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## TRUSTS VS. SAFETY GROUPS

Erika Rosenfeld

Judging from the language, one would think there was an all-out battle raging in New York State between the safety groups underwritten by NYSIF and the self-insured trusts " a battle for the hearts, minds, and workers compensation dollars of the states employers. Given the complexity of the issues, the technicalities involved in the analyses, and the specific legal meaning of particular terms, its no easy matter to weigh the veracity or even the legitimacy of the various arguments and assertions.

Any effort to sort out the claims and counterclaims is hampered by the difficulty of separating fact from spin. Moreover, the preponderance of the attacks and the greater vehemence comes from the safety group managers and from NYSIF itself. And while that should put the trusts on the defensive, their generally temperate responses suggest a lack of concern, real or feigned.

On One Hand, On the Other Hand


As the NYSIF website puts it: [Safety group plans] are dividend participation plans designed for employers in the same trade or industry who, by cooperative effort, seek to curtail accidental injuries or occupational disease, thereby reducing their insurance costs. Qualified participants receive an advance discount. In addition, individual experience ratings, when promulgated, are applied. Six to ten months after completion of the policy year, a group accounting is made. Each group member receives a proportionate share of any dividend earned.

Put another way, qualified participants are those that are safety-conscious and have a record of low claims relative to premiums. **According to Adam Friedlander, president of the Friedlander Group, which manages several safety groups, members receive an advance discount of 25 percent and, since 1992, have earned dividends averaging 37 percent. Authorization from the state is required before dividends can be paid.**

Self-insured trusts are homogeneous groups of employers who band together under the oversight of the Workers Compensation Board. According, again, to the NYSIF website, following a feasibility study, proposed members sign a letter of intent and an application is then filed with the board. That application includes a payroll report, by classification code, for each member; paid claims and loss reserve information; a financial statement for each participant; and various other financial and contractual information. If the application is approved, the board chairman sets the amount of the collateral the trust is required to post, in the form of a bond, the deposit of securities and/or cash, and/or the provision of an irrevocable letter of credit.

According to Richard Flaherty, chief operating officer of First Cardinal, each trust members up-front contribution is based on that employers experience modifier and past losses, as are the annual premiums, the money from which is invested. The trusts board, elected by and comprised of members, makes the initial decision on the payment of dividends, but approval by the Workers Compensation Board is required.

Apples, Oranges, and the Occasional Brussels Sprout

In interviews with various companies that manage self-insured trusts and a careful reading of print materials and websites, one finds relatively little direct criticism or analysis of safety groups or of NYSIF, making it difficult to evaluate the advantages claimed by the latter two entities. Indeed, even NYSIF creates some confusion " albeit inadvertently, perhaps " in the way it describes its strength in the marketplace. While the funds website claims that [m]ore businesses in New York State buy their workers compensation insurance from NYSIF than from any other source, and NYSIF is the largest provider of workers compensation insurance in New York State, Bob Lawson, NYSIFs public information officer, reports that NYSIF writes 38 percent of the states workers compensation market. Without contesting that all three statements may be factually true, one is still left wondering what each really means.

In contrast, NYSIF itself, while devoting barely a paragraph on its website to an explanation of safety groups, discusses trusts at length under the heading, Know The Risks of Self-Insurance. And there are, indeed, risks; and there have been problems. But deciding what risk is inherent and how severe a particular problem may be is a matter of interpretation: the facts do not, after all, speak for themselves, and context and source are everything.

Take, for example, the issue of management and service. While some trusts are self-administered, others are managed by a company; neither is inherently safer or stronger than the other. In both cases, billing, payments, claims administration, accounting, and the like are all handled by the manager. The larger and well-established self-insured trust managers argue that they provide a higher level of service, including, for example, weekly or monthly automatic payments of premium bills, or in-house safety engineers with industry-specific knowledge and experience. First Cardinals claims adjusters, said Flaherty, have a smaller load than NYSIFs, therefore they can do a phenomenal job in handling each case.

So does NYSIF, said Rick Mege, vice president of Hamond Safety Group, who explained that, contrary to the impression created by some of the trust managers, At NYSIF, there are dedicated people who handle only safety group claims. Were not in the general population where the bad reputation comes in. But he also acknowledged that every group administrator handles claims differently. Some, like Hamond, instruct clients that all claims must go through the administrator, which reviews the claim before forwarding it to NYSIF, and tracks its progress.

Some managers are very proactive in managing a claim, NYSIFs Lawson said. Others, especially associations, may not be as knowledgeable and depend more on us. Asked about compensation for safety group administrators, Lawson said that they can charge a fee to members and that the fee has a maximum limit, but he was unable to say whether there is a relationship between compensation and the effort and level of service provided.

Though there are some variations, most sources say that, for self-insured trusts, roughly 30 cents of every dollar pays for reinsurance, claims handling, broker commissions, and related administrative costs; the remaining 70 cents is available to pay claims. **In a November 2000 article, Friedlander writes that trust operating expenses usually consume 35 percent of premiums, adding that dividends can deplete another 35 percent, leaving only 30 percent of premiums to cover claims.**

But First Cardinals Flaherty notes that, in fact, the full balance after operating costs is available to pay claims and dividends are not paid out to members unless and until the claims are covered.

A more substantive issue concerns rates. Again, comparisons are difficult to make. Compensation Risk Managers (CRM), another large and well-established trust manager, responds to the question of premiums by saying that members are charged based on their individual loss history, prevailing state manual rates and experience modification.

