



Consider Loss-Sensitive Program Structures to Reduce Cost and Improve Cashflow During COVID-19

June 9, 2020

As COVID-19 continues to negatively impact businesses across all sectors nationwide, now is an ideal time to consider an Alternative Program Structure/Loss-Sensitive Program that may help your business save money and improve cashflow.

Many buyers of primary casualty insurance including Workers' Compensation, Automobile and General Liability are on a guaranteed-cost program structure. In these programs, also called first-dollar programs, the insured pays a fixed premium in exchange for full coverage of a loss, including damages, defense costs, claims handling, etc. Companies have historically preferred the convenience and budget stability of these programs. The times, however, have changed.

In addition to creating cashflow and liquidity problems for many insureds, the COVID-19 pandemic will likely exacerbate an already challenging insurance market characterized by rate increases and tighter underwriting standards across all lines. We anticipate that a challenging market will remain throughout 2020 and into 2021, and few buyers of insurance will be spared.

While it is always a good idea to review alternative program structures with your trusted insurance broker, these solutions are especially worthy of consideration now, while the pandemic continues to damage and disrupt business operations.

Your insurance broker can help you:

- Evaluate your total cost of insurance as well as any cashflow and liquidity implications related to existing program structures.
- Evaluate and perform a cost-benefit analysis of alternative loss-sensitive program structures in which you will assume greater losses in exchange for reductions in fixed cost premiums and improved cashflow. This is especially important if you are currently on a guaranteed cost program and/or dividend program.

Benefits of Loss-Sensitive Programs

Compared to guaranteed-cost programs, loss-sensitive programs require the insured to bear some portion of the loss – usually on a vertical, per-occurrence basis so these programs can present the risk of higher costs if the loss experience is poor. However, with a targeted claim and risk control program and when viewed in a multi-year period, loss-sensitive programs offer many insureds the opportunity to obtain significant savings in total cost of risk while improving cashflow.

These structures can provide several advantages including:

- **Improved cashflow and investment income.** Many loss-sensitive programs can be structured on a pay-as-you-go basis, which enables the insured to improve cashflow and receive investment income on the retained loss reserves.
- **Lower premium.** In exchange for bearing some portion of the loss, which is capped both vertically and horizontally, the insured receives upwards of a 20% to 70% credit on the guaranteed-cost premium depending on the amount of loss retained and the type of loss-sensitive program.
- **Savings through aggressive loss control and claims handling initiatives.** The incentive to control and reduce losses by the insured is often greater since savings accrue directly back to the company itself.
- **Price stability.** While loss-sensitive programs will not eliminate pricing volatility entirely, they can help reduce the swings in pricing that often come with guaranteed-cost programs in hard markets.

Loss-Sensitive Program Structures

There are a variety of different loss-sensitive program structures to consider, including:

1. **Dividend Plans:** Insureds can earn back a percentage of premium based on loss ratios not exceeding a certain percentage.
2. **Group Captives:** Insured obtains benefit of leveraged purchasing to drive down fixed costs. Pre-funding of expected losses, but investment income accrues to the insured. 80% of insureds moving into a group captive program are coming off a guaranteed cost or dividend program. Group captives tend to be one of the more competitive loss sensitive program options for middle market companies.
3. **Risk Retention Groups:** Member-owned, authorized, and admitted insurance company insuring liability only, where risks are pooled and shared among each other. Profits are retained by policyholders rather than being passed to a commercial insurer.
4. **Deductible:** Small or large deductibles, which are usually structured on a paid loss basis. In these programs, the insured is assuming a portion of the loss themselves within the deductible layer before any risk transfer to the insurer is triggered.
5. **Incurred-Loss Retrospectively Rated Programs:** Insured pre-funds expected losses but investment income accrues mainly to insurance company.
6. **Self-Insurance:** Small or large self-insured retention levels, which are structured on a paid loss basis. Similar to deductible programs, the insured is assuming a portion of the loss themselves within the self-insured retention layer before any risk transfer to the insurer is triggered.
7. **Single Parent Captive:** A single parent captive works on conjunction with deductible or self-insured programs to wring out additional efficiencies.
8. **Non-Subscription:** For employers with Texas payroll who meet the criteria. Texas is the only state that allows private employers to opt out of the workers' compensation act and not purchase coverage.

There are other factors to consider when evaluating loss sensitive program structures, including collateral requirements. The following exhibit compares and contrasts many of the considerations of the various program structures.

Program Structure Comparisons

Program Structure	Budget Stability	Loss Sensitivity	Cashflow	Tax Deductibility	Impact of Collateral	Incentive to Control Losses	Ability to Control Claims	Administrative Burden	Ease of Exit
Guaranteed Cost	High	None	Low	Premium - Yes	None	Low	Low	Low	High
Dividend Program	Medium	Low	Low	Premium - Yes	None	Medium to High	Low	Low	High
Small Deductible	Medium	Low	Low	Premium & losses as paid out	Medium	Medium to High	Medium	Low	Medium
Group Captive	Medium	Medium	Medium - pre-funded losses earn investment income	Premium & pre-funded losses	Low to Medium	High	Medium	Low	Medium
Large Deductible	Low	High	High	Premium & losses as paid out	High	High	Medium to High	Medium	Low
Incurred Loss Retro	Low to Medium	Medium to High	Low	Premium & pre-funded losses	Low	High	Medium to High	Medium	Medium
Qualified Self Insurance	Low	Medium to High	High	Premium & losses as paid out	High	High	High	High	Low
Single Parent Captive	Low	High	Low - expected losses paid into captive subsidiary	Premium & pre-funded losses	High	High	Medium to High	High	Low

How Can USI Help?

USI offers the following important services and more, to help clients better understand how a loss sensitive program structure may be beneficial:

- Benchmarks to show how peer companies are structuring their casualty programs.
- Loss forecasts and variability studies.
- Risk-retention analysis to help clients determine the optimum per-occurrence retention levels, maximum premiums, and the impact that accruals for retained losses will have on their balance sheet.
- Cost-benefit evaluation of varying loss-sensitive program structures compared to guaranteed cost.
- Evaluation of pre-loss efforts, such as safety initiatives and other loss-control programs.
- Evaluation of post-loss efforts, such as claims handling, managed care programs, and return-to-work initiatives.
- Assess the ability to post collateral and evaluate applicable collateral alternatives.
- Analysis of additional administration needs.

While loss-sensitive programs can result in a higher cost than first-dollar programs in any given year if claims are left unmanaged, loss-sensitive programs tend to be more cost effective over time, especially for companies that remain proactive with respect to controlling losses and managing claims.

Learn More

As companies see higher insurance premiums and reduced capacity from carriers as a result of the COVID-19 pandemic, loss-sensitive programs are becoming an important alternative to guaranteed-cost structures. To learn more about these programs, contact your USI representative, or visit us at www.usi.com.

Additional Resources

For additional resources, tools, information, and links, please visit our COVID-19 resource page at www.usi.com/public-health-emergencies.



This publication and the information contains proprietary information of USI Insurance Services, LLC. Recipient agrees not to copy, reproduce or distribute this publication, in whole or in part, without the written consent of USI Insurance Services. The contents of this publication are for information purposes only and are not intended to be exhaustive nor should any discussions or opinions be construed as legal advice. Contact your broker for insurance advice, tax professional for tax advice, or legal counsel for legal advice regarding your particular facts or issues. USI Insurance Services assumes no liability for consequences of any actions taken on the basis of the information provided herein. ©2020 USI Insurance Services. All Rights Reserved.