

Beating the Insurance Dilemma: Solutions for Middle Market Companies

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AGENDA

- The Insurance Dilemma
- Beating the Insurance Dilemma - Spectrum of Risk
- Captives
- Retro Plans
- Large Deductible Plans
- Self Insurance
- Closing Comments







RISK MANAGEMENT PRINCIPLES

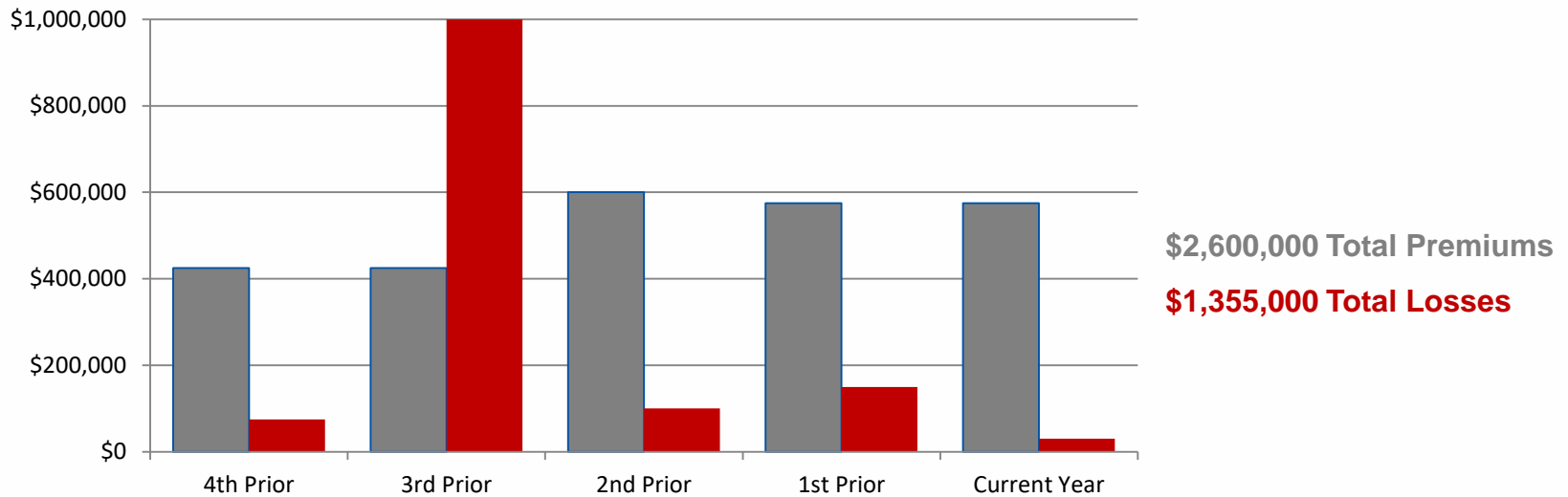
Basic Acknowledgment

- Losses can be controlled. But some are inevitable

Basic Approach:

- Retain losses that are predictable
- Transfer losses that are not – losses that are catastrophic in nature
- Find the most effective method in reducing the total cost of risk over a period of time

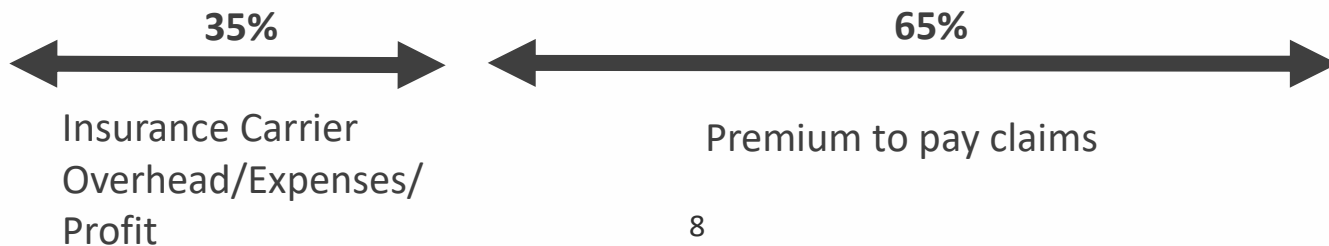
THE THEORY



You would be better off not buying insurance and paying your claims out of pocket. Unfortunately, most companies can't survive when they suffer a catastrophic claim, particularly when it happens early in the organization's existence.

INSURANCE CARRIER ECONOMICS

For every \$1.00 an insurance company takes in, it wants to pay \$0.65 or less in claims. If it is able to do so, it makes an underwriting profit.



IDEAL ALTERNATIVE RISK CANDIDATES

- Currently paying \$200,000+ of premium for WC, GL, and Auto coverage
- Favorable historical claim experience
- Comfortable with calculated upside risk
- Financially stable
- Strong commitment to safety and risk management
- Prefer a long-term solution over the transactional renewal process



SPECTRUM OF RISK – BEATING THE INSURANCE DILEMMA



	Guaranteed Cost	Group Captive	Retro Plan	Large Deductible	Self-Insurance
Premium	100% Fixed	Fixed Costs + Loss Funds	Fixed Costs + Claim Allocations	Fixed Costs + Claims Paid	Admin Costs + Claims Fund
Typical Premium Range	\$0-\$500K	\$200K-\$1M	\$300K-\$1.5M	\$500K+	\$1M+
Typical Deductible	None	\$75-100K	\$100k+	\$250K+	\$500k+
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Premium Sensitivity to Losses	None	Moderate	Moderate	High	High
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Risk Sharing	No	Yes	No	No	No

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GROUP CAPTIVES

First step away from the guaranteed cost world.

