

• Is there a type of coverage I’m overlooking or should be considering?
• What costs may I incur that are different than my current program?
• Are there any cash flow impacts I need to be aware of?
To be clear, this eBook is meant as a helpful, general guide and is not meant to be construed as legal or financial advice. Be sure to speak with your insurance broker.

When Staffing Goes Shopping

Given the nature and needs of running a staffing firm, owners and risk managers must address a number of unique liability exposures and consider the delicate balance of controlling costs and transferring risk. To assist in that effort, it’s valuable to clearly understand where you sit on the Risk Transfer Spectrum (see image).

**RISK TRANSFER SPECTRUM**

DO YOU WANT TO TRANSFER OR KEEP RISK
HOW MUCH ARE YOU WILLING TO PAY TO SHIFT RISK?
HAVE YOU REVIEWED KEY CONSIDERATIONS?

Being proactive and knowing which insurance option best fits your needs will allow you to make informed decisions. Let’s explore the most common insurance options and compare costs, tax implications, impact on cash flow, and how to find the right fit for you.
Guaranteed Cost

It's a simple "set it and forget it" approach to a workers' compensation program.

When first venturing into the insurance coverage arena, most businesses begin under a Guaranteed Cost option. It's a simple "set it and forget it" approach to a workers' compensation program. This simply means that you pay a flat fee (or rate) up front for a specific amount of coverage. It's often preferred because it allows a total transfer of your workers' compensation risk to the insurance carrier along with a predictable cost. However, this predictability comes with a significant price. Guaranteed Cost is typically the more expensive option because the insurance carrier needs to protect themselves from losses you may have and also be profitable.

Does it fit you?

Flat-fee, Guaranteed Cost policies are ideal for small to mid-sized businesses because this option doesn't contain any surprises. While you may still be subject to audit, your claims activity doesn't have any bearing on the cost of coverage.

With Guaranteed Cost policies, you gain a lot of consistency, as well as offload administrative burden of claims management, however, you're paying a price for those benefits and the cost is built into your premium.

There are other plans available which can be less pricey to manage, but you need to be willing and able to financially retain a higher degree of your workers' compensation exposure and have the human resources to manage such a program's administrative requirements.

Tax Implications

Premium is paid during the policy period and the insured receives a tax deduction for all premiums paid.

Cash Flow

The insurance company reaps the benefits of improved cash flow because they collect premiums before losses occur although those losses may not be paid out for months or years after the premium is collected.
Deductible

In a Deductible plan, the insured is responsible for reimbursing the insurer for claims up to a certain dollar amount and the insurer is responsible for paying claims in excess of that deductible amount.

The maximum amount of risk retained by an insurer per life is called retention. The retention level for Deductible plans varies (and so there are small Deductible plans and large ones). In addition to paying for all losses under the deductible amount, the insured must pay a deductible premium. That is determined by multiplying the guaranteed cost premium by a deductible credit which depends on the retention level that the insured chooses. The larger the retention level, the larger the deductible credit given, resulting in a smaller premium.

In short, as with all elements in the Risk Transfer Spectrum, the more risk you hold onto, the less you may have to pay in premium.

Does it fit you?

There are many considerations to determine if this plan is the best fit. Review the example described below and remember to account for related costs such as the Letter of Credit (LOC).

<table>
<thead>
<tr>
<th>Tax Implications</th>
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<td>The deductible premium is paid during the policy period and the insured receives a tax deduction for all premiums paid. However, it is important to note that the losses – which are the substantial part of the total cost – are not tax deductible until the losses are actually paid.</td>
<td>On a Deductible plan, the insured retains control of loss funds until they are actually used to pay losses. As a benefit for taking greater risk, the insured receives all the benefits of improved cash flow.</td>
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An important aspect that needs to be evaluated when analyzing a Deductible plan is the aggregate stop loss limit, which is the total amount that the insured could be obligated to pay for losses under the deductible.

