 by Phil Gusman

WCB Rate Adequacy Review: A Step in the Right Direction

Workers' Compensation Board Seeks to Bring Formality To Ratemaking Process for Trusts

The recent rate adequacy reviews conducted by the New York State Workers' Compensation Board (WCB) on the state's group self-insured trusts are being seen by most as a good step in bringing formality to the rate-making process. Those who manage trusts and those who compete with them agree that the WCB will be more effective as a regulator of, and an authority on, the trusts now that it reviews rates in a prospective manner as opposed to retrospectively.

There are, of course, differing opinions as to the impact that these reviews will have on group self-insured trusts' rates. Additionally, the overall arguments for and against the practicality of trusts as an alternative to safety groups and standard carriers still exist. Trust managers continue to maintain that trusts serve as a competitively priced, service-oriented workers' compensation option for the right employers; critics continue to hold that the risks associated with trusts far outweigh any benefit, particularly the risk of joint and several liability (see sidebar – pg. 10).

Calling for Review

News of the rate adequacy review came in the form of a July 27, 2006 letter from the WCB to the state's group self-insured trusts requesting that they submit a rate adequacy review that supports the rates that they will charge as of January 1, 2007. "The rate analysis should be prepared by a qualified actuary and should clearly identify the breakeven rate and assumptions therein," the letter states. "This rate analysis should become the foundation for pro-forma financial statements. Any deviation from the breakeven rates should be identified and justified."

According to Mary Beth Woods, director of licensing for the WCB, the review was sought to allow the board the ability to make changes in the rate structure, if needed, before rates go into effect, rather than after.

Rich Flaherty, president and CEO of First Cardinal LLC, a Latham, N.Y.-based administrator of self-insured trusts, explained that, in the past, trusts would file their annual statements with the board four months after the year ended. At that time, Flaherty said, the state would know whether the trusts had set the proper rates. "Basically," said Flaherty, "Sixteen months after the rates were issued, that's when [the board] knew whether [the trusts' rates] were correct or not."

He added that, before the rate adequacy review, a trust could, if it wanted to, come up with an arbitrary discounted rate. "Now you can't do that," Flaherty said. "Now you have to have an actuary approve your discounts."

Over the last couple of years, Flaherty said, the WCB has increased its oversight of the state's trusts – meeting frequently with trusts' board members and educating them as to what their responsibilities are. Additionally, Flaherty said that the WCB has been diligent in reporting which trusts are adequately funded, and which are under-funded.

Now that the WCB has taken a further step – conducting the rate adequacy reviews, Flaherty said, "We [First Cardinal] think it's great." He added, "It's so logical – they should have been doing this from the get-go."

Flaherty said that the state is now formalizing, for all trusts, standards that responsible trusts have held themselves to all along.

Funding

But, according to an article that appeared in the November 20 *Insurance Advocate* (N.Y. Self-Insured W.C. Trusts: Rising Prices and Broker Concerns), written by Adam Friedlander, president of Friedlander Group, a group manager of four workers' compensation safety groups, while the rate adequacy review may simply be a formality for some trusts, it could expose artificially low rates that others have been charging. "The inadequate rates that many workers' compensation self-insured trusts charge may increase effective January 1, 2007, due to imminent changes in regulations from the New York Workers' Compensation Board," Friedlander wrote. His article also held, "Many trusts charged inadequate rates to cover the ultimate development of all expenses, including reserves, administrative expenses, assessments, and reinsurance."

To support this contention, Friedlander noted that, in addition to five trusts closing down in 2006, 44 percent of trusts in the state are deemed "under-funded" by the WCB.

Woods said that the board defines under-funded as a trust with assets under 90 percent of liabilities.

Friedlander said that inadequate funding has long been the biggest issue facing trusts. "The bottom line is that they're not collecting enough money to cover their expenses," he said. "I don't know the specific reason why they're under-funded, I just know that the fact is they don't collect enough money, due to their pricing, for what they're offering."

Asked if the issue of under-funding was indicative of a few mismanaged trusts, or whether it was a larger issue with trusts in general, Friedlander said, "When you consider that almost half of them are either under-funded or closed, then I think those numbers speak for themselves."

It Depends On What the Definition of "Under-Funded" Is

While a hard figure can be placed on the number of under-funded trusts, what that number won't show is to what degree the trusts are under-funded. And, short of asking the individual trust administrators personally, that information is unattainable, as the WCB currently does not provide any additional data beyond stating whether a trust is funded or under-funded.

