Is the Self Insurance Option for You?

National Self Insurance Summit 2010

Mark Hurst

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Outline of presentation

1. What are your options?
2. Who can be self insured?
3. Financial assessment

   => self insurance v insurance
4. Other financial considerations
5. Requirements of self insurers
6. Current issues
7. Conclusion

What are your options?

What are your options?

- **Insurance under state-based schemes**
- Advantages
  - Pay premiums
  - Simple
  - Costs reasonably well known
- Disadvantages
  - Premiums may be significantly higher than costs under self insurance
  - Less control over costs
  - Different OH&S rules
  - Different premium formulas/processes
  - Many regulators to deal with

What are your options?

- **Self insured under State-based schemes**
- Advantages
  - Potential to be significantly lower cost than premiums
  - More control over business
  - Potential cashflow benefits
- Disadvantages
  - Approval process can be demanding
  - Potentially more volatile cash flows
  - Have to pay full amount of claims up to reins. retention
  - Expenses: upfront and ongoing
  - Long term claims can last forever
  - Directly responsible for unpopular decisions
  - Requires commitment from senior management

What are your options?

- **Self insured under Comcare scheme**
  (Not currently available due to moratorium)
- Specific advantages
  - One set of OH&S rules
  - Uniform set of benefits / rules across all employees
  - Equality across staff
  - Simpler systems and processes
  - Lower compliance costs
  - Single dispute resolution process
  - Potential to standardise / centralise claims management
- Specific disadvantages
  - Must compete with Commonwealth authority
  - Require separate licence for each legal entity
  - Weekly benefits generous (and long term)
  - Employee issues

Who can be self insured?

Who can be self insured?

- Different rules for every state
  - NSW / Comcare: must have at least 500 employees
  - Qld: 2000 employees
  - SA: 200 employees
  - Vic / Tas / WA: no minimum
- Financial resources to pay benefits
- Good OH&S systems – adequate safety procedures and safe working conditions
- Capacity to properly administer claims (either by own staff or outsourced)
- Procedures for rehab and return to work for injured employees

Who can be self insured?

- Self insurer licences
  - NSW: whole group or single licence (must be 100% owned)
  - Vic, Qld & SA: have to self insure whole company
  - Tas, WA: no restraints
  - Comcare: need licence for each legal entity