In a Deductible plan, the insurance company or a third-party administrator (TPA) takes care of all the claims and then collects from the insured for loss payments that the insured is required to pay under the deductible. The insured will need to setup an escrow fund at the beginning of the policy period and the carrier or TPA will pay losses out of the escrow fund. The contract will detail when and how often the escrow fund needs to be replenished by the insured. In a large Deductible plan, the insurer typically has control over claims management and will charge the insured for the administrative cost in handling the claims.

Another important component to understand is the Letter of Credit (LOC) that the carrier may request before binding coverage. This LOC is held in the event that the company is unable to pay claims under the retention level. Since the carrier is still responsible for paying these claims, the carrier can draw down on the LOC to provide claim payments. The reason that LOCs or cash collateral are mandatory for all large Deductible plans is to make sure that the insurance company only takes on underwriting risk and not financial risk.

Banks charge for issuing LOCs, so remember to include this cost in the total cost of the plan. It’s also important to consider how this Letter of Credit will be collateralized and identify any waterfall implications it may have on other credit facilities. Keep in mind that your assets will be tied up in your insurance, and so not providing any return as a financial investment nor available to you for capital investment.

**Retrospective (Retro) or Loss Sensitive**

A Retrospective or Loss Sensitive plan is defined as an insurance method in which “the final premium is based on the insured’s actual loss experience during the policy term, subject to a minimum and maximum premium, with the final premium determined by a formula which is established in the insurance contract.”

In order to evaluate different types of Retro plans, it is important to perform a loss projection for the upcoming policy year. Since the major driver of insurance costs is the losses, the ultimate loss numbers can be plugged into the different loss sensitive formulas to estimate the total cost of each program.
In order to evaluate different types of Retro plans, it is important to perform a loss projection for the upcoming policy year.

At the beginning of the policy year, the insured pays a standard premium which consists of the basic premium and the loss projection determined by the insurance carrier. In 18-22 months from the inception of the policy (depending on your policy’s conditions), the insurance company values the losses and uses a formula to estimate the ultimate loss cost.

If the standard premium is greater than the developed Retro premium then the insured will receive money back. If the standard premium is less than the developed Retro premium then the insured will have to pay the amount of the difference to the insurer. After the first calculation at 18 months, there will be subsequent calculations every 12 months until all losses are closed out.

Most of the time, Retro plans have a maximum premium limitation which caps the amount of premium the insured must pay. This is necessary because many insureds would not be interested in a plan that did not place a limit on a possible loss. The maximum premium tends to be somewhere between 1.2 to 1.5 times the standard premium.

You may be wondering “how much can I save in premium costs by taking on more risk?” Again, it’s all about the losses and what your claims history shows that determines, in part, what you will pay in premiums. There is no “set it and forget it” payment structure as you move away from Guaranteed Cost.

**Does it fit you?**

Retro programs are ideal for larger companies that are able to shoulder additional risk, yet can be confident in their ability to keep claims below the threshold at which premiums would go up. These programs usually have variable rates and large deductibles so that if a claim occurs the insured participates in a significant portion of payment. This lowers the upfront costs, resulting in significant savings for those with low claims activity.

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<td>The standard premium is paid during the policy period and the insured receives a tax deduction for all premiums paid.</td>
<td>Most Retro plans improve the cash flow of the insurance carriers, simply due to how the premiums are determined and paid (e.g., pay the difference or get a refund).</td>
</tr>
</tbody>
</table>
A Captive insurance company is not a suitable option for all insureds or for all situations. A Captive insurer is generally defined as an insurance company that is wholly owned and controlled by its insureds; its primary purpose is to insure the risks of its owners, and its insureds benefit from the Captive insurer’s underwriting profits.

There are lots of different captive arrangements in the marketplace today. For one, there is the Single Parent (or Pure) Captive, which is owned and controlled by a single parent organization and is formed as a subsidiary of that organization. These are appropriate for very large organizations that can easily handle a $3-4M loss.

