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Aggregate Numbers Create Befuddlement

SIGs Claim Vindication, but Critics Not Satisfied

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There is a running controversy as to whether the Office of Self-Insured Plans, part of the Division of Industrial Relations, should release California's workers' comp self-insured groups (SIGs) financial data. James Ware, chief of OSIP, refuses, saying there is no authority for the release. But neither is there a prohibition against the release, say critics. OSIP did release some limited aggregate financial data on the entities, but critics remain highly concerned about the entities' financial stability even after the release.

More than 3,000 companies are covered within SIGs. Without more definition or specificity, the financials have insurers scratching their heads. Why? If numbers like these came from an insurance company, there would be cause for major concern, say industry experts.

As background, readers should understand that the data, some of which we show below, provide some level of comfort to the California Self-Insured Security Fund (CSISF), the payer of last resort for self-insurers that fail. But CSISF says it would still like to see individual groups' financial statements.

With a deepening financial crisis, concern is becoming more pressing. Unlike insurance companies, SIGs are not required to publicly disclose their financial statements. They are not rated. Neither certificate holders and brokers nor workers, injured workers and others who may have a real interest can judge a group's health.

"Just because the entire insurance industry is good, that must mean AIG is hunky-dory." —Mark Rakich, Assembly Insurance

Legislative Interest

The missing financial detail hasn't been lost on the Legislature. Even though aggregate data sent out by OSIP suggest that the SIGs as a whole can handle the exposure, it's still requesting an industry study.

"Just because the entire insurance industry is good, that must mean AIG is hunky-dory," quips Mark Rakich, Assembly Insurance Committee chief consultant.

With California workers' comp costs steadily creeping up, SIGs advertise themselves as a way for employers to control their expenses as opposed to the traditional market.

Self-insured groups are entities comprising a homogeneous group of employers all in the same industry. The group, really a third-party administrator, acts very much like an insurance company, establishing reserves, administering claims, and paying benefits to injured workers. The members pay a contribution, instead of premium. The contribution covers only claims and overhead.

Many insurers are wary of SIGs, citing the "all the eggs in one basket" problem. Employers become jointly and severally liable for one another. That means if one large employer fails, smaller ones could be left holding the bag on its claims. Workers' comp insurance has a long tail. If an employer leaves a SIG, it's still responsible for paying out the claims for the group, during the period it was a member, sometimes for many years.

Numbers

One set of numbers included in the OSIP data lists total SIG contributions—the same thing as premium—at $187 million and total surplus at an 80% confidence level of $33 million. This indicates a 6:1 ratio.

"If liabilities include reserves, that's a lot with not much to back it up."

— Mark Webb, vice president of governmental relations, Employers Direct Insurance Company

"If this were an insurance company, this is when the Department of Insurance would come in and say, 'We need to talk about how you're doing things,'" says one industry source. Admittedly, it may be the way the numbers are presented, but that's not the only thing that jumps out.

Covered payroll is listed as $5.2 billion, but there are 318,145 employees. This suggests that employee wages are below the poverty level. Erika Monterroza, OSIP spokeswoman, says that's easily explained by the part-time, intermittent nature of many employees, especially in the restaurant industry. "An employee could work for one hour and quit," she says.

Because SIGs' statistical data are not reported to the Bureau, there is no enforcement of classifications. Having this many payroll and loss data omitted from the rest of the state's numbers could skew Bureau data.

There is also a separate row listing total liabilities of $249 million and another listing total reserves of $209 million. On insurance company financials, those are the same thing. "If liabilities include reserves, that's a lot with not much to back it up," says Mark Webb, vice president of governmental relations for Employers Direct Insurance Company.

Joe Burgess, CHSI California senior executive vice president, says that SIGs tend to keep tighter control on their costs, run leaner and put every possible penny back into the program. He admits that the data as presented, describing liabilities and reserves, might be a little confusing.

