The Role of Mega-Deductibles in Workers Compensation Insurance

The Center for Insurance Policy and Research

Agenda

- Use of large deductibles in Workers' Compensation Insurance
- The role large deductibles have played in some workers' compensation insurer insolvencies
- The role of large deductible policies and Professional Employment Organizations (PEOs)
- The impact of additional regulation proposals on stakeholders

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Project History

- Fall 2014 - Nevada Insurance Department asks if other states are seeing filings for billion dollar deductibles
- 2014 Fall NAIC Meeting - NAIC Workers' Compensation Task Force adopts a charge to update 2006 study on the use of large deductibles in Workers' Compensation

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Project History

- Spring 2015 - Study group assembled with representatives from:
  - State Insurance Departments,
  - Guaranty Funds,
  - Insurance Companies,
  - Interested Parties,
  - Professional Employment Organizations,
  - Trade Associations

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Project History

- Summer 2015 - Forty-three conference calls were conducted to gather data and information about how large/mega-deductibles are used by insurance companies and their clients
- Fall 2015 - First draft of study released for comments
- December 2015 - Second Draft Released for comments

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Project History

- Spring 2016 - Third Draft released for comments. Comment period ended April 11th.
- April 29th - Comment discussion call held
- May 2016 - Additional revisions in process

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Next Steps

- Adoption by NAIC/IAIABC Joint (C) Working Group
- Adoption by Workers' Compensation Task Force
- Adoption by Property and Casualty Insurance (C) Committee
- Adoption by Executive (EX) Committee and Plenary

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Revisions to the Large Deductible Study Draft

- An executive summary and recommendations have been added to the draft
- Over 90 comments were considered and where appropriate revisions to the draft were made.
- The California Workers Compensation Insurance Rating Bureau has supplied deductible information for insertion in the study.

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Key Findings

- A small percentage of workers compensation insureds select deductibles over $100,000.
- Many insurance company insolvencies over the past 20 years have involved insurers writing large deductible workers' compensation business
- In many of the insolvencies studied the collateral provided by insureds was insufficient or uncollectible by guaranty funds

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Key Findings

- Many of the insolvencies studied involved insurance companies with PEOs as clients
- The National Association of Professional Employment Organizations (NAPEO) is working with its members to adopt best practices and procedures
- Insurance companies believe current underwriting standards, polices and procedures are adequate and do not believe additional regulation is warranted

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Recommendations

Ask the Financial Condition (E) Committee of the NAIC to consider:

– Whether the existing reporting framework under Annual Statement Note 31 should be enhanced by additional disclosures, or should be replaced with a framework that books policy reserves on a gross basis and establishes explicit standards for credit for anticipated deductible reimbursements.

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Recommendations

Ask the Financial Condition (E) Committee of the NAIC to consider:

- Whether other types of loss-sensitive programs, such as retrospective rating plans, should also be subject to some or all of the standards that apply to large deductible programs.

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Recommended Legislation

- Enact legislation establishing financial requirements for large deductible workers' compensation coverage, including the following:
  - A definition of large deductible coverage that includes traditional policies subject to endorsements or side agreements that shift risk back to the employer
  - Size and financial strength requirements for insurers writing large deductible policies
  - Limitations on the risk employers may retain, relative to their financial capacity
  - Requirements for collateral, including prohibitions against commingling it with other assets of the insurer or pledging it for other competing purposes

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Risk-Based Capital Standards Recommendation

- Recommend the NAIC Financial Condition (E) Committee be charged to develop risk-based capital standards associated with large deductible business, and ensure that they reflect not only the risk associated with any anticipated reimbursements that are unsecured or under-secured, but also the risk that adverse reserve development might result in losses within the deductible that exceed the collateral that is currently deemed to be adequate.

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Recommendation-Financial Review

- Require the insurer's finance department staff to evaluate the creditworthiness of policyholders where their liability to reimburse the insurer for large deductible payments is unsecured or under secured.

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Recommended Duties in Insolvencies

- Enact legislation that governs rights and duties of the various parties regarding deductible business in insolvencies. The NAIC and the NCIGF have both developed model language on this point.
- If regulators detect that a company with this type of business may be financially troubled, regulators could conduct a special examination. Such examination would be conducted by an examiner with expertise in this business and could be paid for by the guaranty association.

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Guaranty Association Recommendation

In states that do not already have such language enact provisions substantially similar to the text below which would permit the collection of large deductible reimbursements from insureds.

- "The Guaranty Association shall have no cause of action against the insured of the insolvent insurer for any sums it has paid out except such causes of action as the insolvent insurer would have had if such sums had been paid by the insolvent insurer."

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Recommendation - Non-Reporting Entities

The Working Group recommends that states compile information related to non-reporting entities as they are identified. A third party could be enlisted to study the compiled data and make additional recommendations.

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State Actions

- Illinois passed Senate Bill 1805 and the governor signed it into law in August 2015
- Oklahoma has circulated a draft to working group members and asked for comments
- Indiana is considering large deductible legislation
- Missouri has a large deductible bill awaiting signature by the governor

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