



2013 Annual Issues Symposium



Don't Just Speculate, Investigate!

The Story Behind the PEO Study

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Practice Leader and Chief Economist
May 16, 2013

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underwriting safety healthcare regulat
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workers comp networking regulations

The Story Behind the PEO Study

- **What Are They Saying About PEOs?**
Much of It Is Speculation
- **Why No Prior Investigation?**
It Would Be Really Difficult
- **Initial Findings?**
Speculation Upended
- **External Push Back?**
More Investigation
- **Our Own Push Back?**
Work in Progress

What Are PEOs?

Why Are There Concerns?

Typical PEO Services

- Payroll
- Workers compensation
- Risk management
- Employee benefits
- Recruiting
- Training and development

“Employer of record” for the leased workers from a PEO client company

Source: National Association of Professional Employer Organizations (www.napeo.org)

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Annual Issues Symposium
2013

What Are PEOs? Why Are There Concerns?

Key Stakeholders:

- Workers
- Employers
- PEOs
- Regulators
- Insurers
- Ratemaking organizations

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What Are PEOs?

Why Are There Concerns?

- Regulatory Concerns and PEOs:
 - Worker abuse/lax workplace safety
 - Inadequate OSHA reporting
 - Compliance with state WC proof of coverage
- Speculation about PEO Behavior and Ratemaking:
 - Under-report or misclassify payroll
 - Under-report workplace injuries
 - Avoid/distort experience rating mods

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Linking Policy and Unit Reporting Systems

- Started With Unit Data
- Proof of Coverage (POC)
 - NCCI's PEO team in Regulatory Services Division
- Linked Policy and Unit Reporting Systems
 - Data and IT

Understanding the Data

- Multiple Policy Types in POC Data:
 - Master policies
 - Multiple Coordinated Client policies
 - Multiple PEO policies
 - PEO Direct Employee policies
- Changing Regulatory Environment:
 - State regulations affect PEO market shares by PEO policy models over time
 - Worked again with NCCI's PEO team

Understanding PEOs and Issues in Experience Rating and Residual Market

- Experience Rating Concerns and PEOs
 - NCCI's Experience Rating Team
- Residual Market Issues and PEOs
 - NCCI's Residual Market Team

Ratemaking Data Issues and PEOs

AES Class Ratemaking Team

- Data Validation Issues and PEOs
- Creating Industry Group Level Data

Insolvencies and PEOs

- Working With Annual Statement Data
- Estimating Loss Reserve Adequacy
 - Schedule P

Obtaining External Information

- NAPEO Member List
 - Linked to WC data for market share and size analysis
- Google Search
 - Obtaining names of insolvent companies
 - Linked to WC data for PEO share and loss experience analysis
 - For background; no plans to publish individual company data
 - Linked to Annual Statement data for reserve analysis