Concept: Retain losses that are predictable (frequency losses) and transfer losses that are not (catastrophic/severity) losses

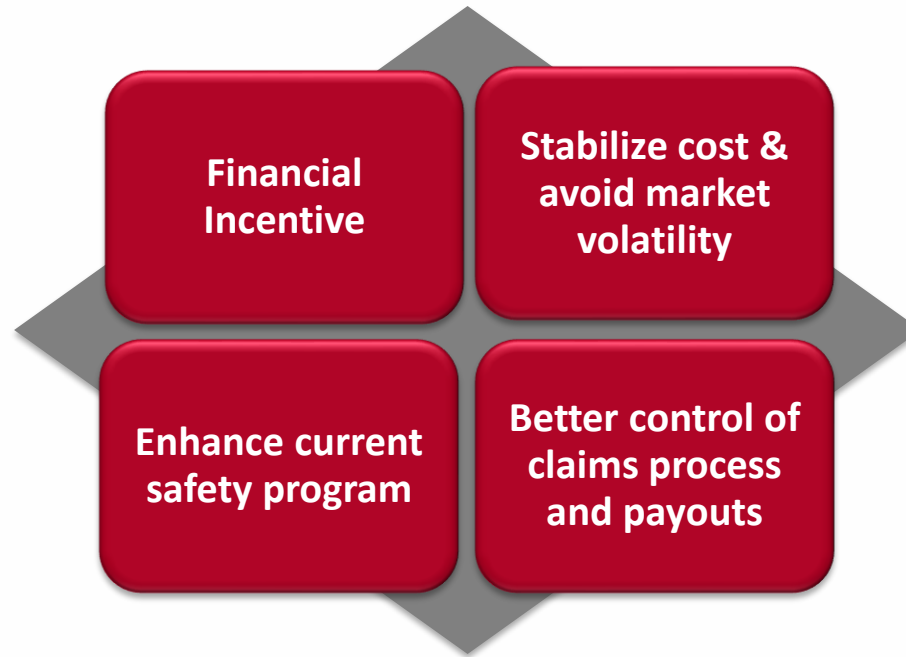
Frequency losses that are controlled through:

1. Safety
2. Claims Management

Catastrophic/Severity losses are managed through:

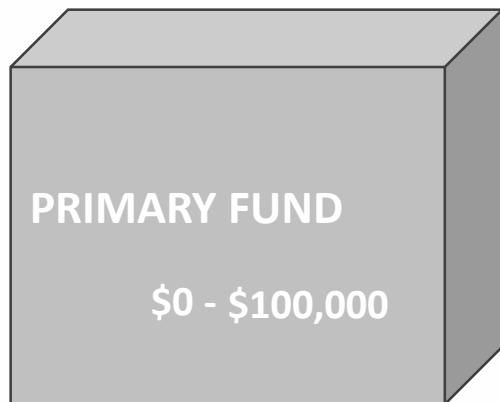
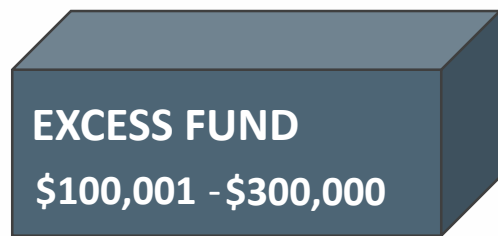
1. Risk Sharing
2. Reinsurance

WHY COMPANIES JOIN - THE ADVANTAGE



- 1) **Financial Incentive:** Get up to 50% of your premium back each year.
- 2) **Stabilization:** Avoid swings in the marketplace. Renewals become more predictable and stable over time.
- 3) **Safety:** Dedicated safety consultant to supplement your current safety program.
- 4) **Claims:** Unbundled approach. Lower costs and more control.

MEMBER LOSS FUNDS



Initial Pay-in Premium includes:

1. Primary Fund (Member claims < \$100,000)
2. Excess Fund (Group claims >\$100,000)
3. Operating Costs

$$\text{PAY-IN} = \text{Primary} + \text{Excess} + \text{Operating Costs}$$

Member can be assessed for One (1) additional Primary Fund

$$\text{MAX} = 2 \times \text{Primary} + \text{Excess} + \text{Operating Costs}$$

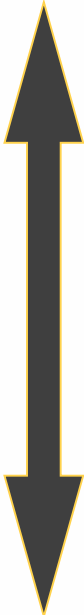
Assessments occur when:

- Your claims that are less than \$100,000 exhaust the Primary Fund
- Group claims exhaust all member funds

