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Workers' compensation insurance is one of the largest lines of commercial insurance in the United States. In 2011, direct written premiums for all companies writing workers' compensation insurance on a primary basis were \$47.8 billion; while direct written premiums for insurance carriers writing workers' compensation policies on an excess basis were \$9.6 billion.¹

The majority of employers elect to transfer all of their workers' compensation risk to a workers' compensation insurer through the purchase of a standard workers' compensation policy. However, many employers with the financial means and ability to manage their own claims and safety programs elect to 'self-insure' their workers' compensation exposure. The Self-Insurance Institute of America estimates that more than 6,000 corporations and their subsidiaries nationwide operate self-insured workers' compensation programs.

While the workers' compensation system has successfully operated for more than 100 years, a recent workers' compensation bankruptcy case signaled implications for self-insurance across the country. In 2011, Prime Tanning-Hartland (Prime Tanning) filed for Chapter 11 bankruptcy protection. The debtors' plan of reorganization contained several features that would have overturned state workers' compensation law and damaged the ability of the states to regulate workers' compensation self-insurers.

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Employers can meet their workers' compensation obligation by purchasing insurance or by becoming a state-certified self-insurer. A self-insured workers' compensation plan is one in which the employer assumes the financial risk for providing workers' compensation benefits to its employees. In other words, rather than purchasing a workers' compensation insurance policy to pay for work-related injuries, a company would instead pay the cost of each claim themselves (i.e., out of pocket) as they are incurred, instead of paying a fixed premium to an insurance carrier or to a state-sponsored workers' compensation fund.

When a company elects to self-insure their workers' compensation exposure, they literally step into the role that is normally filled by an insurance carrier. They commit to fulfill

all the duties and responsibilities that an insurance company would provide. They also subject themselves to greater scrutiny by state insurance regulators than if they had simply transferred their workers' compensation risk to an insurance company.

When self-insured workers' compensation operates properly, it can result in lower overall costs and greater control for the employer. However, if the employer is not financially sound, workers' compensation self-insurance can be a disaster for the employer and have tragic results for injured employees. That is why most of the states that allow workers' compensation self-insurance have put strict requirements in place to ensure that there will be funds available to pay for employee injuries.

Self-insurance is permitted in 48 states. In each of these jurisdictions, there are rules governing the respective self-insured programs. Most of the states only allow large, financially stable companies to self-insure their workers' compensation exposure if they can meet rigorous qualification standards (see sidebar on page 9). Most of the states also require that businesses making this election provide collateral to protect injured workers in the event that the business is unable to pay those benefits.

Figure 1 on the following page reflects the significant role that self-insurance plays in workers' compensation. Approximately 20% of all workers' compensation coverage is provided through self-insured plans. There has been some modest growth of self-insurance in workers' compensation, even during the Great Recession of 2007–2009.

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Becoming a workers' compensation self-insurer is not a trivial matter. Any company that assumes these risks is making a serious long-term financial commitment. The problem is what happens when a self-insurer, such as Prime Tanning, goes bankrupt?

On November 14, 2011, Prime Tanning-Hartland, a leather tanning firm operating under several subsidiary names in Maine and Missouri, sought Chapter 11 bankruptcy protection in a U.S. Bankruptcy Court in Bangor, Maine.² The reor-

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¹ NAIC, 2011 Market Share Reports for Property/Casualty Groups and Companies.
² The company operated under the names Irving Tanning Company; Prime Tanning Co, Inc.; Prime Tanning Corp.; Gudahy Tanning company, Inc.; Wismo Chemical Corp.; and Prime Tanning Company, Inc.