The Story Behind the PEO Study

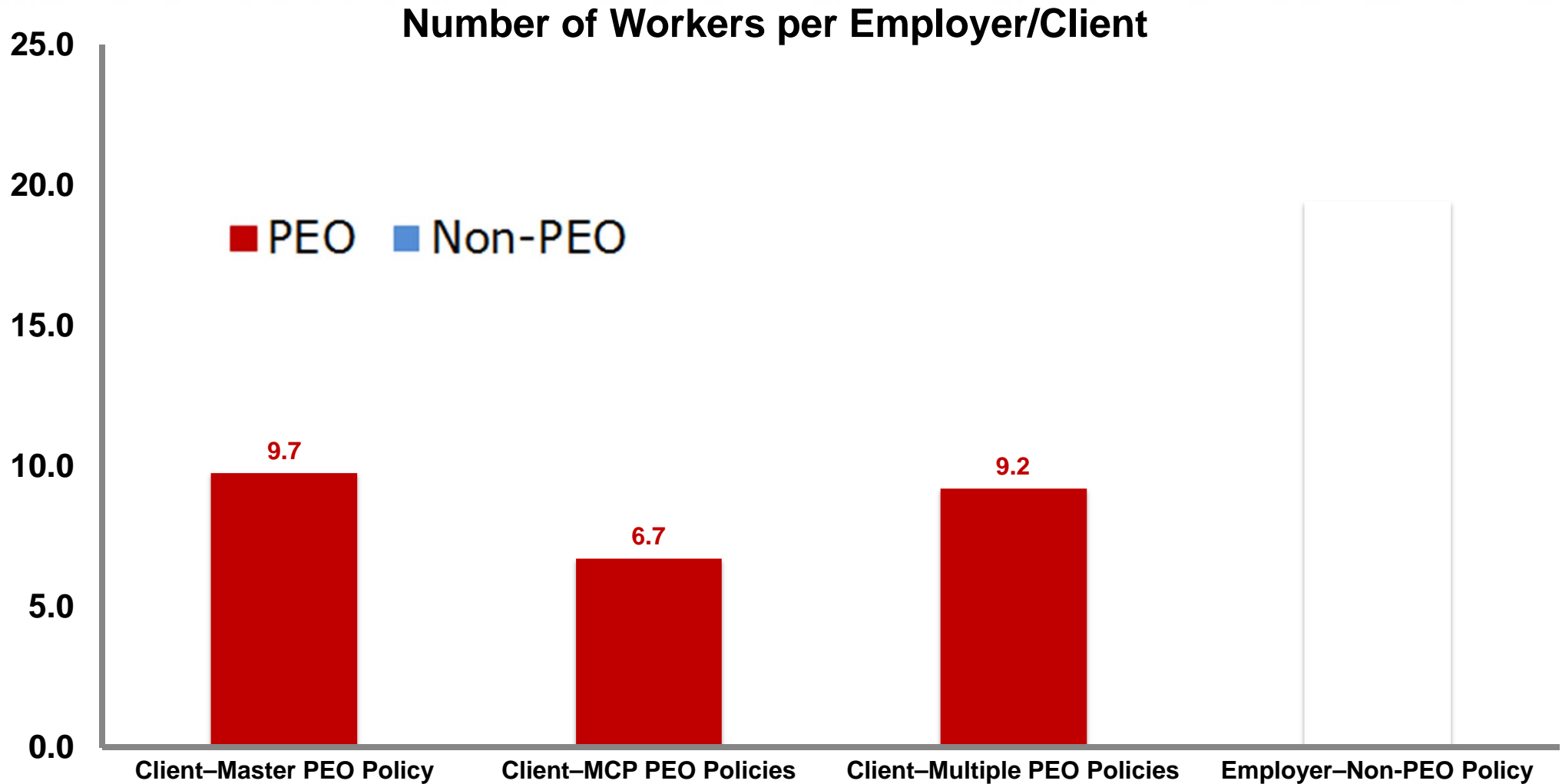
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PEOs in the WC Market