CAPTIVE MECHANICS

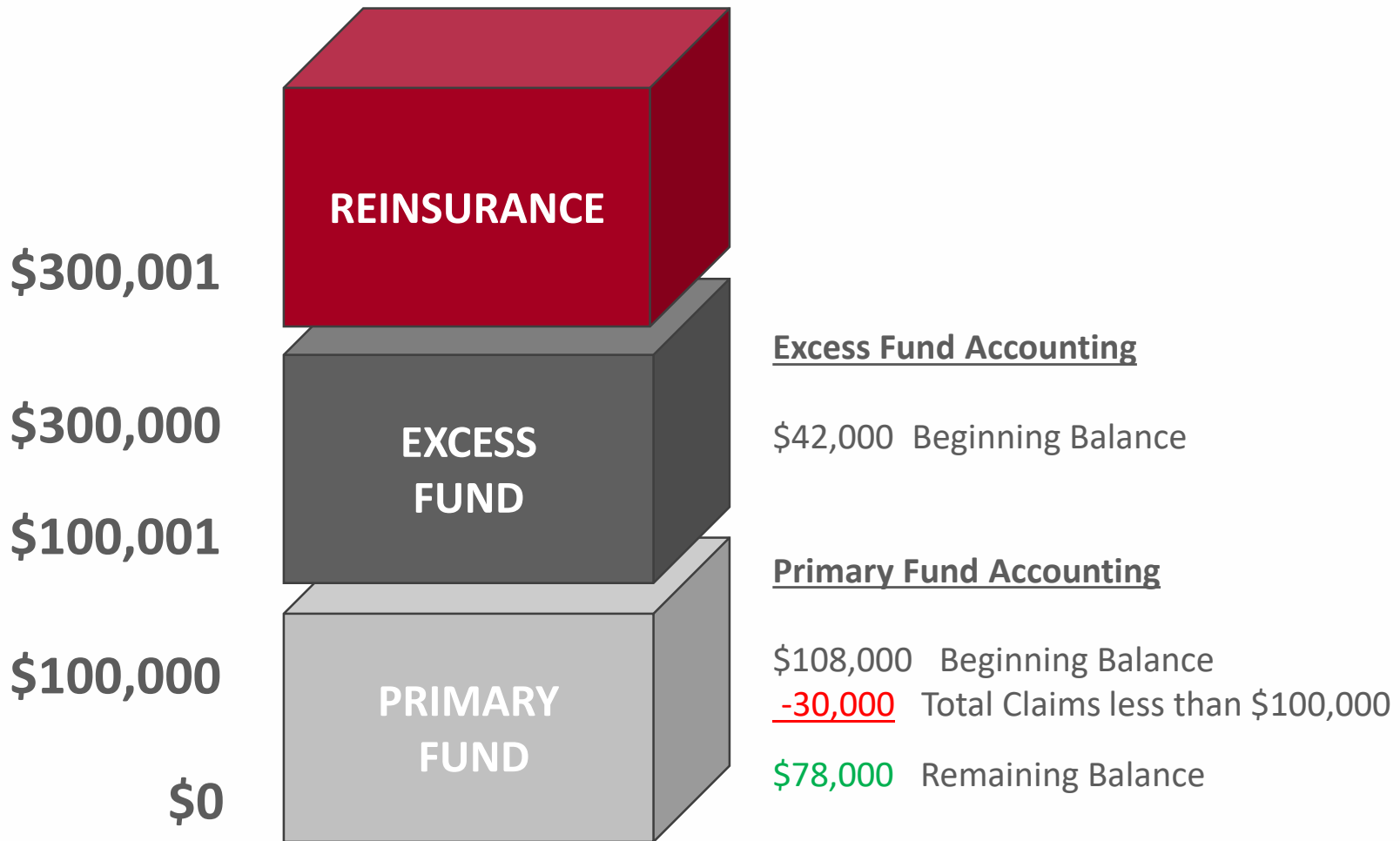
Sample member is paying \$300,000 in total pay-in premium

Premium Breakdown

Operating Costs:	\$150,000		MIN \$150,000
Loss Funds:			
Primary Loss Fund:	\$108,000		
Excess Loss Fund:	<u>\$42,000</u>		
Total Loss Funds	\$150,000		PAY IN \$300,000
Potential Assessment:	\$108,000		MAX \$408,000