"The reserves are part of the overall liabilities. [There are] other things that could be additional liabilities. Most groups are done on an accrual basis, so a prepaid member through December 2009…could be a liability, but the reserves by far are the biggest chunk," Burgess says.

SIGs point to OSIP data as proof that groups are financially healthy. Total assets per financial statement are listed as $267 million, and total liabilities per financial statement are listed as $249 million. Liabilities as reported at the 80th percentile plus other liability totals are listed at $236 million.

"This is exactly what the public needs to see without delving into anyone's privacy rights," says Clay A. Jackson, president of Affinity Group Administrators. "Are SIGs properly funded? I say the answer would have to be yes."

According to OSIP, there are differences between deposit requirements for self-insured employers and insurance companies.

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> *— Clay A. Jackson, president of Affinity Group Administrators*

"The OSIP requires deposits based on estimated cost of claims. DOI may require more assets than premium, in the case of [SIGs], assets are not just surplus but include deposits posted SIP, reserves and any other assets," Monterroza says. "Groups are evaluated on liabilities versus assets. When the assets exclude liability, there is a surplus."

Industry skeptics don't think this adds much clarity. SIGs file GAAP statements with OSIP. The ceded losses are assets from the standpoint of transferring liabilities to a reinsurer, or in the case of SIGs, an excess insurer. Insurer deposits are calculated based on premium net of reinsurance. It looks like OSIP calculates the SIG deposits in much the same way. "I don't see how you can say that case reserves are assets," quips one source.

Under fire from the insurance industry, SIGs say they have had to fight off characterizations that they are unstable and underfunded, primarily because of the problems with New York SIGs. Bermuda-based CRM Holdings Ltd. agreed to surrender its seven trusts in New York based on allegations related to proper reporting and adequate cash reserves. The unfunded liabilities are in the tens of millions. CRM also runs SIGs in California but has not had similar problems here.

"[W]e're not New York," Jackson says. "There are regulations in place to protect the members of SIGs," he says, adding that the California regulations are the result of studying and improving upon other states' regulatory structures. "These weren't written in a vacuum."

SIGs point out that California's regulations are some of the strictest in the nation, with an 80% actuarial confidence level, excess insurance requirements and the California Self-Insurers Security Fund to pay the claims of SIGs that do fail.

Are Regulations Enough?

"From a regulatory standpoint, a California SIG is pretty bulletproof, but in this economy, who knows," says Jeff Pettegrew, CSISF executive director.

But from a solvency perspective, Pettegrew says he has no idea how SIGs are doing because CSISF isn't allowed to see their financials. Pettegrew understands that the data show SIGs to be in good shape overall, but they're not specific enough.

"The problem is we still can't determine if each of the 29 SIGs is compliant. We need some sort of parenthetical explanation that the confidence level is being met by all the SIGs," Pettegrew says.

Pettegrew says that the SIGs don't object to providing CSISF with their financial data, but some of them don't want their financials made public. He says a standard, audited financial statement minus individual members' premium payments, claims information and payroll should not be an issue, especially for employers considering membership.

"I've had brokers call me asking what happens if the SIG goes insolvent? 'Will you be enforcing the joint and seve liability?' They're asking me this, and I can't answer it because, number one, I'm not the regulator and, number tw I don't have any information to say [if] they're viable," Pettegrew says.

No SIGs have defaulted in California yet, although a few have closed. One SIG that closed last year was the Plastic Manufacturers Self-Insurance Program, administered by the aforementioned CRM. According to OSIP, it continues to pay benefits and file reports.

“We can’t release the financials, [but] if there is a group that may default, we can let [CSISF] know,” says OSIP chief Ware, adding that if a SIG doesn’t pay a security deposit, that’s reason enough to alert CSISF. Ware, who has been boning up on SIG operations, says the problems in New York added some urgency to his studies. “It was already in motion, but it rose to the top,” Ware says.