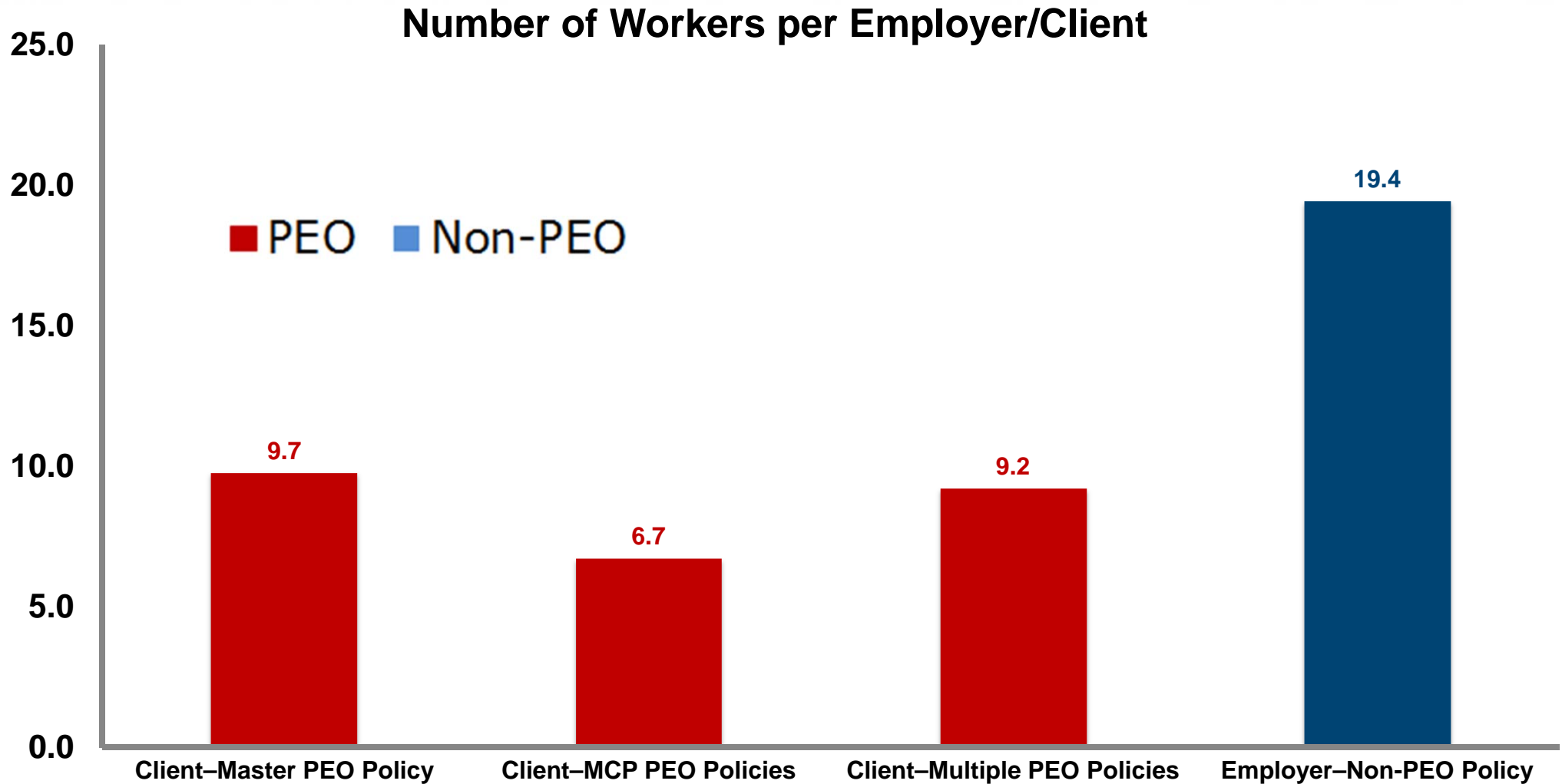
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PEO Clients Appear to Be Small Businesses



Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI, for Policy Year 2007

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Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI, for Policy Year 2007

PEOs in WC Markets Over PY 2004 Through PY 2010

- On Average Small Market Shares
 - 1 to 2 percent payroll share in the voluntary market
 - 2 to 6 percent of the residual market
- Great State Variation
- In PY 2009:
 - Florida—6 percent in voluntary market
 - Arizona—30 percent in residual market

Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI

Voluntary Market: 37 NCCI ratemaking states; CA, DE, MA, MI, MN, NJ, NY, NC, ND, OH, PA, WA, WI, and WY are excluded

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NCCI is not the residual market plan administrator in IN, TN, MO, and NE



PEO Loss Experience (@2nd Report)

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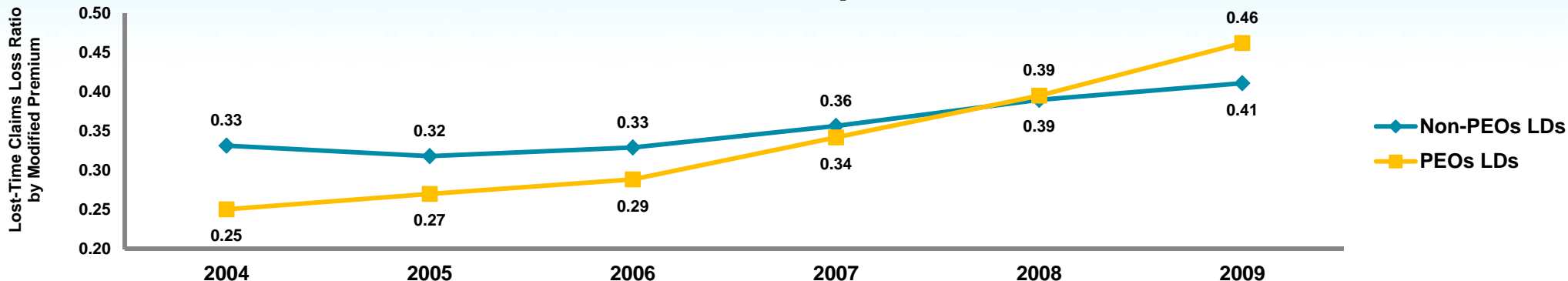
PEO Loss Experience Is Comparable to Non-PEO

- **Frequencies are higher by number of workers**
 - Indicating that under-reporting claims is not apparent in the data
- **Severities are comparable**
- **Loss ratios by manual premium and modified premium tend to be comparable, if not lower**
 - Indicating that under-reporting or misclassifying payroll is not apparent in the data
 - Also indicating that there is no major problem with PEOs avoiding experience mods

Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI
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Comparable or Lower Loss Experience