LOSS EXAMPLE #1 – A TYPICAL YEAR

\$30,000 of total claims less than \$100,000 per claim

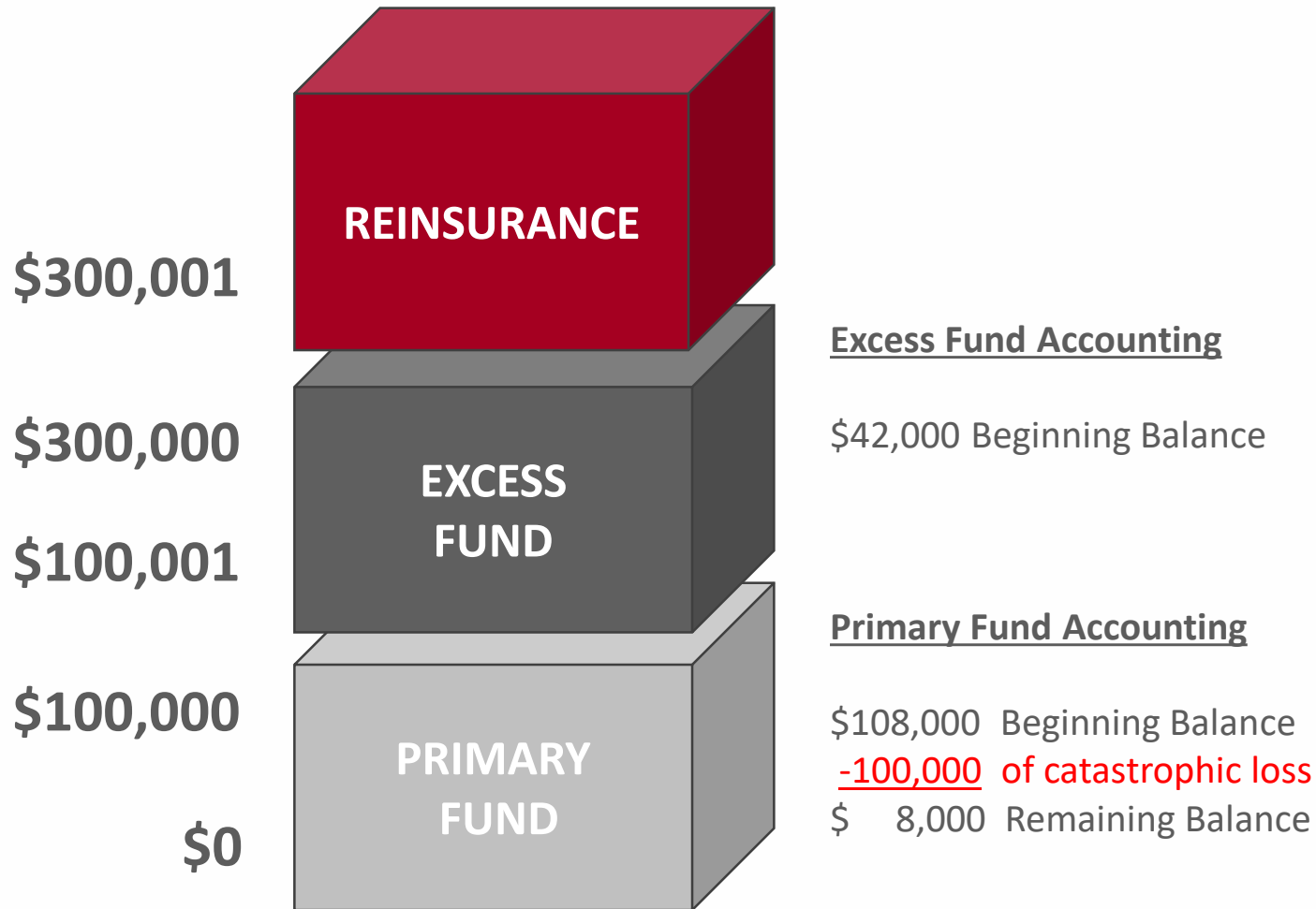


LOSS EXAMPLE #1 – ESTIMATED RETURN

\$ 78,000 Primary Fund
+ 42,000 Excess Fund
+ 5,000 Estimated Interest
\$ 125,000 Estimated Return

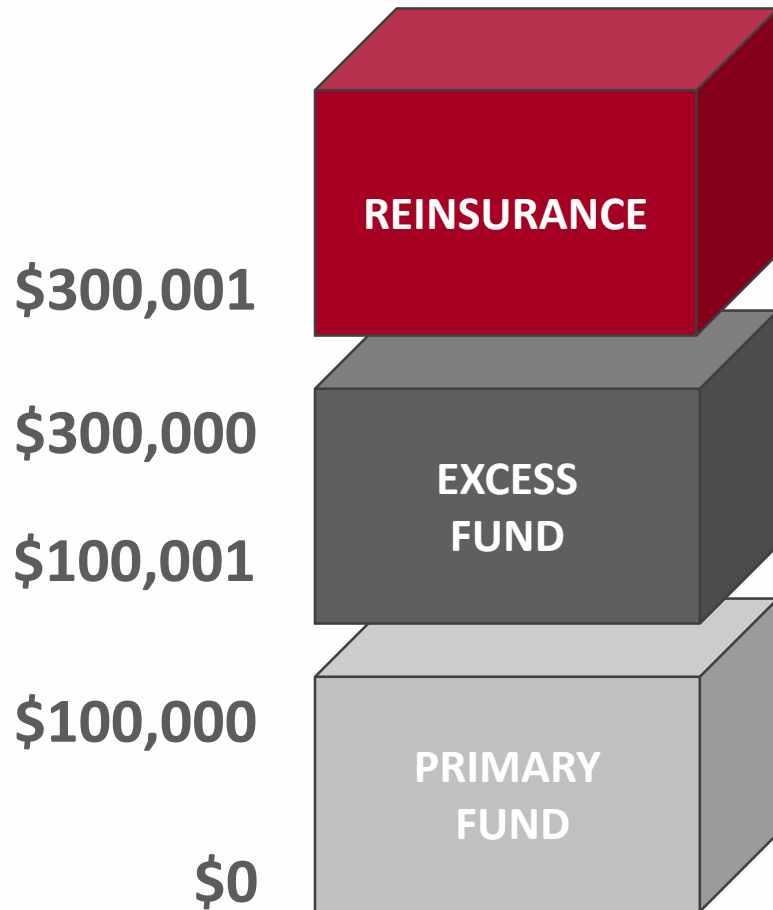
LOSS EXAMPLE #2 - A CATASTROPHIC YEAR

\$1,000,000 catastrophic claim.



LOSS EXAMPLE #2 – A CATASTROPHIC YEAR

\$1,000,000 catastrophic claim.