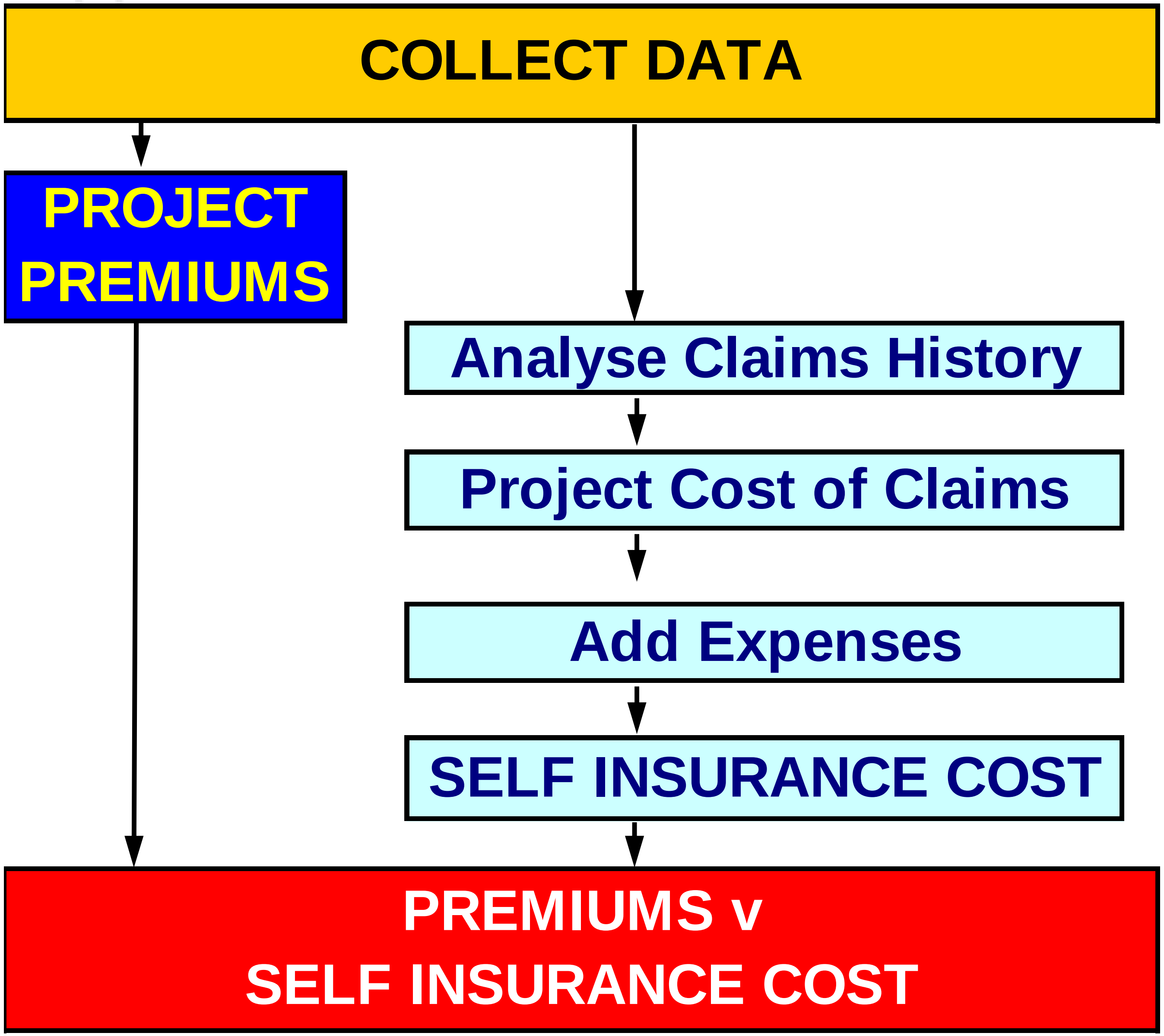
- In Vic, Qld, SA must take on pre-self insurance ("tail") claims – receive payment from WorkCover

Financial assessment

Financial assessment

- **Compare premiums currently paying for insurance with the expected costs under self insurance**
  - Perform comparison historically and then project for future years

Assessing financial viability



Collect data

- **For each <u>State</u> and <u>company</u> going back <u>5 to 10 years</u> collect:**
  - Premiums
  - Wages and employee numbers
  - Individual claims data
    - Both Open and Closed claims
    - All claims at each balance date for last 5 to 10 years to understand how claim costs have developed over time

Collect data

- **Other information**
  - Projected wages and employee numbers
  - Details of how the company has changed, and is expected to change (eg. acquisitions, claims management changes, risk management initiatives)
- **Data adjustments**
  - Exclude divested/lapsed companies
  - May want to exclude nil/minor claims
  - “Gross up” latest year if not full 12 month period

Collect data

- **Data checks**
  - Individual data v any Board / management reports
  - Does level of average claim size and claim frequency look reasonable
  - Have numbers and costs moved sensibly over time
  - Review largest claims
- **Data collection (and validation) can be a lengthy process**

Collect data

Wages & Premiums

Year	Wages	Premiums	Premium rate
	$m	$m	
2005	330	3.1	0.9%
2006	340	2.8	0.8%
2007	360	2.1	0.6%
2008	380	2.2	0.6%
2009	390	2.9	0.8%

Claims data

Injury Year	Claim Numbers	Claim Costs	% of Wages
		$m	
2005	233	0.8	0.2%
2006	218	1.9	0.6%
2007	300	1.1	0.3%
2008	202	1.4	0.4%
2009	137	0.6	0.1%

Assessing financial viability

1. Collect data
2. **Project premiums**
3. Self Insurance Cost
   i. Analyse claims experience
   ii. Project cost of claims
   iii. Add expenses
4. Projected Premiums v Self Insurance Cost

