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ALTERNATIVE RISK FINANCING: OPTIONS TO TRADITIONAL INSURANCE

Retro plans, large deductibles and captives - potential cost savings to your current plan. These concepts all fall into the category of alternative risk financing and they very well may be a good choice for your business.

In our first article on alternative risk financing, we provided a general overview on three high level concepts you should consider before evaluating what insurance program is right for your company. They were:

1. Your company's goals and objectives
2. Collateral
3. Mergers, acquisitions and private equity.

As the second article in our series, we will take a deeper look into the alternative risk financing tools that could potentially save your company money compared to traditional insurance programs. These alternative risk financing tools include:

1. Retrospective Rating Plans (Retros)
2. Large Deductible Plans
3. Group Captives

It is important to note that the details of these three types of plans are negotiable with your insurance carrier and can be customized to fit your company's goals and objectives. Alternative risk financing options have one thing in common: they allow you to pay insurance premiums based on your own loss experience instead of the insurance company's trends and experience. The benefits include:

- An advantage over traditional insurance plans if your company's losses are lower than the industry average.
- The potential for improving your company's cash flow and a faster reward for your efforts to prevent and manage claims.
- More transparency with your insurer's pricing.

While the benefits of lower costs as a reward for low losses may outweigh any of the negatives, you'll want to be mindful that your company could pay higher premiums if you have an adverse loss year, and the final cost of the plan will not be known until all claims have closed. Remember – the plans don't have to be complicated if you negotiate the best alternative risk financing option for your company.

RETROSPECTIVE RATING PLANS (RETROS)

Also known as Loss Sensitive Plans, they allow for the premium to be adjusted "retroactively" depending on your losses, subject to the plan's minimum and maximum premiums. The plan is simply a mathematical formula and all plans share five similar components:

1. Your losses, which are typically capped at a specific amount.
2. Claims handling expense to handle those losses.
3. The insurer's administrative and overhead costs.
4. Excess premium which is the "risk sharing" component of the plan.
5. An amount to pay state premium taxes.

These components are all embedded in an insurance company's premium for traditional insurance plans. The difference is that these costs are based on the insurer's entire book of business so they are far less negotiable.

Retros can also be based on either paid losses or incurred losses. With paid losses, you reimburse the insurer for only the losses they have actually paid. With incurred losses, you advance funds for both the paid losses and the claims reserves that are estimated, but may be paid at a later date. The excess premium amount will vary depending on the individual losses, as well as the plan's minimum and maximum. In other words, the more risk you assume, the lower the cost.

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LARGE DEDUCTIBLE PLANS

Large Deductible Plans are very similar to Retros and have the same basic plan components including minimums and maximums. The differences are:

1. You reimburses the insurer for claims within the selected deductible, so Large Deductible Plans usually have greater cash flow benefits than Retros.
2. There is no premium tax charged for losses within the deductible.
3. Collateral is required to secure the losses which are yet to be paid, usually a letter of credit.

Advantages of Large Deductible Plans include:

· There are minimal adjustments.

· The potential to improve your cash flow because you don't pay for the losses until the insurance company does.

While not having to pay premium tax seems like an advantage, most states have imposed assessments and surcharges which usually equal the amount of the premium tax. With Large Deductible Plans, you'll want to keep in mind that Letters of Credit will build up. However, they can be managed to a reasonable level if you understand and have negotiated the amount that is needed by the insurer.

In Wisconsin, Large Deductible Plans are not approved for Worker's Compensation but insurers can craft a Retros based on paid losses that can give the same cash flow benefits. Large Deductible Plans are still common for other lines of coverage.

GROUP CAPTIVES

Generally, Group Captives are formed by two or more companies to provide Worker's Compensation and other coverages to their member owners. Most Group Captive plans have similar pricing components to Retros and Large Deductible Plans. The difference is that each member is an owner so they may have more influence over their program. Because of this influence, Captive costs are very transparent to the insurance buyer. A Captive also provides stability of future insurance costs for members who are willing to control their losses.

Group Captives also typically require collateral. As in other types of alternative risk financing, the final premium is dependent on the insured's losses so the Captive costs will be based accordingly.

There are other types of Captive solutions, such as Single-Parent Captives, which are owned by and insure the risks of only one insured. Another type of Captive is an 831b Captive, which can be set up for tax purposes. More information is available about these Captive options but a Group Captive is the most comparable to a Retro or Large Deductible Plan.

Any of the above alternative risk financing options may be cost effective for your company. Before making that decision, it is important to understand the options and the amount of control the insurance buyer actually has in the process.

For more information, please visit johnsonfinancialgroup.com or give us a call at 800.236.5546.

This information is not intended to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.