Excess Fund Accounting

\$42,000 Beginning Balance
-42,000
 \$ 0 Excess Fund Balance

Primary Fund Accounting

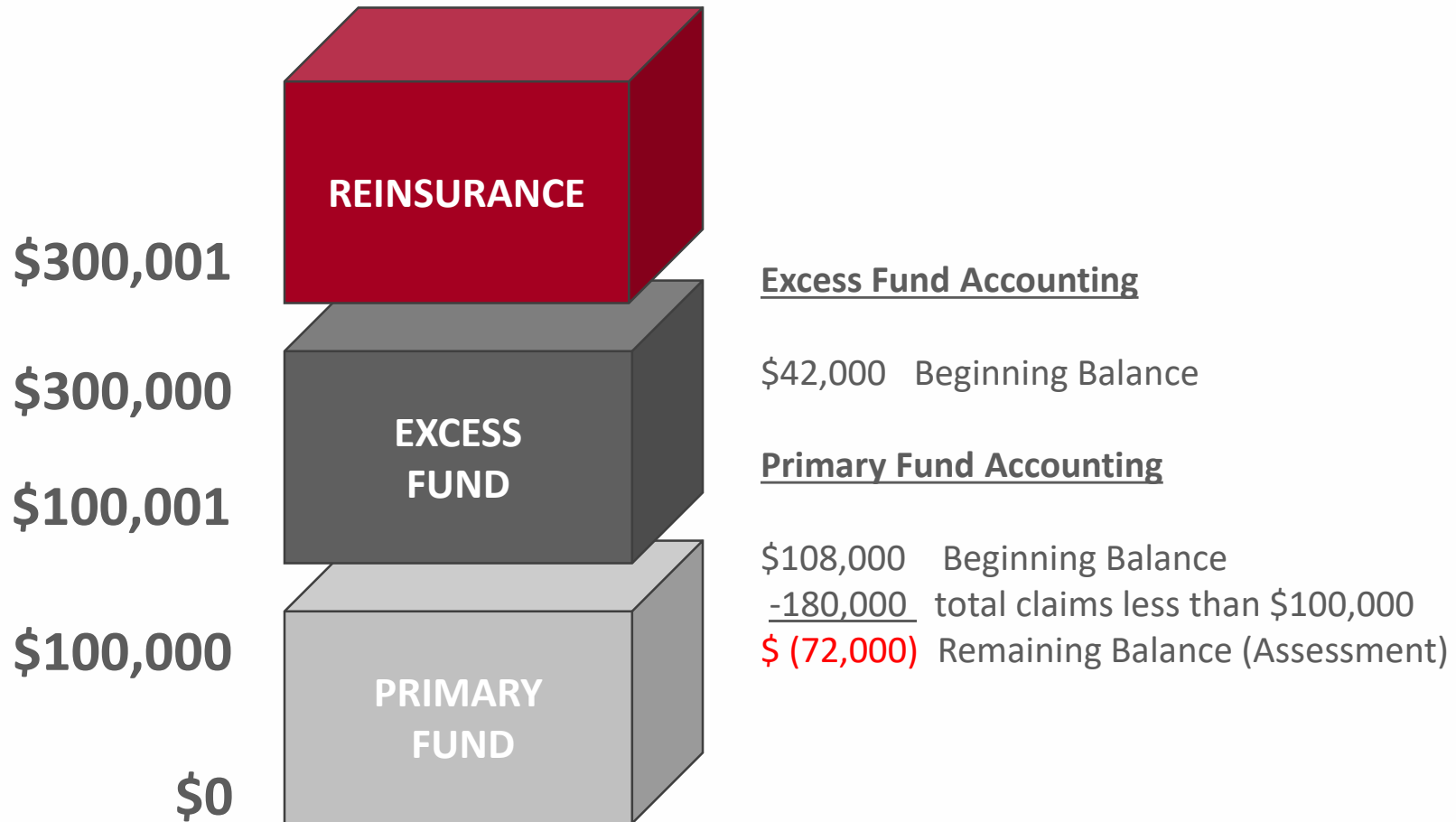
\$8,000 Beginning Balance
-8,000 of catastrophic loss
 \$ 0 Primary Fund Balance

A CATASTROPHIC YEAR – FINANCIAL IMPACT

- Majority of Loss Reinsured Away
 - \$1,000,000 Claim
 - \$700,000 Transferred to Reinsurer
 - \$300,000 Retained by Captive
- Impact on Risk Sharing Minimized
 - Member contributed \$108,000 from Primary Fund
 - Member contributed \$42,000 from Excess Fund
 - Total Member contribution - \$150,000
 - Group shared \$150,000 on a pro-rata basis – Impact on other members minimized

LOSS EXAMPLE #3 – A HIGH FREQUENCY YEAR

\$180,000 of total claims less than \$100,000 (Ex. ten \$18,000 claims)



LOSS EXAMPLE #3 – A HIGH FREQUENCY YEAR

\$ 42,000 *Excess Fund Balance*

+ 5,000 *Estimated Interest*

\$ 47,000 *Estimated Results*

\$72,000 Assessment - Paid over 3 years on a quarterly basis

CAPTIVE FINANCIAL ANALYSIS (EXAMPLES)

Policy Year	Captive Pay In Cost	Captive Fixed Costs	Captive Losses	Net Captive Cost* (Fixed Costs + Losses+ 3% Est. Risk Sharing)	Equity
19-20	\$ 205,000	\$ 98,400	\$ 4,292	\$ 108,842	\$ 96,158
18-19	\$ 205,000	\$ 98,400	\$ 1,688	\$ 106,238	\$ 98,762
17-18	\$ 205,000	\$ 98,400	\$ 255,688	\$ 287,000	\$ (82,000)
16-17	\$ 205,000	\$ 98,400		\$ 104,550	\$ 100,450
15-16	\$ 205,000	\$ 98,400	\$ 42,225	\$ 146,775	\$ 58,225
Total	\$ 1,025,000	\$ 492,000	\$ 303,893	\$ 753,405	\$ 271,595