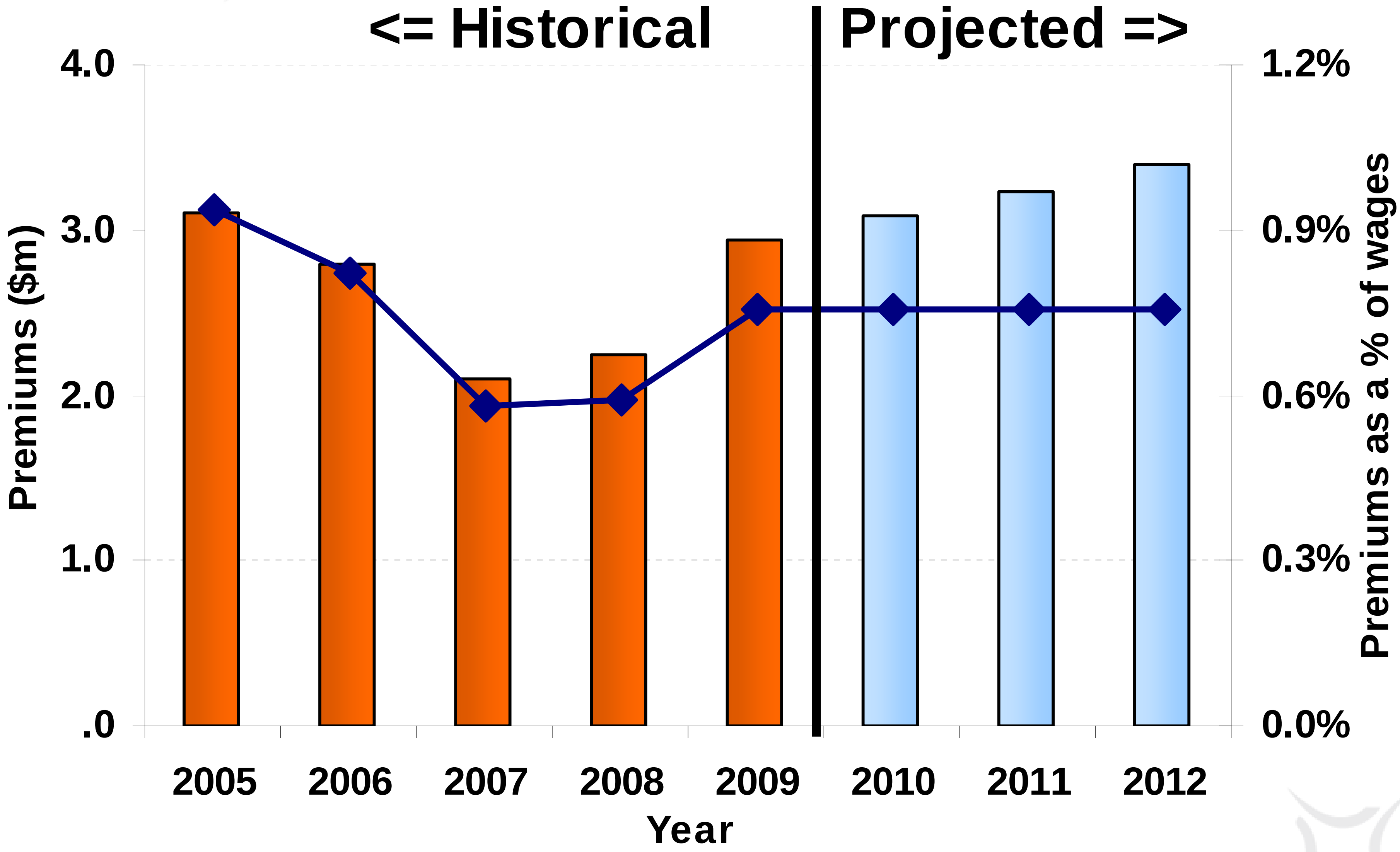
Premiums

- **Analyse the premiums you are paying:**
  - How much are you paying in each state?
    - May be worth considering self insurance in some States and not others
  - Are premiums (rates) reducing/increasing?
  - What are your expectations for premiums going forward?
    - Consider funding ratio of schemes, historical movements in premiums, benefit changes, legislative reforms etc
    - Changes to your organisation?

