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## The Keys to Self-Insured Group Formation

by Haley Jorgensen

Self-insured groups generally form out of a necessity to drive insurance costs down. They first originated in the United States during the 1980s—a time when the hard insurance market limited availability of workers compensation coverage and premiums soared. Since then, self-insured groups have come and gone. It seems the self-insured groups that have stood the test of time—benefiting member companies through hard and soft markets—are those that were properly structured at inception and remain aggressively managed today.

In this article, the first in a three-part series, experts experienced in self-insured group formation and management offer their insights on how to establish a successful self-insured group, and simultaneously, avoid the governmental clutter, pitfalls and headaches along the way.

Self-insured groups are designed to provide the benefits of self-insured companies to like organizations without the size or ability to self-insure on their own.

Each member of a workers compensation self-insured group contributes to a collective fund, which is used to pay for operating expenses such as claims and administrative costs. Simultaneously, that fund is invested for additional gains. Because a self-insured group can include a large number of companies of various sizes, each member of the group contributes differently to the fund. A member with a high loss history and large payroll contributes more than a small company with a low loss history.

In general, self-insured groups help create a stable market within a specific industry for workers compensation, according to Ed Costner, president of Casualty Actuarial Consultants, a provider of professional casualty actuarial services to the risk management industry, serving approximately 100 self-insured groups nationally. "In self-insured groups, profits gained from underwriting are returned to the membership instead of an insurance company," he says.

It is also easier to control program costs by unbundling services, such as claims and loss control, and finding third party administrators (TPA) to handle them. Moreover, profits are returned to members based on the profitability of the members' accounts. Thus, there are significant benefits for member companies.

From start to finish, the entire self-insurance group formation process can span six to 18 months, according to Bryan Thomas, who has personally been involved in the development of six such groups as CEO of CCMSTI, which caters to around 60 self-insured groups, often handling claims, loss control, accounting and new member solicitation.

The following best practices represent a break-down of lessons learned from those in the trenches of self-insured group formation:

### Acquiring Association Backing

Typically, groups are formed with the support of an industry association, says Thomas, which includes a number of member businesses. According to many experts, association backing is often critical to long-term success and without this, the program may never get off the ground.

Patricia McLaughlin, executive director of the Illinois Movers' and Warehousemen's Association (IMAWA) is a good example. She was heavily involved with forming the self-insured group for this association, the Illinois



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Movers' and Warehousemen's Risk Management Group (IMWRMG). Not only does the association's staff know the industry and the individual players, McLaughlin points out that the association's backing of the group delivered instant program credibility.

According to Thomas, the association should be in it for the members' benefit. "Endorsement of a legitimate business association is absolutely critical to success," he says. "If it is the association's goal to have a member benefit, you'll have a great program. If they only want a piece of the action, it will never work." **Choosing the Right Partners**

Once the association supports the self-funded concept, the association chooses its business partners including TPAs, brokers, accountants and additional service companies. Careful selection will deliver economy, credibility and results. The TPA helps the association determine if a self-insured group is wanted by potential members and is financially feasible. Then, that TPA will move forward to handling governmental approval, underwriting, administrative and management functions.

McLaughlin knows first hand that getting in with the wrong crowd can be financially devastating. Her association's first choice to handle the formation of IMWRMG resulted in loads of money and time lost. "We wasted an entire year with a scam guy," she says. "If you don't pay attention to the people you hire to manage the program, you can have immediate, catastrophic results for members. You need to make sure that you select a TPA that is experienced, credible and trustworthy."

#### **Determining Feasibility**

That TPA will then help the association determine if a self-funded pool is financially feasible. Is group formation practical and advantageous?

During this stage of the game, the TPA clearly and skeptically evaluates whether or not forming a self-insured group would be beneficial to members, according to Thomas. Often, surveys are distributed to potential members in order to gather critical data relating to workers compensation.

The process is technical and detailed. "You must take members' losses and payrolls of prior years and use that data to forecast expected losses for the upcoming period," says Costner. "Then you add on expenses the trust must pay, including excess insurance, the TPA fees, commissions, premium taxes and administration. You need to know that at the end of the day you'll have enough money to pay losses and expenses."

Furthermore, financial documents vary from state to state. Some require financial information on every member, and some states mandate this only for core groups. "In the end, you must have the blessing of the state regulatory agency to start the group," he says.

Once data indicates a self-insured group concept is feasible and beneficial, the TPA works to locate excess insurance carriers, gain governmental approval and solicit quality members.

#### **Government Approval**

It is important to note that each state's regulatory requirements are unique. A skilled TPA with a proven track record of establishing self-insured groups is key to leading the association through the regulatory maze. They will prepare and submit applications to the state regulatory agency and obtain certificates of authority and required bonds. This involves meeting with the division of workers compensation, providing projected financial statements and demonstrating that members of the group operate within the same industry and have the same governing classification. At this time, it is also necessary to submit a business plan for the group, a copy of the bylaws, a listing of membership and a listing of service providers.

#### **Establishing Underwriting**

Thereafter, the TPA makes recommendations on rate structure and funding levels to the group's board of trustees; provides underwriting guidelines and quotations for prospects; and develops financial projections and an operations plan. At this point, members officially buy into the group concept.

It is essential to gain quality members who present low loss ratios to underwrite the new group, according to experts. Otherwise failure is imminent. Jon Richardson of Holmes Murphy Insurance Agency, in Peoria, Illinois, helped solicit members for Mid-West Truckers Risk Management Association in the early 1990s. "Not obtaining a quality group of members to underwrite the program is a common mistake of many self-funded groups," he says. "You have to include companies in the pool that take a proactive approach to safety."

Often, gaining membership involves personally visiting companies in order to fully explain the advantages of the program. "You can't lose the underwriting discipline or it will be over," says Thomas. "Our philosophy is to be candid and open to

association members. [But] if they don't meet the underwriting criteria, their company doesn't qualify."

This does not mean the company will be shut out entirely, however, as many are able to readdress the troubling issues and then become valuable members. "We work with them and tell them what to do to qualify," says Thomas. "It works. We've had countless companies over the years that have improved and come into a group."

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*This article is the first in a three-part series. **Part 2: Effective Self-Insured Group Management** will appear in the February issue.*

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