*Table includes 3% risk sharing per year 48% Fixed Costs

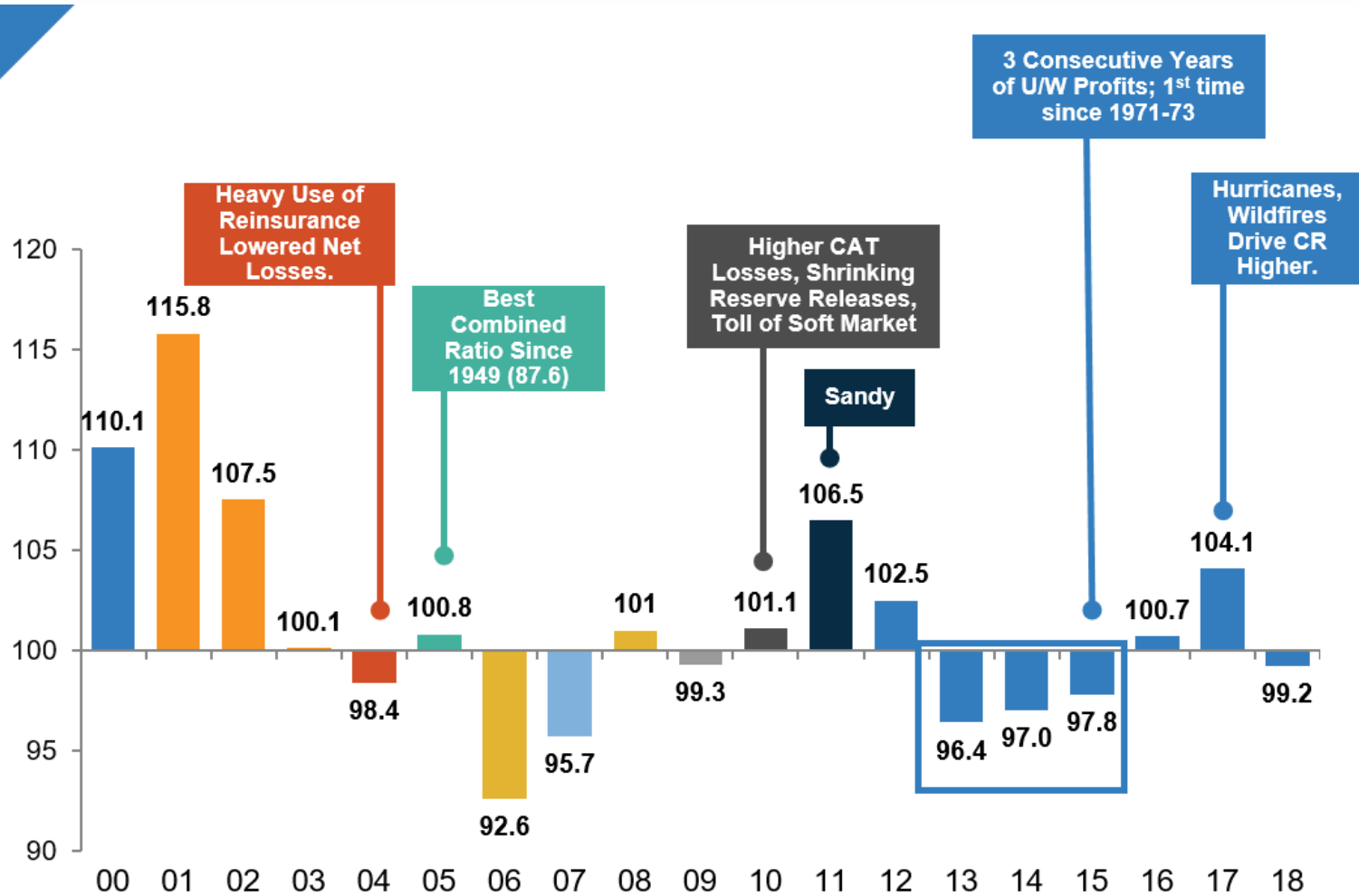
5 Year Equity Balance \$271,595

Policy Year	Captive Pay In Cost	Captive Fixed Costs	Captive Losses	Net Captive Cost* (Fixed Costs + Losses+ 3% Est. Risk Sharing)	Equity
2017-18	\$ 258,555	\$ 124,106	\$ 26,170	\$ 158,033	\$ 100,522
2016-17	\$ 265,194	\$ 127,293	\$ 651	\$ 135,900	\$ 129,294
2015-16	\$ 267,557	\$ 128,427	\$ 19,145	\$ 155,599	\$ 111,958
2014-15	\$ 279,303	\$ 134,065	\$ 8,041	\$ 150,486	\$ 128,817
2013-14	\$ 256,078	\$ 122,917	\$ 8,774	\$ 139,374	\$ 116,704
Total	\$ 1,326,687	\$ 636,810	\$ 62,781	\$ 739,391	\$ 587,296

*Table includes 3% risk sharing per year 48% Fixed Costs

5 Year Equity Balance \$587,296

INSTABILITY



Sources: Insurance Information Institute, A.M. Best; ISO, a Verisk Analytics company; I.I.I. estimate for 2018.

Fee Transparency or Iceberg?

An image of an iceberg floating in the ocean. The tip of the iceberg is visible above the water surface, while the much larger, submerged part is visible below. A horizontal line separates the surface and the submerged parts. A white arrow-shaped callout box points to the tip of the iceberg.

Typically the focus is here.

But what's below the surface?

Cost of claim

- Liability
- Workers' Compensation

- Bill Review Fee Schedule
- Targeted Bill Review
- Specialty Bill Review
- PPO Fees
- PT Network Fees
- Triage Fees
- TCM Fees
- FCM Fees
- Diagnostic Services
- Pharmacy Bill Review
- Durable Medical Equipment
- Recovery and Subrogation
- RMIS Access Fees
- Administration Fees
- Claim Reporting Fees

OTHER CONSIDERATIONS - TYPICAL REQUIREMENTS

- Each underwriting year stands on its own. One bad year won't have a large impact on renewal pricing.
- One time purchase of share of stock
- Typical collateral requirements:
 - 85% of Annualized Primary Fund 1st Year
 - 85% of Annualized Primary Fund 2nd Year
 - 85% of Annualized Primary Fund 3rd Year