@2nd Report

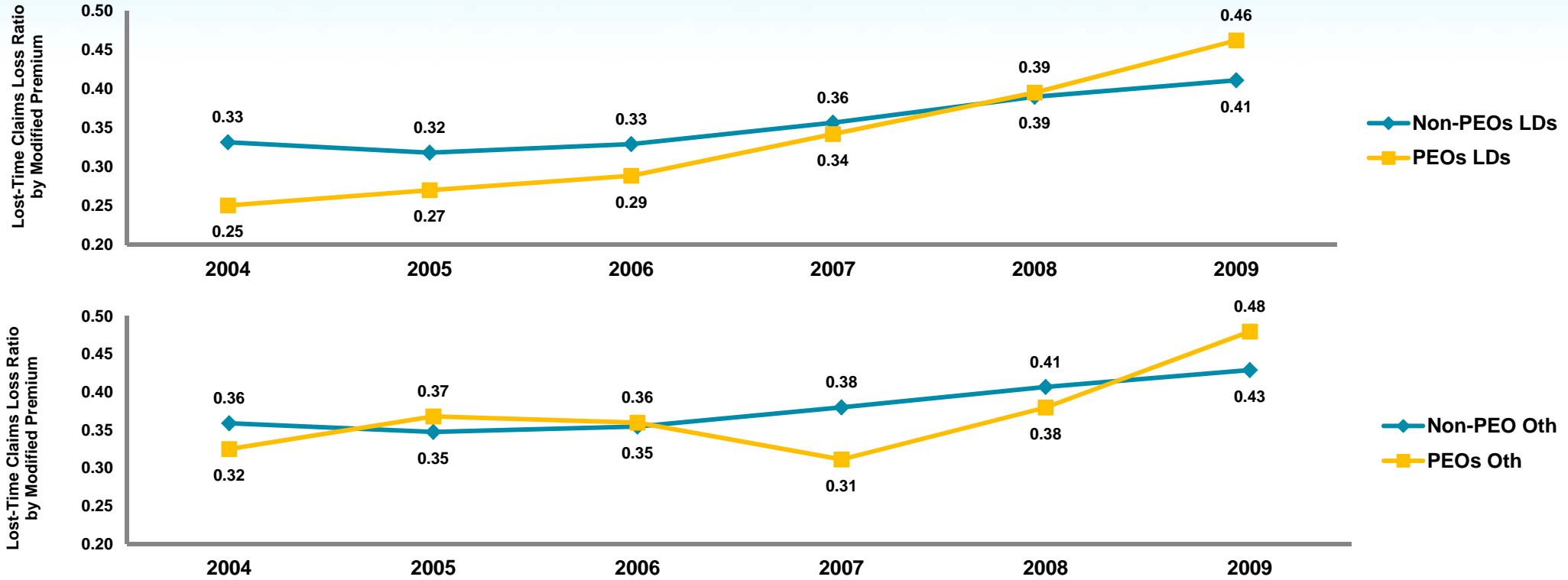


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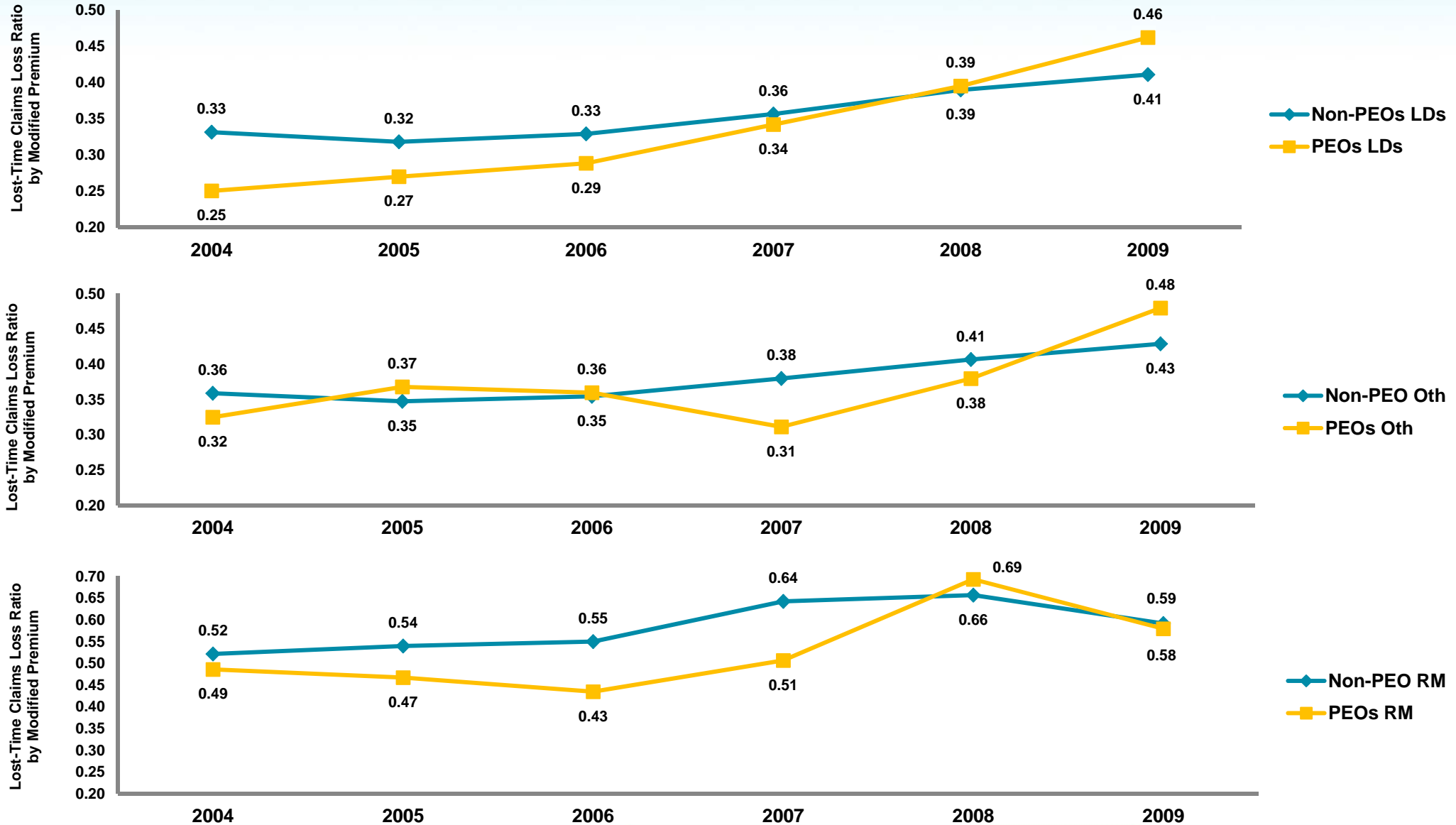