Asked about rates, Lawson said, While NYSIF and commercial insurers are working off rates set by the New York State Insurance Rating Board (NYSIRB), which tells you that if you are a nurses aide, for instance, your rate is X dollars, the trusts dont work off that, in an effort to come in lower at the outset.

But rates may not tell the full story. In announcing its decision to form a self-insured trust, administered by First Cardinal, in collaboration with another related industry association, the New York Oil Heating Association asks Why Switch from The State Safety Group? and responds by stating, Over the past six months, the New York State Insurance Fund (NYSIF) has made administrative changes in the state safety group program. These changes have led to increased costs for workers compensation insurance through the State Fund, due to the imposition of and increase in the construction assessment, a lowering of upfront discounts and dividends, and the requirement for larger contingent reserves. These changes have led to premiums some 25 percent above last year.

### Risky Business?

Rates and their adequacy are one of several issues underlying the most serious charge against some self-insured trusts: under-funding. The numbers are not subject to dispute: in the October 28, 2005 Summary of Funding Status of self-insured trusts in New York State, issued by the Workers Compensation Board, the regulatory funding position of 30 of the 64 trusts was described as under-funded. Either more than half of the trusts have no funding issues, or nearly half the trusts are under-funded " take your pick. In addition, two self-insured trusts were recently shut down by the Workers Compensation Board for their inability to meet financial standards. **And Friedlander said that members of 12 trusts have been hit with assessments to make up for funding shortfalls.**

This is no small matter for trust members. Under statute, all members are, as the legal jargon holds, jointly and severally liable for claims against any one member of the trust. In theory " though evidently not yet in practice " this poses significant financial risk for trust members. Moreover, said Rick Mege of Hamond, section 50F of the state workers compensation law holds members of all other trusts operating in New York State liable if a single trust and all its members have insufficient funds to pay the claims. As Martin D. Rackoff, co-CEO of CRM, explained the process in a 2005 article in Insurance Advocate, The [Workers Compensation Board] would collapse the security it obtained from the trust upon inception, then look to the individual members of the insolvent trust. If these actions still left a shortfall, an assessment of the entire self-insurance community would be issued.

But Daniel G. Hickey, Jr., co-CEO and chairman of the board of CRM, points out that every member of a particular trust would have to be virtually out of business before the workers compensation board could assess the other trusts. That's never been done in New York State, he said, and there appears to be some question as to the precise circumstances under which that provision of the law would come into play.

So what exactly does under-funded mean? Simply put, under current standards a trust is under-funded if its assets are less than 90 percent of liabilities. That ratio, as Flaherty described it, is kind of convoluted, depending, as it does, on what the state considers an asset and how it determines liabilities. Tougher financial rules were developed for trusts in 2001, according to WorkCompCentral, and took effect two or three years later and were applied retroactively. Hickey explained that, under the new regulations, only cash and cash equivalents are considered assets, which jeopardized the statutory financial standing of some trusts.

Take, for example, one of First Cardinals trusts, a large non-profit with 52 chapters who are the trusts members. As Flaherty described it, at the end of one year, there was a deficit in the program, and the parent organization issued an irrevocable letter of credit to cover the shortfall. The state doesn't count the letter as an asset, Flaherty said, explaining why that trust is rated as under-funded.

He and Hickey both say that most under-funded trusts can easily remediate themselves and come into compliance; [t]hat is the goal of the Workers Compensation Board, Hickey noted, adding that such trusts are, in fact, retaining members and improving their funding status. Under-funded trusts must also submit a plan to the board explaining the means by which they intend to comply.

Hickey, among others, pointed out that, while self-insured trusts came into being some 20 or 30 years ago, their rapid proliferation is relatively recent. As the industry grows up, he said, and is subject to regulatory changes, there will be some [trusts] that can't make the grade. But [the finding of under-funding of some trusts] is in no way a negative for the entire trust industry " it shows that the state is being responsible and holding administrators to a higher standard.

### Compliments and Competition

Once the brickbats have stopped flying and the flaming arrows have been extinguished, both sides of the debate acknowledge, if indirectly, a degree of hyperbole, generalization, and stereotyping in their assertions. Flaherty, for instance, expressed great respect for the upper management at NYSIF " they're decent, honest, intelligent, though he said he has issues specifically with the safety groups.

The safety groups and NYSIF can't quite resist a final modification of their expressions of respect. NYSIF's Lawson said, We take no satisfaction and no pleasure in the fact that two trusts are being disbanded, because [trusts] do serve a purpose, as long as there is a real emphasis on homogeneity and they price their product right. We are not in any way saying that trusts don't provide a service and don't have a role to play in workers compensation; but there are pitfalls.

**Friedlander, one of the most outspoken critics of self-insured trusts, commented that trusts aren't inherently bad, if they are well-run and charge appropriate premiums and are selective in their**

underwriting. But, he pointed out, Theyre riskier by definition. Why self-insure and agree to be jointly and severally liable? Its like signing a blank check.

In the end, one word keeps echoing: competition. Friedlander said, In New York State, [trusts] are not competitive, because there are too many fully-insured funds that are better. He added, The question is not are they viable, but can they compete? He is among a number of experts who argue that the trusts competitiveness has been artificially supported in the past and that, as the states scrutiny continues to sharpen, they will have to raise rates and/or impose assessments on members, diminishing their ability to compete with the safety groups.

On the other hand, David Dickson, director of PIA of New York State, argues that self-insured trusts have provided a competitive product for employers. Others, like NYCAN chairman and IIABNY member Larry Gilroy, simply say that the trusts are an excellent vehicle for the right investors and suggest that prospective trust members do their due diligence as thoroughly as the trust managers say they do theirs.

Of course, it all depends on what you mean by competition.

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