Total = 2.5X Average Annualized Primary Fund

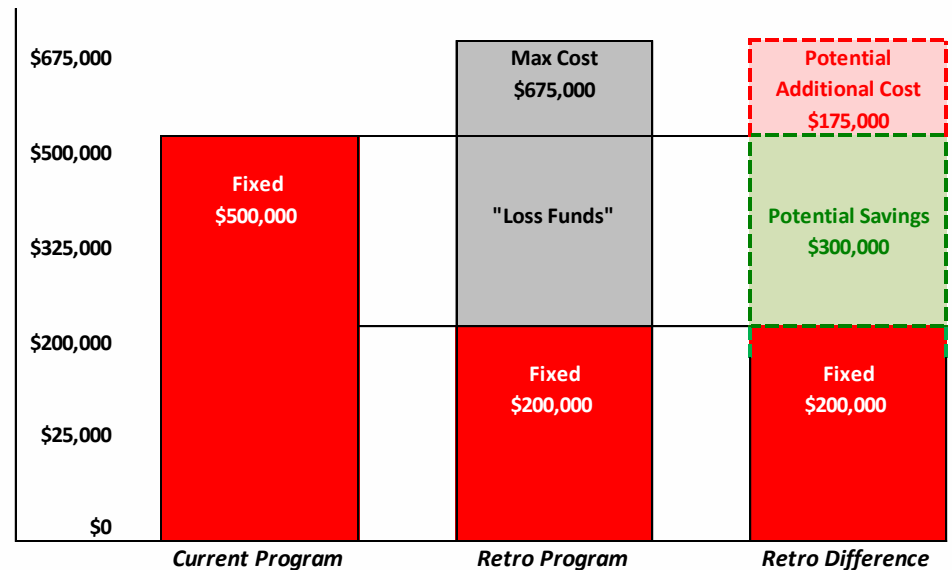
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RETRO PLAN

- Individual arrangement, no group risk sharing
- Can include WC, GL, and Auto
- Can be structured on a paid loss or incurred loss basis – depending on structure, there can be a cash flow advantage
- Opportunity for 60%+ premium savings
- 30-40% upside risk
- Carrier or 3rd party safety services
- Carrier or 3rd party claims administration
- May require collateral



RETRO QUOTE SUMMARY -

Loss Levels	Converted Losses x TM (Loss x LCF)	Minimum Premium (Basic x TM)	Indicated Retro Premium (IRP)	IRP % of Standard Premium	Non-Subject Premium	Total Program Cost
\$0.00	\$0.00	\$190,328.75	\$190,328.75	38.66%	\$10,311.89	\$200,640.64
\$45,000.00	\$50,163.37	\$190,328.75	\$240,492.12	48.84%	\$10,311.89	\$250,804.01
\$90,000.00	\$100,326.73	\$190,328.75	\$290,655.48	59.03%	\$10,311.89	\$300,967.37
\$135,000.00	\$150,490.10	\$190,328.75	\$340,818.85	69.22%	\$10,311.89	\$351,130.74
\$180,000.00	\$200,653.46	\$190,328.75	\$390,982.21	79.41%	\$10,311.89	\$401,294.10
\$225,000.00	\$250,816.83	\$190,328.75	\$441,145.58	89.60%	\$10,311.89	\$451,457.47
\$270,000.00	\$300,980.19	\$190,328.75	\$491,308.94	99.78%	\$10,311.89	\$501,620.83
\$315,000.00	\$351,143.56	\$190,328.75	\$541,472.31	109.97%	\$10,311.89	\$551,784.20
\$360,000.00	\$401,306.92	\$190,328.75	\$591,635.67	120.16%	\$10,311.89	\$601,947.56
\$405,000.00	\$425,136.25	\$190,328.75	\$615,465.00	125.00%	\$10,311.89	\$625,776.89
Loss Levels to Reach:						
Minimum Premium	\$0.00	\$190,328.75	\$190,328.75	38.66%	\$10,311.89	\$200,640.64
Standard Premium	\$270,953.64	\$190,328.75	\$492,372.00	100.00%	\$10,311.89	\$502,683.89
Maximum Premium	\$381,376.55	\$190,328.75	\$615,465.00	125.00%	\$10,311.89	\$625,776.89

- ♦ Indicated Retro Premium (IRP) calculation = {(Standard x Basic Factor*)} + (Incurred Losses x LCF) x Tax Multiplier
*Basic Factor includes all insurance charges
- ♦ Allocated Loss Adjustment Expense (ALAE) is included in billable loss(es).

RETRO PLAN – KEY DIFFERENCES FROM A CAPTIVE

- Individual arrangement, no group risk sharing
- Less control in a retro plan, especially if carrier requires the carrier's safety and claims services (i.e., cannot unbundle)
- Collateral is not always required
- Quicker return – typically six months after close of policy year

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Risk Sharing	No	Yes	No	No	No

LARGE DEDUCTIBLE

	Prefunded		Pay-As-You-Go	
	Incurred Loss	Paid Loss	Incurred Loss	Paid Loss
Standard Premium	\$1 million	\$1 million	\$1 million	\$1 million
Letter of Credit (LOC)	\$300,000	\$400,000	\$300,000	\$400,000
Loss Fund/Escrow Account	None	None	\$50,000	\$50,000
Premium Installment Schedule	\$50,000 per month	\$45,000 per month	\$14,000 per month + Losses	\$16,000 per month + Losses
Total Paid After 12 Months	\$600,000 + LOC	\$540,000 + LOC	\$668,000 + LOC + Loss Fund	\$317,000 ¹ + LOC + Loss Fund
Minimum Premium	\$125,000	\$150,000	\$168,000	\$192,000
Projected Final Cost (w/Total Losses of \$500,000)	\$675,000 + LOC	\$700,000 + LOC	\$718,000 + LOC	\$742,000 + LOC