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Is It Industry Mix?

- PEO industry mix by payroll is comparable to non-PEO
- Loss ratio experience across industry groups is comparable
 - Exception: miscellaneous group shows adverse loss experience for PEO clients
 - Initial analysis indicates transportation industry exposure in PEO clients may be a factor

Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI



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The Story Behind the PEO Study: External Push Back

- Anecdotal data suggests that PEOs are problems
 - Why no apparent material differences between PEO and non-PEO lost ratios?

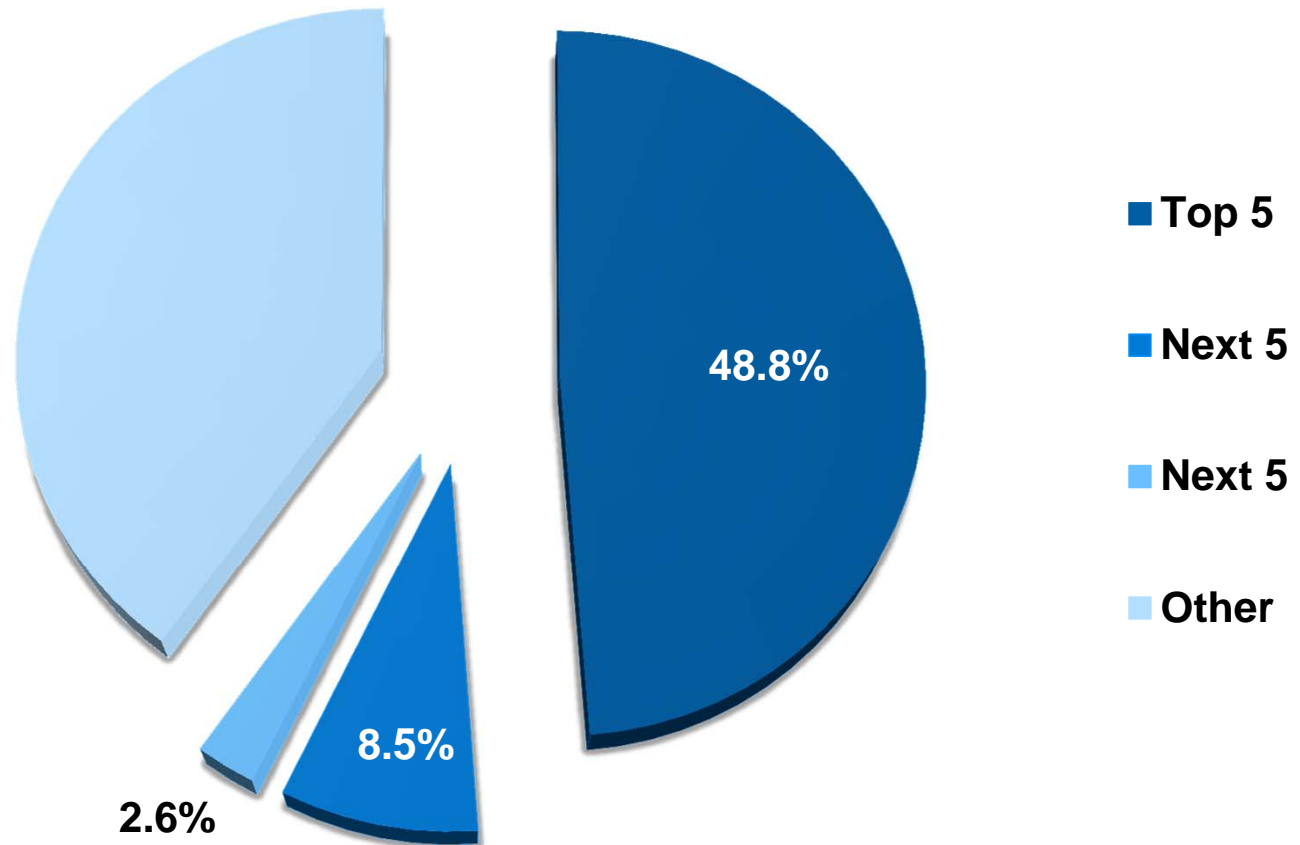
Assertions

- PEOs may look OK at Second Report
 - But reporting delays by PEOs likely result in worse ultimate experience
- PEOs are responsible for the three most recent WC insurer insolvencies
- More PEO data must be excluded from ratemaking because of poor data quality
- PEOs serve as a “front” for “mod washing”

Workers Compensation Data Suggests That the PEO Market Is Highly Concentrated

15 Largest PEO Companies Comprise Approximately Two-Thirds Market; National PEOs Members Make Up Majority of PEO Industry