Premiums

- **Helpful to understand mechanics of the premium formula:**
  - Rules and premium formulae vary by State
  - The larger the employer the more weight that is generally given to the claim experience component in the premium formula
  - Reductions in industry premium rates may not mean lower premiums

Premiums



<= Historical
Projected =>
Premiums ($m)
4.0
3.0
2.0
1.0
.0
1.2%
0.9%
0.6%
0.3%
0.0%
Premiums as a % of wages
2005
2006
2007
2008
2009
2010
2011
2012
Year

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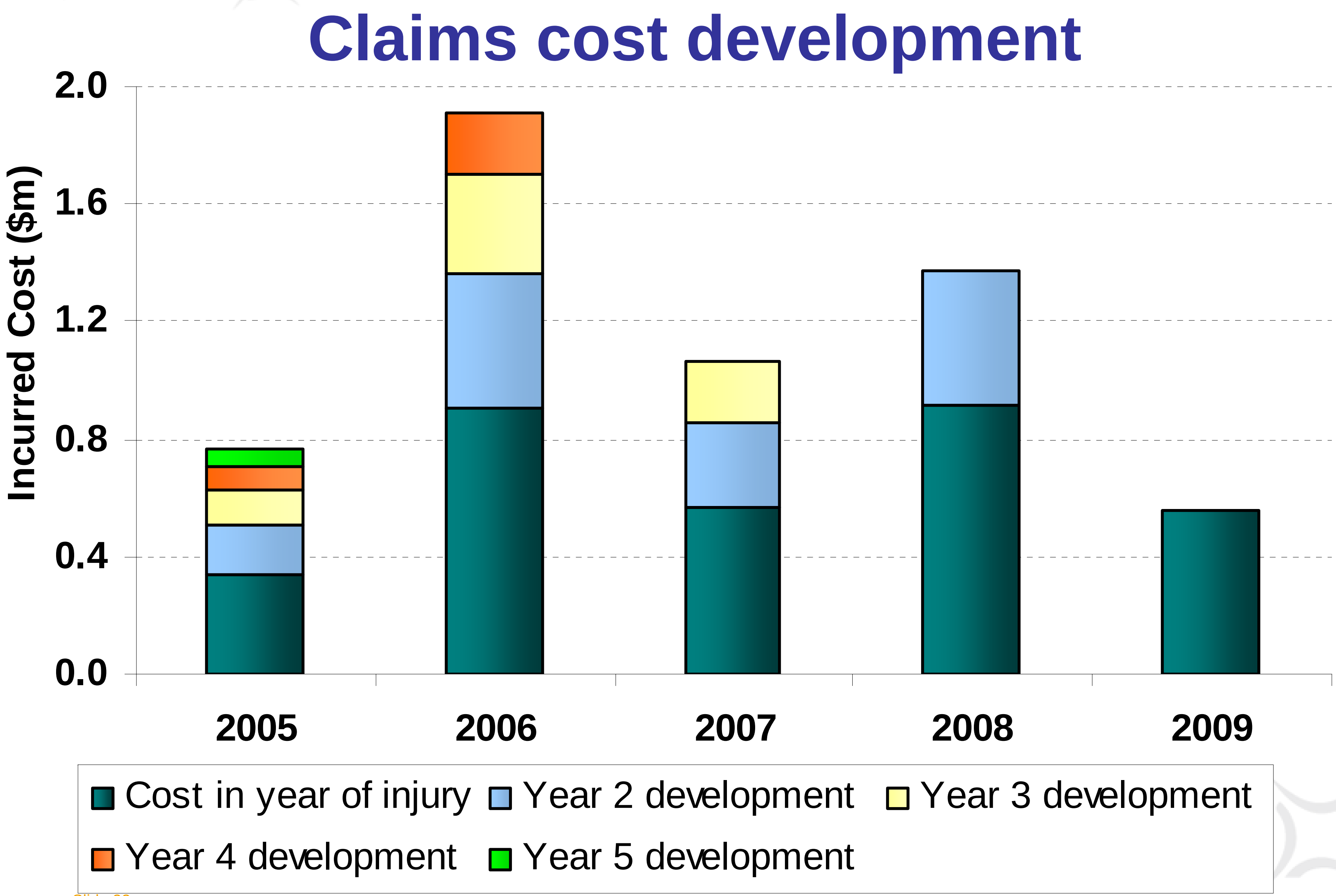
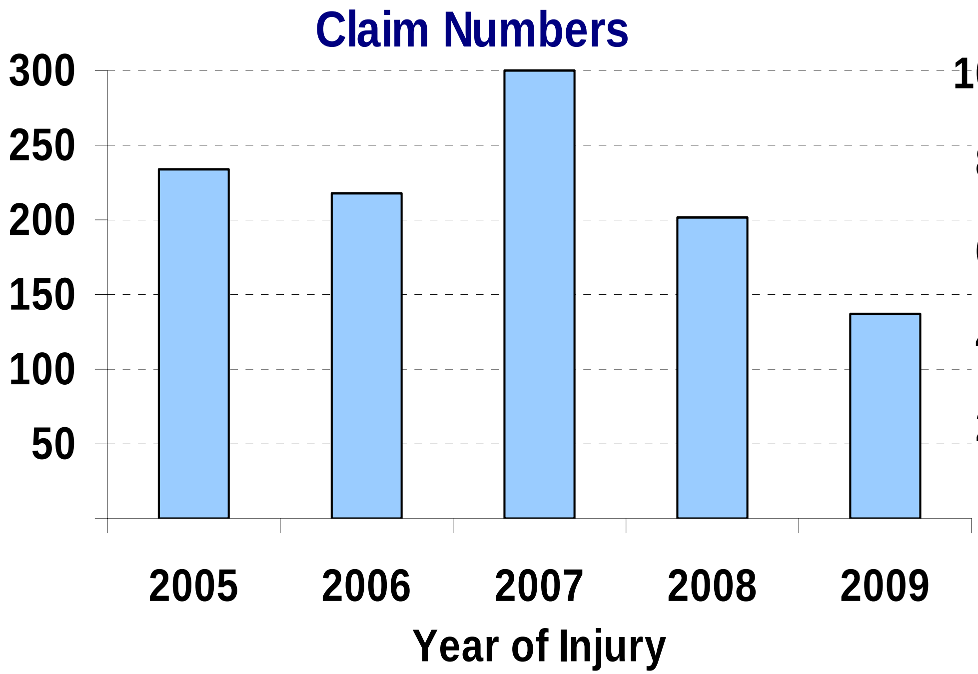
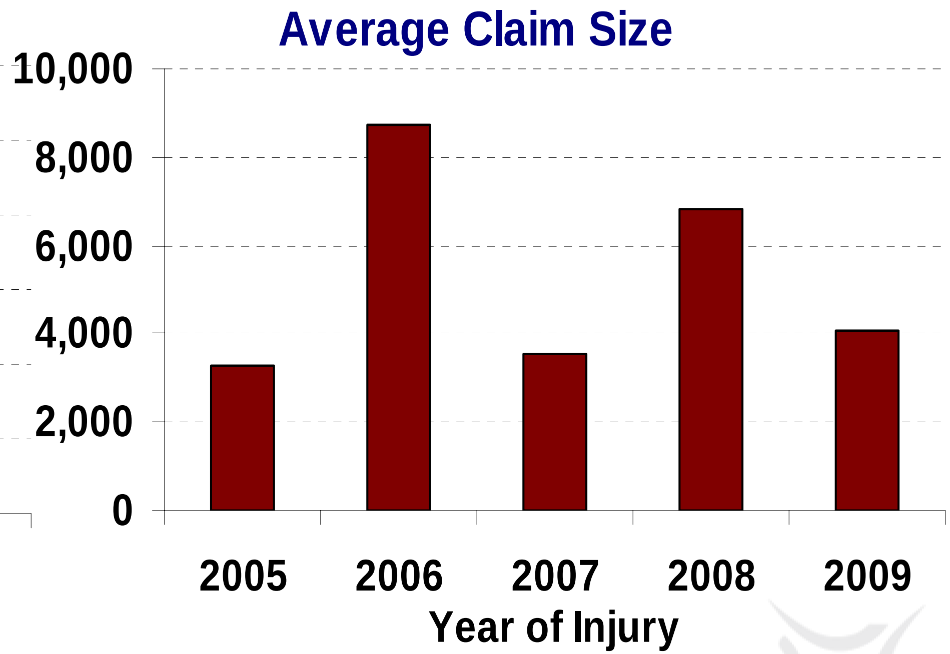
Analyse claims experience