And, as noted by Chris Mason, chief operating officer of New York Compensation Managers, Inc. (NYCM), a Syracuse, N.Y.-based trust administrator, "Because a group is under-funded doesn't mean it's going under. There's a certain connotation to 'under-funded' – you could be 89.5 percent funded…and you'd still be deemed under-funded by the comp board."

But if the negative connotation of "under-funded" can hurt the image of a trust that may be right on the bubble, the vagueness of the term can be a problem for interested parties, such as agents and brokers, who want to avoid placing clients in a trust that may have more serious funding issues. This lack of specificity on the true financial wellbeing of "under-funded" trusts has frustrated some, according to David Dickson, president of PIANY. He said, "One of the complaints is a lack of transparency in terms of, if [trusts] are under-funded, are they under-funded by $1? Are they under-funded by $1 million?"

Art Wilcox, workers' compensation spokesman for the New York State AFL-CIO, went one step further, and questioned why trusts listed by the board as "under-funded" are allowed to continue to operate. "It's real problematic to me that the board lists them as under-funded, but yet they're in business," said Wilcox. "I believe that the board has the power to determine whether a trust can be in business or not. And I don't really understand how they exercise it. What are the grounds for removing a trust or allowing it to stay in business?"

The Flow of Information

For her part, Woods explained the board's position, noting that, with respect to the limited information disclosed by the WCB on under-funded trusts, there are ongoing discussions about providing more infor-

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Joint and Several Liability – The 'Showstopper'?

The issue of joint and several liability, and how it affects group self-insured trusts and trust members, brings out a wide range of opinions from those who know the industry. The potential risk is undeniable – all trust members are liable for any shortfall in their trust. In the event of a shortfall, members receive assessments, and are obligated under the contracts they sign to pay those assessments.

The interpretations of this risk, however, vary.

On joint and several liability, Dickson declared, "It could be a showstopper, depending upon what the unfunded liability of the trust actually is, and the amount of the assessment."

Friedlander questioned, "If you're a business owner, and a small percentage of your expenses are workers' comp, why would you take all the risk of becoming an insurance company with your competition as partners, and if they don't pay their assessment, then you're on the hook for their premium – not just your own, but your competitor's premium?"

Flaherty and Mason argued that joint and several liability is not necessarily a negative for trusts. Flaherty said that, although it has not come into play for First Cardinal, "Joint and several is a great stick to say 'hey, you better be committed to safety and good claims service,' because if the losses exceed the premium, in that case, you're going to have to pay more money. You're jointly and severally liable, so you're going to have to pay an assessment."

Mason agreed, noting, "It's characterized as a bad thing when it may in some cases be an asset to the group," he said.

Again, though, the potential risk is real. Dickson explained, "One of the trusts that closed here – there was a conference call with the comp board and the trust members – [members] were told that there was a liability; that the liability was significant, and that the liability for 2005 had not been evaluated yet, and that there would be another evaluation in 2006, and 07, and 08, and 09, and so on – [and] that there would be further assessments, and because they had entered into a contract, they had no option but to respond to the assessment. And if they did not, then they would have to deal with the Attorney General's Office."

It has also been stated that if trust members are unable to cover the assessments, then all trusts become liable for the shortfall. Flaherty, though, said that critics of trusts have mischaracterized this scenario. He explained that it is not only trusts that would be liable in this case, but rather all self insurers, including the state's many individual self insureds. He noted that critics have implied that the risk is spread only among the 60-70 trusts, when in actuality the pool is much larger, and the potential cost to each trust minimal.

Essentially, it comes down to risk vs. reward. Dickson said, "If done right; if managed well, trusts can be, and in some cases are a competitive alternative that is workable for those employers who are fully aware of what they are and how they work, and what they do. And I can tell you there are some trusts that do a spectacular job."

Mason said, "I don't think a trust is for everyone. I think you need to do your homework." He recommended that those who are interested should look at trusts individually and get a comfort level with them before making a decision.

Friedlander saw significantly more risk than reward. He said joint and several liability is really the primary difference between safety groups and trusts, but he maintained that it is a big difference. "Structurally, they're similar," he said. "It's just that last piece of insurance that [trusts] don't have." He added, "I think [trusts are] inherently more risky than a fully-insured product, but some people might be willing to take that risk [of joint and several liability]. But the market's so competitive, and there are so many competitive alternatives, that I don't really see where the fit is – the justification to take that risk. Because the safety groups, and some dividend plans with standard carriers, are so competitive, that I don't see the need to take the risk for what's turning out to be a more highly priced product at the end of the day – when you factor in the discounts and dividends of trusts, they're not competing with more-competitive, fully insured products."