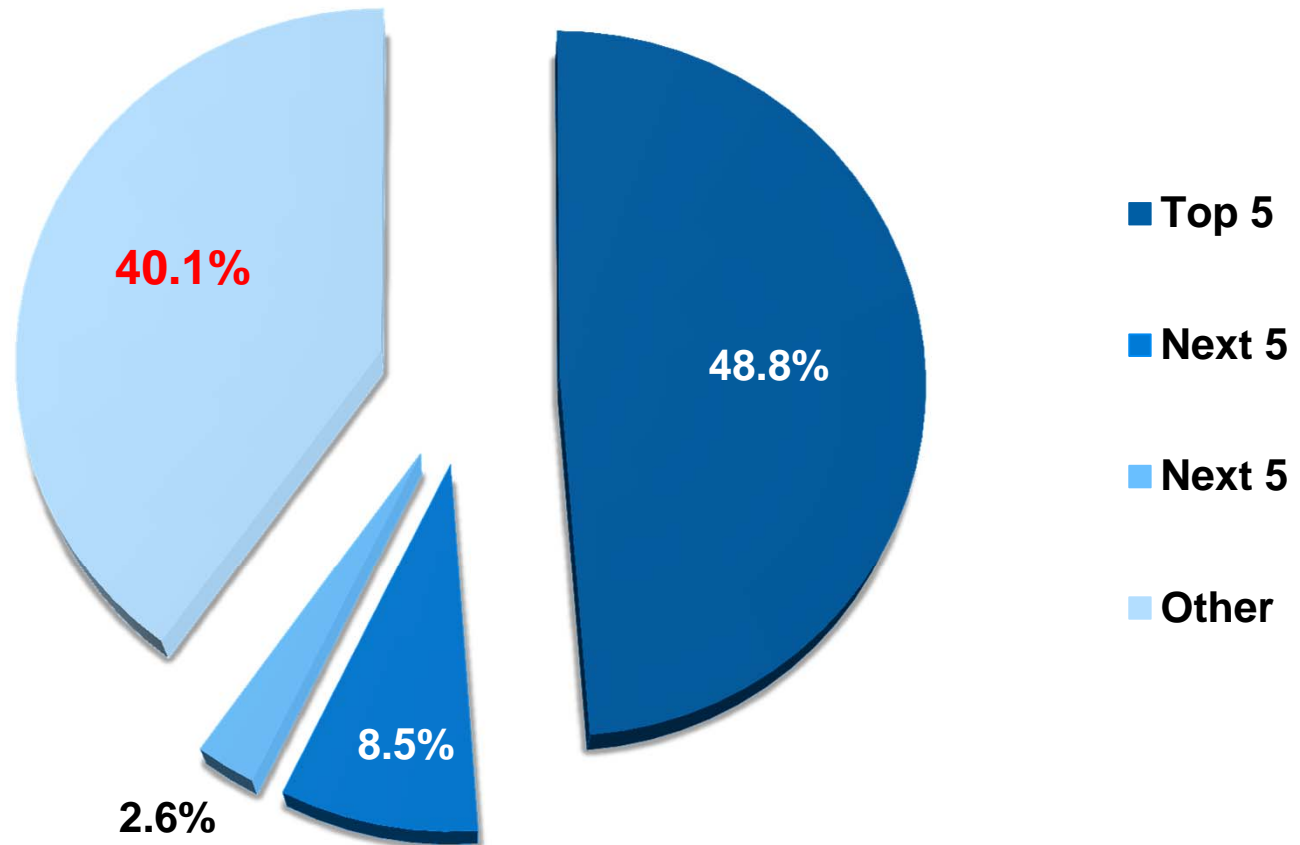
Policy Year 2009 Data



Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI National Association of Professional Employer Organizations (NAPEO) ©NAPEO 2012; Used with permission PEO policy models—Master policy, MCP policies, Multiple PEO policies, and PEO direct employee policies are included National PEOs list was based on membership list at napeo.org in April 2012 MCP policies may not have PEO information as named insured NCCI 37 ratemaking states only

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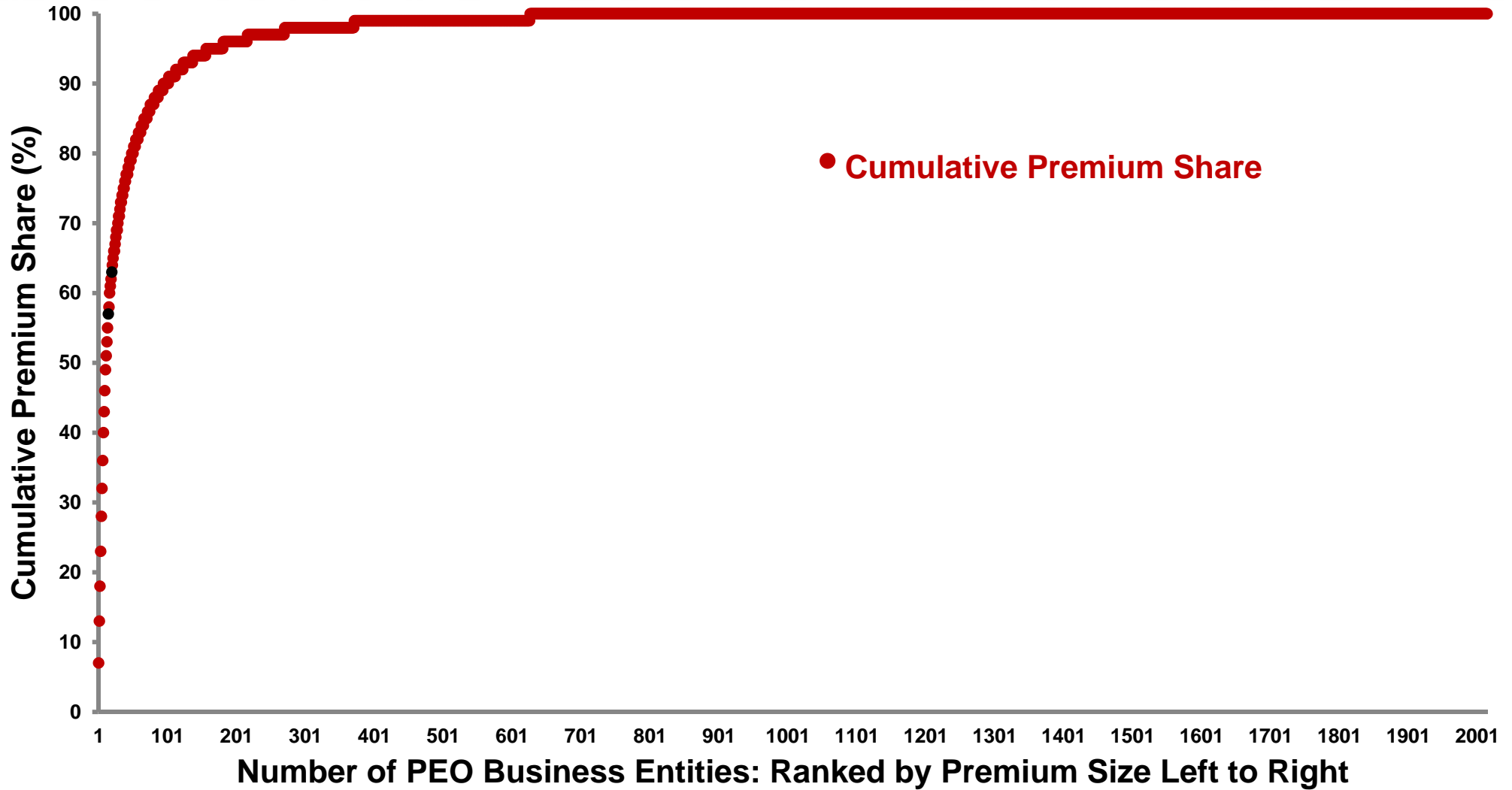
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PEO Size

