ART COLUMN FOR FEBRUARY

A captive for comp means a breakthrough for SIGs

By Dick Goff

Self-insured workers' compensation groups (SIGs in our acronymically obsessed business culture) are poised to advance to a higher level of existence that will benefit their sponsors and members alike.

SIGs have proliferated primarily because of previous unavailability or high price of traditional workers' compensation insurance. Their members tend to be prudent, safety-conscious employers who appreciate the opportunity to share risk with other employers who also share their values.

I was reminded of the growth of the SIG industry by Steven Link, writing in last month's *Self-Insurer*, who reported that SIGs now operate in over 30 states and cover about 10 percent of the nation's workforce.

SIIA currently promotes the reliability and performance of SIGs through its series of articles on the Workers' Compensation page on its website (www.siia.org). These articles extol the various ways that SIGs serve accident-prone industries such as logging, agriculture, transportation and others with longtime spotless records, steadily decreased premiums and dividends paid back to their members. I recommend them for your reading pleasure.

That all being said, I return to my original point that SIGs are poised to advance to a higher level through the application of alternative risk transfer (ART). That will cause some head scratching by knowledgeable readers because they know that state workers' compensation regulators universally ban captive insurance companies from insuring workers' compensation. If they didn't, every trade and profession would add comp to the coverage by their federally enabled risk retention groups.

But ART is about to enter the workers' compensation arena through a unique application that could dramatically expand in future years. My source for this development has sworn me to secrecy until the ink is dry on contracts, but I can relate structural concepts here without identifying the state or principals involved.

SIGs everywhere have a common problem: state regulators' appetites for increased security deposits to assure continuity of claims – even applying to programs that haven't missed paying a claim in decades. Security deposits amount to varying percentages of the SIGs' retained risk – several hundred thousand dollars and up for most plans.

In the meantime, SIGs are paying handsomely for their excess or stop-loss insurance that covers specific and aggregate claims above the plans' selected retention levels.

You can see where this is heading: if a SIG tries to lower its excess coverage premium by raising its retention level, the state is liable to come calling with a demand for a larger security deposit. Why do they do this? Because they can.

Here's what the SIG in question intends to do:

1. Contract with a fronting insurance company to insure specific and aggregate claims above the retention level to $5 million and *simultaneously* reduce retention– in this case from $750,000 to $250,000.
2. Under a three-way deal orchestrated by the ART consultant, the fronting company will cede back excess coverage of $750,000 to a captive insurance company formed by the trade association that owns the SIG. Under the mechanics of the program, the insurance company will pay claims and recover them from the captive through its Regulation 114 Trust, a federal entity that resolves state concerns about security and has been blessed by the National Association of Insurance Commissioners.
3. Request from the state a refund of its security deposit in proportion with its reduced retention of risk – in this case, two thirds.

The SIG's security deposit refund will cover the costs of forming and operating the captive and the premium paid to the fronting company for risk in excess of $1 million. The trade association has pushed the traditional insurer out from $750,000 level, which will bring its excess coverage premium down substantially.

The result is that the trade association has taken control of its group workers' compensation plan by bringing down the overall cost of risk for its insureds; put trade

association money to better use by investing in securities through the captive; and created a new profit center for the trade association for the benefit of its members.

In a nutshell, that's why ART exists: to create win-win scenarios for captive owners and insureds. As this structure solidifies I'll report back how it works out.

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