Assumes 10% Loss Conversion Factor

Incurred Loss Advantage – Lower collateral requirement

Paid Loss Advantage – Better cash flow

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SELF INSURANCE

- Absolutely the cheapest way to buy insurance:
 - Lower program administration costs (fixed costs)
 - Better claims management and control
 - Improved cash flow
- Greatest degree of flexibility from a claims standpoint

SELF INSURANCE – HOW TO GET THERE

- Feasibility Study
- State Approval:
 - Generally need 300 employees
 - Five years of certified financial statements
 - Five years' loss history
 - In business for not less than five years
 - Excess WC insurance acceptable to Department of Insurance
 - Minimum \$300K in security
 - Annual review process
- Commitment to Safety
- TPA for Claims

CLOSING COMMENTS

To move to an alternative risk program, you would need to believe:

1. Your claim experience will be favorable moving forward
2. You can control and prevent the majority of your losses
3. You are willing to bet on yourself
4. You are prepared to potentially pay more if you have a bad claim year

To stay in the traditional insurance marketplace, you would need to believe:

1. Your claim experience may trend in a negative direction
2. Your claims are unpredictable and difficult to manage
3. Your premium will decrease year over year in the standard market
4. You prefer a more conservative approach to buying insurance, even if it means you spend more

IS AN ALTERNATIVE RISK PROGRAM RIGHT FOR YOUR COMPANY?

- Does your company have a favorable loss history?
- Is your company financially sound?
- Is safety a top priority?
- Are you willing to take calculated risks and bet on yourself?



ALTERNATIVE RISK – BROKER PARTNER CONSIDERATIONS

- Partner with a broker who is knowledgeable, not just familiar
- Partner with a broker who is able to deliver on safety
- Partner with a broker who is able to deliver on claims



COTTINGHAM & BUTLER OVERVIEW

- National provider of risk management and employee benefit solutions
- Privately held - *established in 1887*
- Headquarters in Dubuque, IA
- Over 3,500 customers nationwide
- 1,000+ employees
- 25th largest Insurance Broker in US, top 10 privately held
- 95% retention rate across entire book of business
- Posted \$188.8M revenue in 2018



Business Insurance

100 LARGEST
BROKERS
OF US BUSINESS

CLAIMS – CBCS ADVANTAGE

Areas of Inquiry	CBCS	Standard Market
Claim reported	24/7/365	Good luck
Assignment	Dedicated adjuster for all claims	Multiple adjusters - Medical only - Indemnity - Subrogation
Staff turnover	3%	20-25%
Claim reviews	Client determines frequency	Conference call with multiple adjusters
Reserving	Fact/experience-based Client in the know	Formula - Diagnostic codes - Actuarial study
Settlements	Client determines settlement authority	Pay it and close it

SAFETY SERVICE PLAN – KEYS TO SUCCESS

Onsite Consultation

- Safety & Health Gap Analysis
- Mock OSHA Compliance Investigation
- Loss Leader Assessment
- Develop Injury Prevention Training Manual
- Facility/Worksite Inspection
- JSA/JHA Development
- Additional Services Based on Clients' Losses/Compliance

Professional Development

- Safety Webinars (monthly) – Transportation and General Industry
- Risk Control Workshop
- Management/Supervisory Training Programs

Safety Communication Tool

- Safety Breaks (monthly)
- Payroll Stuffers (monthly)
- Accident Countermeasures (quarterly)
- Risk Management Center Website



COMPREHENSIVE SAFETY SERVICES

Safety Solutions:

- Sprain/strain injury prevention
- Slips/trips/fall injury prevention
- Injury Management/Return to Work Programs
- Workers' Compensation Risk Improvement Process (RIP)
- Accident/Incident Investigation & Prevention
- Safety Advantage
- Management Safety & Health Program Analysis
- Safety & Health Auditing
- Machine Guarding Audits
- Job Safety Analysis
- Written Program development
- Construction Safety
- Healthcare Safety
- OSHA citation consultation
- Mock OSHA & DOT Inspections
- Fleet Safety Programs
- Safety Communication Tools
 - Safety Breaks
 - Accident Countermeasures
 - Tool Box talks

Safety Training:

SMSC professionals have a reputation for providing creative, interactive training solutions that employees actively participate in. Our safety professionals can provide meaningful safety training solution for your employees, supervisors, and managers to allow them to train on safety within your organization. Training solutions include:

- STePS (supervisor and management skill development)
- Leadership & Safety Excellence
- Effective Safety Committees
- Accident/Incident Investigation
- OSHA 10 and 30 hour training (manufacturing and construction)
- Ergonomics Training
- Train-the-Trainer
- HAZWOPER (8-,24, and 40 hour courses)
- Confined Space Entry (refresher and new employee)
- Respiratory Protection
- Effective Employee Safety Training

Industrial Hygiene Services

SMSC provides comprehensive industrial hygiene programs and assistance. Our skilled industrial hygiene professionals evaluate worker exposure to toxic substances and contaminants. We examine physical and environmental stressors that may threaten a job task, and design controls as appropriate. We use trained hygienists with all work reviewed by certified safety and industrial hygiene professionals. Our industrial hygiene solutions include:

- Facility Surveys/Risk Assessments
- Employee exposure monitoring (toxic gases, vapors, fumes, dusts, mists)
- Indoor Air Quality Assessments



ALTERNATIVE RISK CREDENTIALIALS



- Offering Member-Owned Group Captives since 1993
- 99% Client Renewal Retention Rate
- Vertically Integrated services (captive management, brokerage, claims & safety)
- 266 members in C&B captives and growing
- Member dividend returns of over \$150M