Analyse claims experience

- Also look at components - claim numbers and average claim size - to check if any underlying trends
- Talk to employer to help understand experience





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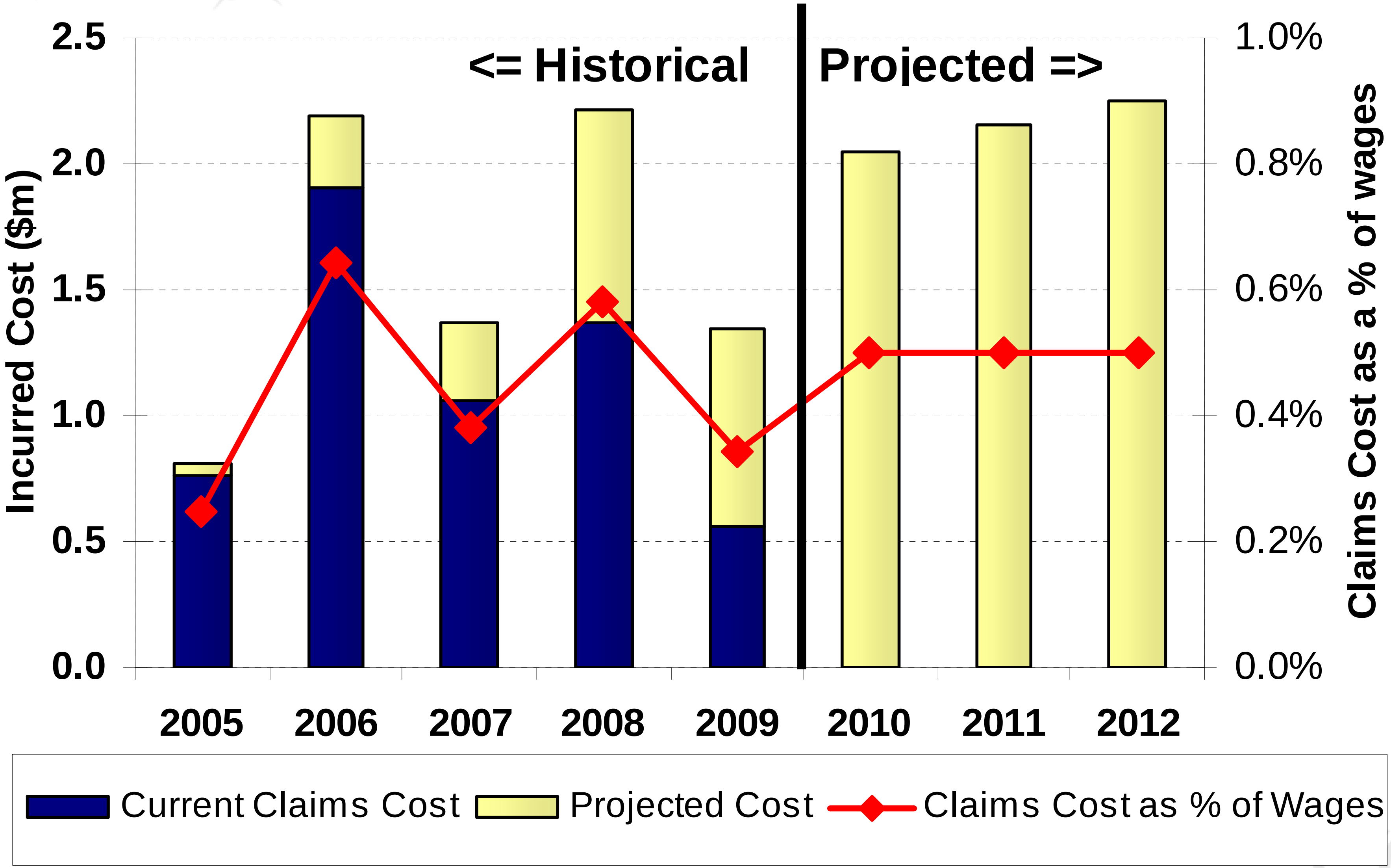
Project cost of claims