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mation on the funding status. However, she added, the board is currently trying to structure the information in a fair and clear manner to avoid any misinterpretation of the numbers. "Until that's done, we don't really feel comfortable releasing the details because people treat things differently, and to just throw up the flat percentage would be potentially misleading," Woods said.

She added that, for agents and brokers seeking independent information on trusts, the board plans to be a comprehensive resource. "We are working with consultants to redesign all of the reporting requirements for the groups, and the entire program, and once we have that on an apples to apples basis where we feel comfortable, then we would expect to release a lot more information," according to Woods.

Woods also said that information which could be considered proprietary is generally not released. Trust members, she said, can get "all kinds of information" from the WCB, but access to that information for agents, brokers, and the general public is left to the discretion of the trust administrators.

Flaherty, Mason, and Steve Zogby, IIABNY chair-elect, and executive vice president, Scalzo, Zogby and Wittig, Inc., stated that agents and brokers looking to place business in trusts should meet with the trust administrators and review financials, underwriting guidelines, and other information so that their clients can make informed decisions on which trust, if any, best suits their needs. "That's not too much to ask," Flaherty said. "And it makes you a better broker because you know the product better, and you know the individuals better."

Dickson, though, cautioned that agents and brokers should take care because they are not covered under their E&O policies in terms of recommending a trust to clients. As a safeguard, he suggested making presentations comparing trusts to trusts, and trusts to other options. "So the decision point is really with the employer of the company that's deciding where to place the workers' compensation obligation."

Back On the Path

Regarding the continuation of operations for trusts deemed under-funded, and the formula used to decide if they should remain in business or be closed, Woods said, "Oftentimes it depends on the degree of under-funding. If they've been under-funded for five years – just because it's five years doesn't mean they're going to be closed down. If they have a good remediation plan in place, and they're systematically doing the things they need to do to get them back to a fully funded status, then obviously we want to encourage them to move in the right direction. If they're not responding to remediation; if they're not able to achieve full break-even rates and maintain a substantial portion of the membership, then whether or not they continue becomes a question for us."

With the rate adequacy reviews, Woods said the WCB has a new tool for oversight, and that may help the under-funded trusts achieve fully-funded status.

Zogby said, "I think [the rate review] will go a long way in helping to clean up those trusts that are under-funded and not performing well. I think that's a good step."

Friedlander said that, under the new guidelines, the board no longer worries about whether or not a trust is under-funded, "they will just make trusts charge the appropriate premium to make sure they're fully funded."

Mason described the rate review from a trust's perspective. "It's worked well for us. We've learned a lot from it. I think it made our groups profitable because of it." He added, "A lot of it is just consistency." As for the impact on NYCM, Mason said, "We had an auto group that was 108 percent funded last year, and we had a rate analysis done; there was a slight increase in the rates – we implemented those rates and it hasn't been much of an issue."

Flaherty said that his experience has been positive, but he noted that First Cardinal groups have long conducted measures such as comprehensive actuarial reviews, and regular board meetings. "For us, [the rate review] had no impact because we've been doing this in the past," Flaherty said.

Friedlander, though, has seen a wider impact already. "I've seen a letter come out from one trust where they were going to charge board rates plus 13 percent, which is almost 45 percent more than what we charge in our safety groups," he said. He added, "The brokers and members of the trusts didn't seem to be fazed by the fact that their trusts were under-funded, even though you'd think they'd be very concerned. But they're going to be concerned if their rates go from, say, $7,500 to $11,300 – that will get their attention."

Flaherty and Mason, meanwhile, stated that price is only a small part of what trusts can offer. "Our claim to fame isn't pricing right now. We don't fight on pricing," Flaherty said, pointing instead to the level of service provided by trusts, and First Cardinal in particular. "We far exceed everyone's expectations, and we end up making the broker look like a hero because they love us. Low case loads for claim adjusters, and we only do comp., so we're able to provide great service," he said.

"A lot of companies offer [similar services]," Mason added, "but I think we can provide it better because of the limited number of members in the specific industry that we're in." [*IA*]

Is This the Year of Reform?

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the report's contents is willing to name dollar figures, Wilcox said that "there is significant underpayment of premium in this state, based on people fudging their payrolls," and he blames "a real lack of aggressiveness on part of the insurance industry…regarding enforcing payroll."

Florida, he noted, has recently passed statutes that "put teeth" into enforcement and prosecution, including significant monetary penalties. "We believe that [addressing payroll fraud] alone would contribute [considerable] savings," he said.

It is worth noting that, as the state's attorney general, Spitzer made a name for himself as an insurance fraud fighter. And the fight, it seems, is far from over. [*IA*]