ART GALLERY COLUMN FOR OCTOBER

ART may provide an 'out' for NY SIGs

By Dick Goff

Faced with some massive deficits among mismanaged (and probably earlier misregulated) workers' compensation self-insured groups, and despite the presence in the state of many healthy SIGs, New York chose to throw the babies out with the bathwater by effectively tossing out SIGs by the end of this year.

This is not breaking news, folks. The decisions were a long time coming, including attempted but failed legislation a couple of years ago. But what the legislature couldn't accomplish at that time, a state task force did by recommending cessation of all SIGs, and that was ratified earlier this year by the legislature.

The current rule doesn't say "death penalty," of course. Nothing so crude as that. It provides a "new start" for existing SIGs beginning in 2012. All they have to do is post funds equaling claims liability for the prior year, and by 2014 they must fully fund all prior losses plus anticipated losses for the upcoming year. Plus, oh yes, no new SIGs may be formed in the state.

This is not insurance, but simply advance payment of workers' compensation costs. One leading agent for workers' compensation coverage knows of one, and maybe two, SIGs that plan to comply with the new highly restrictive rules. That's from a current SIG population of about 25, down from more than 65 in recent years.

New York, of course, isn't the only state that has SIGs in the crosshairs. There are indications that California could be the next state to clamp down on SIGs with other states possibly to follow.

I wouldn't be bringing this up now if I didn't sense an ART-based solution. Let's fantasize for a moment that a healthy SIG may be collapsed into a fronted captive insurance company that protects members from losing their equity and provides solid coverage moving forward with insured owners still participating in the rewards of the risk.

This is actually being done right now elsewhere in the country, and provides a method for agencies of all types – TPAs, brokers, MGUs, the whole industry – to take control of their books of business and participate in the risk.

The fronted captive appears to a regulator as a fully-insured traditional workers' compensation plan by an A-rated insurer – pick any household name insurance company. The front cedes back first dollar risk to the captive up to a defined level where the fronting company takes over covering excess losses.

It's also possible to isolate any one company's losses from affecting other members of the captive. This is possible through segregated or incorporated cell structures that are currently available in captive domiciles including Delaware, the District of Columbia, Tennessee, Montana and Vermont among others.

The key to this plan is for the captive to be able to attract a fronting partner on mutually beneficial terms. Big insurance companies look for two things: lower than average risk and as little labor/systems input as possible.

To a fronting company, the ideal workers' compensation captive would be able to demonstrate two characteristics:

First, a controlled book of business that is profitable based on insureds' loss history and actuarial projections. This approach is probably best for niche specialized industries that have low claims experience or incident exposure.

Second, the fronting company will ask how good an administrator will be involved. The program administrator will need bulletproof systems providing computer-friendly consumer online access for claims and other administrative matters. Safety and other loss-control programs will give extra credit. The captive will have to prove it can smartly manage, market and distribute the business.

A Texas company, Workers Comp Solutions (WCS), is working in this area as a workers' compensation wholesaler with $25 million-plus of business written through independent retailers.

WCS tracks all its applicants and can document that it declines about half for one reason or another. That's a golden statistic when a captive approaches a potential fronting partner.

The captive and fronting partner company will operate most efficiently when they build an "underwriting box" that defines acceptable parameters of coverage. Inside the box, you can sign up an applicant and manage all aspects of the business. Applications that fall outside the box can still be submitted for approval on exception.

If this ART-based approach gains momentum toward market prevalence it could create a two-tier workers' compensation universe with all the good risks covered by fronted captives and the poor risks facing expensive commercial coverage or state funds. That will provide the incentive to increase safety management to gradually decrease claims and reduce employers' risk profiles. And that would be a good thing.

Dick Goff is managing member of The Taft Companies LLC, a captive insurance management firm and Bermuda broker at dick@taftcos.com.