FÄ öµ1: EY ää µ:Ca-y ^a T ämäç IP: öó 2005-2010 (É \$ MÈäP-) ³						
Year	Private Carriers	State Funds	Federal	Self - Insured	Total	% of Total Costs Borne by Self-Insured Companies
2005	50,668	18,157	4,096	16,351	89,272	18.3%
2006	51,297	15,555	4,138	15,743	86,733	18.2%
2007	50,512	14,127	4,236	15,889	84,765	18.7%
2008	46,091	12,652	4,341	16,051	79,135	20.3%
2009	41,972	11,041	4,065	16,181	73,260	22.1%
2010	41,347	10,177	4,228	15,550	71,302	21.8%

Costs for employers insured through private carriers or state funds include premiums written in a year and the deductible benefits paid by employers. Costs for self-insurers include the benefits paid by these employers plus the estimated administrative costs.

ganiza on plan pe oned the U.S. Bankruptcy Court to use the self-insurance collateral (i.e., le ers of credit and surety bonds) held by the insurance departments in Maine and Missouri to pay future claims from injured employees.

The creditors pe on alleged that future loss es mates used by the states of Maine and Missouri were excessive. The debtor presented es mates from its own experts to support this allega on. The creditor also asked the court to take the unusual step of establishing a bar date a er which no employees could file claims for work-related injuries. The creditors overall goal was to release funds from securi- es used to fund the loss reserve accounts held by these states to pay future injured workers.

Maine Superintendent of Insurance Eric A. Cioppa, the Maine Self-Insurance Guaranty Associa on, the Missouri Department of Labor and the Missouri Private Sector Individual Self-Insured Guaranty Corpora on all objected to the use of the self-insured collateral. On Jan. 13, 2012, Superintendent Cioppa filed a brief outlining his concerns and the implica- ons for self-insurance regulators across the country.

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Concerns for Regulators

1. Since 1871, the business of insurance has been regulat- ed by the states. In 1945⁴, the passage of the McCarran -Ferguson Act a rmed that the con ued regula on of

the insurance industry by the states was in the public's best interest. If a federal bankruptcy judge did order the release of self-insured workers' compensa on loss reserve funds, it would have superseded state-based regula on.

2. Prime Tanning's creditors had asked that the court establish a bar date a er which no addi onal workers' compensa on claims would be accepted. This would have *precluded workers with latent industrial diseases from filing claims for their injuries*. This could have proved par cularly onerous for past employees, be- cause employees in these tanning opera ons were exposed to chemicals that are now recognized as car- cinogens.
3. It is notoriously hard to set reserves for workers' com- pensa on claims because the claims have long payout periods. Many claims stay open and require payments for anywhere from 10 to 30 years. During that me, a batch of claims is exposed to substan al swings in cost due to medical price infla on, increased treatment and care needed, and claimant life expectancies.

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³ Na onal Academy of Social Insurance, August 2012, pp. 32–33 (par al data from Table 11).

⁴ The McCarran-Ferguson Act stated that the regula on and taxa on of the insur- ance business by the states is in the public interest; Principles of Insurance, Mehr and Cammack, Fi h Edi on, 1972, p. 790.

4. The plan proposed by the creditors would *discharge all potentially liable non-debtor third parties (including guaranty associations)* from their own separate obligations to pay workers' compensation claims that might be discovered after the court-imposed bar date. This would have cut against a well-defined process for guaranteeing payment of full statutory benefits through insurance and other security.
5. Excess self-insurance carriers would exit the market. Insurance carriers rely on letters of credit and surety bonds to guarantee that they will be reimbursed for future loss payments. If this security is compromised or encumbered by bankruptcy judgments, no insurance companies will be willing to accept the risks. Without adequate excess coverage, no potential self-insurer would be approved by state insurance regulators.

tors in an opinion rendered Aug. 28, 2012.⁵ The ruling preserves self-insurance funds to pay Prime Tanning's outstanding workers' compensation obligations.

"The Court concluded that state law, not federal law, determined the nature and the extent of the debtor's interest in the collateral. Reviewing the state law, the Court concluded that the debtors did not have a property interest in the collateral as of the commencement of the case, but rather simply chose an action to recover excess funds under state law. Without that property interest, there could be no present, distributable surplus, even under the debtors' calculations. Thus, the Court denied confirmation of the Proposed Plan, without prejudice."⁶

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Fortunately, U.S. Bankruptcy Court District of Maine Chief Judge Louis H. Kornreich ultimately ruled against the credi-

⁵ Case 10-11757, Doc 597, Filed Aug. 28, 2012, U.S. Bankruptcy Court, District of Maine.