- **First project historical claims cost by allowing for:**
  - Late reported claims
  - Development of existing claims
- **Assumptions regarding future experience:**
  - Base on employers’ claims experience
  - Supplement with industry experience, benchmarks as employers’ own data often relatively small
  - Allow for trends in claims experience, employer growth, change in the company’s profile, legislative changes

Project cost of claims



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Self insurance expenses

- **Claims management expenses**
  - Internal costs including claims handling, management time and administration costs
  - Benchmark allowance = 10% of claims costs

- **Reinsurance premiums**
  - Must purchase reinsurance to provide financial protection from large claims and costly events
  - Reinsurance retentions typically $0.5 - $1 million per event
  - Considerations include: Rules of regulator, price, own large claims experience, risk appetite
  - Benchmark price = approx 0.05% - 0.1% of wages

Self insurance expenses

- **Cost of bank guarantee**
  - Bank guarantee required to secure self insurance liabilities
  - Bank guarantee amount required generally around 150% of liabilities (varies by state)
  - Benchmark cost = 1.0% of Bank guarantee amount

- **Annual Scheme levies**
  - Levies imposed by WorkCover authorities to cover costs of regulation (eg. audits)
  - Vary by state

Self insurance expenses

- **Other ongoing expenses include:**
  - Actuarial / audits / legal: $100k p.a. for this example (varies by State)
  - Consultants (OH&S, ongoing IT): $50k

Self insurance expenses

- **One-off expenses include:**
  - Licence fees: varies by State
  - IT one-off costs: can be significant one-off costs depending on whether managing in-house or outsourcing claims management
  - Audits: OH&S, other
  - Actuarial: for feasibility studies / bank guarantee and tail liability estimates
  - Exit fees: particularly SA
  - Internal training of staff

Self insurance expenses

- Indicative expenses only
- Need to investigate level of expenses
- Excludes one-off costs other than licence fee

Expenses	Basis		Year 1 Expenses
			$000
Claims management expenses	10%	of claims cost	**210**
Excess of loss reins ($0.75m)	0.08%	of wages	**330**
Bank Guarantee	1.0%	of bank g'tee amount	**30**
Annual Levies	4%	of notional premium	**80**
Actuarial, IT and Legal	Other Clients		**100**
Consultants	Other Clients		**50**
Licence Fee	WorkCover		**30**
Total assumed expenses			**750**

Assessing financial viability

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Premiums v Self insurance cost

	Premiums		Self Insurance Cost				
Year	Premium	Premium Rate	Projected Claims Cost	% of Wages	Self Insurance Expenses	Self Insurance Cost	Implied Savings/ (Loss)
	$m		$m		$m	$m	$m
2005	**3.1**	0.9%	0.8	0.2%			
2006	**2.8**	0.8%	2.2	0.6%			
2007	**2.1**	0.6%	1.4	0.4%			
2008	**2.2**	0.6%	2.2	0.6%			
2009	**2.9**	0.8%	1.3	0.3%			
2010	**3.1**	*0.8%*	2.1	*0.5%*	0.8	**2.8**	**0.3**
2011	**3.2**	*0.8%*	2.2	*0.5%*	0.7	**2.8**	**0.4**
2012	**3.4**	*0.8%*	2.3	*0.5%*	0.7	**3.0**	**0.4**