Another arrangement is the Group Captive. A Group Captive is owned and controlled by multiple non-related organizations. It is formed as an independent entity and insures the risks of its owners. There are two types:

- Heterogeneous = the insured organizations share a similar risk profile but come from different industries.
- Homogeneous = the insured organizations are within the same industry but may or may not share a similar risk profile.

Uncovering the risk profiles of all companies involved in the Group Captive is critical to its success. Furthermore, there should be formal guidelines established within the Captive about how prospective companies will be evaluated for induction. For those reasons, it may be an uphill challenge for a staffing business to be permitted into a Group Captive based on its risk profile.

To determine if a Captive program would make sense, an insured and its advisors should evaluate specific criteria including losses, financial resources, and commitment:

- Realize that if historical loss ratios are high, then it is likely that the Captive option will result in considerably increased cost for you, the insured. Also consider predictable losses – the more predictable and consistent the losses, the greater the confidence with which premiums and reserves can be set.

- You will need sufficient financial resources to support the capital investment and the posting of collateral behind the Captive program. You will also require sufficient premium volume; traditional Captive programs typically require a minimum of $750,000 in premium annually to make them a viable option.
• Captive programs will not be the lowest cost option in all years, so to be successful they will require a long-term commitment from their owner/insureds. If an insured is considering a Captive purely for short-term premium savings, it is unlikely to be the right solution.

To explore this option (along with its tax implications and cash flow benefits), consult with your insurance broker and have a Captive feasibility study performed to better understand if a Captive could work for you.

**Other Expectations When Making a Change**

For those that have been considering a change from a Guaranteed Cost program to a Deductible or Retrospective program, it’s critical to determine an optimal deductible to balance your financial risk profile. Your primary considerations will be the capacity of your organization to carry a certain level of risk and your ability to control and cover losses.

Typically, your loss history will provide you with an understanding of expected loss frequency and severity, which will help guide options for you to consider. Know that as your business grows, it may change your ability to control losses and/or place you in a lower or higher risk environment.

Therefore, it’s important to understand where you are heading strategically and balance your financial exposure in your workers’ compensation program. Bear in mind that once you select a Deductible program it’s typically difficult to move back to a Guaranteed Cost program. The insurer will have concerns about your now unknown risk experience and question your financial stability. They will likely provide a quote for you to return to a Guaranteed Cost program with a much higher deductible than you may have seen previously.

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Know that as your business grows, it may change your ability to control losses and/or place you in a lower or higher risk environment.
Getting the best price is important but it must not be the only, or even the utmost, consideration when evaluating which insurance program is the right fit for you. It’s imperative that you also evaluate aspects including:

- Cash flow
- Ability and desire to retain risk
- Letter of Credit required for certain programs
- Costs of managing claims
- Tax and accounting considerations associated with premiums
- Long-term liability management

Plus be aware that no program will likely meet all of your wishes – and at some point, as your business grows, you will likely need to shift from a Guaranteed Cost program in order to maximize your potential profits.

There are certainly plenty of options available, but if you choose to manage this area of business yourself, it’s important to have the right level of knowledge and expertise needed to effectively administer these types of insurance programs. For many staffing companies, it’s proven worthwhile to outsource managing workers’ compensation insurance and other business risk areas to back office partners like People 2.0.

**A Partner You Can Trust**

At People 2.0, we pride ourselves on being loyal staffing industry leaders. Our exceptional team of specialists in risk management, cost control, and claims management are dedicated to helping you isolate risks and reduce costs. Our strategic model aggregates the buying power of many staffing companies while allowing you to shift risk and offload administrative requirements, as well as attain cost-effective premium rates. In partnership with People 2.0, you can better assess exposures and prevent workers’ compensation claims – and when claims do occur, our insurance professionals will respond by managing defense and strictly limiting your exposure. Now you can protect your employees and your business assets while giving more focus to growing your organization.

Learn more about our insurance and risk management offerings:
call 888-270-3579 or visit www.people20.com.