Workers' comp revolt: self insurance

Sacramento Business Journal
EXCLUSIVE REPORTS
From the August 30, 2002 print edition

Kelly Johnson
Staff Writer

As California employers shell out double-digit increases in workers' compensation rates year after year, some are insisting there must be a better way.

Mel Rapton Honda, Elk Grove Ford and Elk Grove Chrysler Jeep believe they've found one. The local car dealerships have joined an auto dealers' group self-insurance pool for workers' compensation, the only such self-insurance pool for workers' comp in the state. The group of about 50 auto dealers formed in January.

Members pay an amount of premium based on their payroll, or number of employees. Those contributions fund expenses and pay any claims. If there's any surplus, the members get it back.

The auto dealers' pool won't be alone for long, predict state regulators and private administrators of such self-insurance programs. Employers from different industries have asked for information about forming their own group self-insurance programs for workers' comp.

Regulators and administrators expect that thousands of other California employers will switch to this alternative-risk program in the next few years, as rising claims costs and other factors push conventional workers' comp insurers to push their rates higher every year.

A 30 percent savings: Bob Burzinski, general manager and chief financial officer of Sacramento-based Mary Ann's Baking Co. Inc., thinks group self-insurance is a possibility for his company. He currently buys the mandatory on-the-job injury insurance for his 140 workers from California's State Compensation Insurance Fund, a public agency that is the state's largest workers' comp insurer.

Burzinski has asked his Sacramento insurance agent, John Marshall of Owen-Dunn Insurance Services, to look into group self-insurance and other options in the alternative-risk marketplace.

Over the last two years, the workers' comp rates for Mary Ann's Baking have doubled. For every $100 of payroll, the company spends $17 on workers' comp insurance.

A few years ago Burzinski considered fleeing the standard workers' comp insurance marketplace, but decided to wait and see what happened. Now, he said, "it's to the point with the exorbitant costs we have to do something."

Mel Rapton Honda joined the auto dealers' self-insurance pool on July 1. The reason can be stated in one word — price, said David Segale, business manager. Had Mel Rapton Honda stayed with its former carrier, Explorer Insurance Co., it would have paid 50 percent more for coverage. The quotes from other carriers were even higher.

Segale expects a 30 percent savings with the pool, called Auto Dealers Compensation of California Inc.

Jerry Kuske, owner of Crown Motors in Redding, was one of the four original members of the self-insurance pool. Two years ago he endured a 100 percent increase in workers' comp rates despite no workplace accidents. His 110-person dealership went from paying $5,000 monthly for coverage to $10,000. Had he not been in the pool, he would have faced another 35 percent increase this year with State Fund.

"So far it seems to be working really well," said Kuske, who also sits on the insurance pool's board. He expects a 30 percent to 35 percent savings.

Why rates are rising: Individual private-sector employers gained the right in 1993 to join with similar companies to form self-insurance pools for workers' compensation. That right came with the state's comprehensive reform of the workers' comp system.

But those reforms abolished the workers' comp minimum rate law starting in 1995, resulting in rock-bottom workers' comp rates. Employers had no incentive to self-insure when they were already receiving attractive rates.

Workers' comp rates began climbing several years ago, and some major insurance carriers went belly up or left the state. That left employers with few options for coverage.

Workers' comp rates have soared for several reasons. Claims are costing more. Meanwhile, insurers are still trying to reach a point where their rates can adequately cover costs. After competitive pricing began in 1995, insurers slashed rates to gain market share. Pricing remained inadequate for years, causing some of the largest carriers operating in California to become insolvent. Now few workers' comp carriers remain, and some are limiting new business. As a result, California employers have few options for workers' comp coverage.

For each of the past three years, the state insurance commissioner has recommended annual increases of more than 10 percent for workers' comp rates. For new policies and those renewing beginning Jan. 1, 2003, the Workers' Compensation Insurance Rating Bureau of California, an industry-backed organization, has recommended insurers raise pure premium rates by an average of 11.9 percent. Insurance Commissioner Harry Low will make his own recommendation soon.

100,000 potential members: To set up their pool, the auto dealers went through a cumbersome application and state approval process that took two years. Auto Dealers Compensation of California formed in January with four auto dealer members. The pool now has about $5 million in premium, said Louise Flemming, the program manager who oversees the day-to-day operations of the program. She works for AV International West Coast Inc., a Pennsylvania-based company that oversees specialty self-insurance plans in that state, in New York, and this plan in California. A third-party administrator in Simi Valley handles the claims.

"The members are pleased," she said. "The members (of the auto dealers group) are referring other dealers."

With the growing number of members in the auto dealers' program, Flemming estimates that the pool will reach $10 million in premium by the Jan. 1 renewal period.

"There are no limits to the size of the group," she said.

The California auto dealers' pool is modeled after a 5-year-old program in New York that has more than 600 new-car dealers.

She is hearing much interest in group self-insurance from California employers. Individual groups and associations, she said, are "taking steps to control their own destiny." For competitive reasons, she didn't want to say from which industries the interest is coming.

"Any homogeneous group would be a possibility," she said.

Within six months, Flemming expects her company will oversee five new group self-insurance pools in California. That number will be 10 within the next year, she predicts.

Of course, competing program administration companies will form to manage other group self-insurance pools.

More group self-insurance pools for workers' comp are coming, said Mark Ashcraft, manager of the self-insurance plans division of the state Department of Industrial Relations. It's his job to regulate these programs.

"I would suspect in the next three to five years we will have a lot of these," he said.

By then, the number of California businesses in group self-insurance pools for workers' comp might be 100,000, Ashcraft said.

He's heard from tire dealers, roofers and companies from several other areas of construction. They're all contemplating applying to form group self-insurance programs.

Balancing cost and risk: That doesn't surprise insurance agent Marshall of Owen-Dunn or Greg Van Ness, managing director for the Northern California insurance brokerage operations for Acordia of California Insurance Services Inc. in Rancho Cordova.

"Larger companies are going to be looking around for alternatives," Marshall said. Desperate times call for desperate measures, he added.

As far back as a year and a half ago, Marshall was receiving many inquires from clients about the alternative-risk marketplace, including self-insurance and captive insurance companies, which provide insurance to — and are controlled by — their owners.

As prices rise, more businesses are weighing the cost of buying the insurance against the risk of keeping the liability on their balance sheet, Van Ness said.

"While most middle-market businesses can still find reasonable insurance pricing vs. retaining large exposures to risk," he said, "it is increasingly part of the evaluation that companies are performing as they review their insurance programs."

The drawbacks: The potential savings from joining a group self-insurance program come with a price. The application process is arduous and slow. Prospective participants must meet tough underwriting guidelines approved by the state. The state looks for employers that are financially sound and have good loss experience, including accident- and illness-prevention programs, Flemming said. They must be approved by the pool's board of trustees and by the state.

They must accept joint liability for their fellow members. If a pool is made up of 100 members and 99 go out of business, the remaining company must pay all the claims, Ashcraft noted.

Participants also agree to remain with the pool for at least three years.

That three-year commitment was the only requirement that Mel Rapton Honda's Segale said he didn't like. "It's a gamble," he said. But he expects the gamble to pay off.

The savings, Flemming said, vary depending upon who insured the participating company previously, and the company's accident experience.

Participants also must follow a strict safety program. Representatives of the insurance pool "come around unannounced and make inspections," Segale said. If a company has a bad safety record, it can be booted out of the insurance pool.

"You've got to be more involved," Ashcraft said. "Self-insurance demands your involvement. This isn't insurance you're buying. There are some negatives to it."