- In this example there are estimated to be savings even prior to allowing for potential improvements in experience due to self insurance

Sensitivity testing

- Important to test sensitivity of results to changes in key assumptions:
  - Projections are uncertain and claims experience may differ from projected
    - *eg. more large claims than expected*
  - Reduced claim costs under self insurance
    - *savings of 10-30% not uncommon*
  - Scheme premiums reduce / increase
    - *Often depends on funding position of Scheme*
  - Benefits increase

Comcare adjustments

- For Comcare assessment need to adjust projected claim costs for different benefits payable under Comcare
- Adjustments depend on:
  - Type of claims that the employer gets (which depends on industry)
    - Long term weekly claims
    - Journey claims
    - Stress claims
  - The States they operate in

Comcare adjustments

- Benchmark allowances used in this example:
  - **Weekly benefits** (depends on number of potential long term claims) = +10% say
  - **Journey claims** (some offset, depends on the number of journey claims currently receive)

    = - 5% say
  - **Stress claims** (again some offset, highly dependant on industry and employer)

    = -2.5% say

Comcare adjustments

- Lower expenses under Comcare than if self insured across several states:
  - Claims management expenses – differences may arise due to different claims experience and some centralisation of claims management function may be possible
  - Reinsurance premiums – no difference?
  - Bank guarantee, annual levies, licence fees and actuarial costs all expected to be significantly less under Comcare but depends on number of states
    - *Assumed approximately 1/3rd*

Other financial considerations

Other financial considerations

- Volatility of cash flows under self insurance
- Whether need to do analysis by division
- Management of long term claims
- Some states have to take on tail claims (Vic, SA, Qld)
- Exposure to any latent disease claims such as asbestos
- Exit fees
- Potential cash flow benefits

Requirements of self insurers

What is required of self insurers?

- Ongoing financial viability
- Need reinsurance
- Need to provide annual report & audited financial statements
- Annual actuarial assessment of claim liabilities
- Provision to cover claim liabilities in balance sheet
- Bank guarantee to secure liabilities

What is required of self insurers?

- Manage claims to certain standards
- Outsourcing must be approved
- Injury management requirements to be satisfied on an ongoing basis
- OH&S audits
- Reporting requirements - typically:
  - Audited financial statements
  - Actuary’s report of outstanding claims liabilities
  - Monthly data return (data downloads)
  - Annual return

What capital is required?

- Typically self insurers require only minimal additional capital (relative to overall business)
  - particularly the case when claims management is outsourced
- Capital required for:
  - Any additional staff (e.g. claims, OH&S)
  - Licence costs
  - IT systems
- Required to hold provision on balance sheet = actuarial estimate of outstanding claims liability
  - Whether to hold risk margin is management decision
  - Risk margins for workers compensation typically 10-15% of outstanding claims liability

Current issues

Current issues

- In deciding whether to self insure need to consider current issues. Some of these include:
  - **NSW** - burner premium on offer
  - **Victoria** - change in legislation / benefits
  - **Qld** – reduction in funding position. Premiums to increase? Common law trends
  - **SA** – deficit. Premiums stable. Exit fees
  - **Tas** – legislation to be introduced July 2010
  - **Comcare** – moratorium until 2011
  - **National -** drop in funding ratio for Schemes. OH&S laws to be harmonised. Increased retirement age

Conclusion

Conclusion

- **Self insurance offers the potential for significant savings as:**
  - Not subsidising poor performers and small employers who are not experience rated
  - Not financing past deficits *OR* paying insurer's profit margin in underwritten states
  - Cost of claims feeds directly into P&L so may be more focus on improving safety and keeping costs down
  - More control over management of claims
  - Cashflow advantages relative to premiums
- BUT it does require significant commitment from employer over an extended period

Questions?

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