⁶ Dan Sovocal, Nixon Peabody, San Francisco, CA; distributed at the IAIABC meeting in Newport, RI (October 2012).

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Most of the states have established a division within either the department of insurance or the department of labor to focus on the regulation of companies that desire to become self-insured for workers' compensation. While specific state requirements may vary, there are several standard requirements:

- **Actuarial review of past loss information:** The goal of an actuarial review is to establish an appropriate loss pick that is based on historical loss payout patterns and is adjusted for current projected payroll activity. Requiring the potential self-insurer to contract for an actuarial study forces potential self-insurers to consider several years of data, rather than focusing on one year with exceptionally good loss performance. It also forces potential self-insurers to consider actuarial loss treatments, such as the application of loss development factors and reserving for incurred but not reported (IBNR) losses. These concepts are somewhat foreign to risk managers or finance department employees that are unfamiliar with workers' compensation losses and how they develop over time.
- **Excess Insurance:** While self-insurers are willing to accept a certain level of risk, they cannot accept unlimited liability. For this reason, self-insurers are required to purchase specific and aggregate excess insurance to protect their company should individual losses or aggregated losses for a given year exceed the values established in the actuarial projection. Examples of losses that would hit the excess policy include injuries to several employees at the same time; e.g., a plane or vehicle crash or an explosion within the plant that injures or kills multiple employees.
- **Bonds/Letters of Credit:** When a company decides to self-insure its workers' compensation insurance, it is taking on a "long-tailed" liability exposure. It could be years before all known losses are paid and all claims for a given year are settled. For this reason, state insurance regulators require applicants to supply security in the form of a bond or letter of credit to ensure that future losses will be paid. These guarantees are especially important because only a few states have established guaranty associations to pay claims for self-insured companies that become insolvent.
- **Claims Handling Ability:** State insurance regulators want to make sure that the self-insurer has sufficient staff to adjust claims on a timely basis and to establish fair and adequate loss reserves. In many cases, the self-insured company does not have employees that can handle the claims work, so they will purchase claims services from a third-party administrator.

For now, a crisis in workers' compensation self-insurance has been averted. The ruling is reassuring for state insurance regulators, because it reaffirms the sovereignty of the regulatory safety nets put in place for self-insurance.

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It is clear from the comments in the judge's ruling that he was concerned with the possible contradiction of the states' self-insurance laws. However, at the end of the day, his decision was based on the ownership interest (or lack thereof) in the security. A complete copy of the judge's opinion and all the legal documents related to this case can be found on the website of the International Association of Industrial Accident Boards and Commissioners (IAIABC).⁷

It is entirely possible that the debtors in this case will attempt to file an alternative plan for reorganization. On November

29, 2012 the debtors filed an appellant's brief petitioning the court to reverse its decision. It contains an appendix that is more than 4,000 pages long. The Maine Bureau of Insurance brief was filed December 13, 2012. On December 20, 2012, the IAIABC and the Southern Association of Workers' Compensation Administrators (SAWCA) filed an amicus brief as a response to the appeal filed by the debtors.⁸

The decision in this case will affect all of the states that allow workers' compensation self-insurance. State insurance regulators and the NAIC will continue to closely monitor developments in this case. Additional information can be found on the NAIC Workers' Compensation (C) Task Force Web page.⁹

⁷ www.iaibc.org/i4a/pages/index.cfm?pageid=3978.

⁸ www.naic.org/documents/committees_c_wctf_related_docs_prime_tanning_case_amicus_brief.pdf

⁹ www.naic.org/committees_c_wctf.htm



Save the Date

CIPR BRUNCH

INSURANCE FOR ACTS OF TERRORISM

Tuesday, April 9, 2013*

10:00 AM - 12:00 PM

During the NAIC Spring National Meeting in Houston, Texas

**Date and time subject to change. Visit the CIPR Events Page for the latest information: www.naic.org/cipr_events.htm*