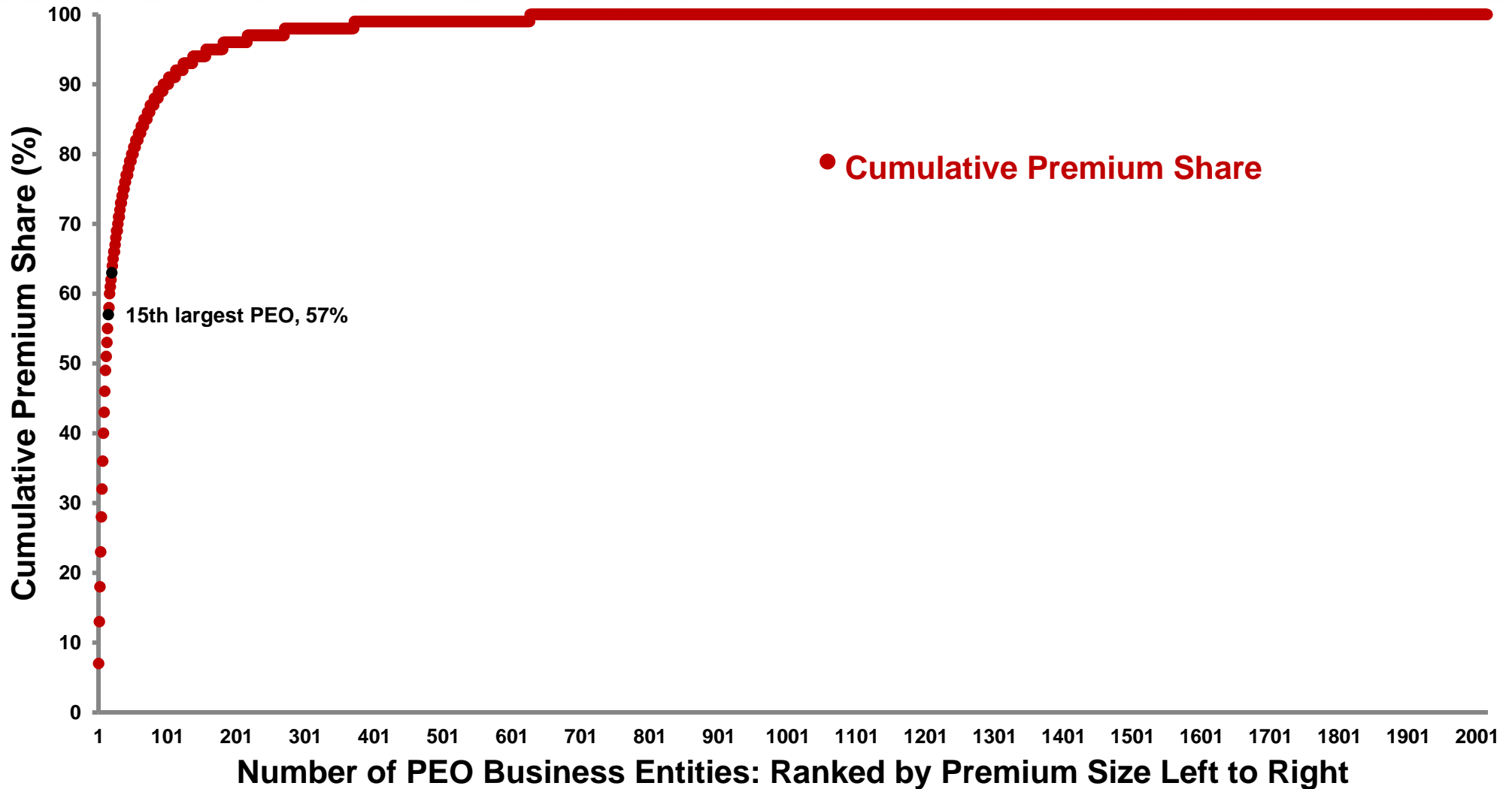
PY 2007 PEO Business Entities With Master Policies



Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI
NCCI 37 ratemaking states only

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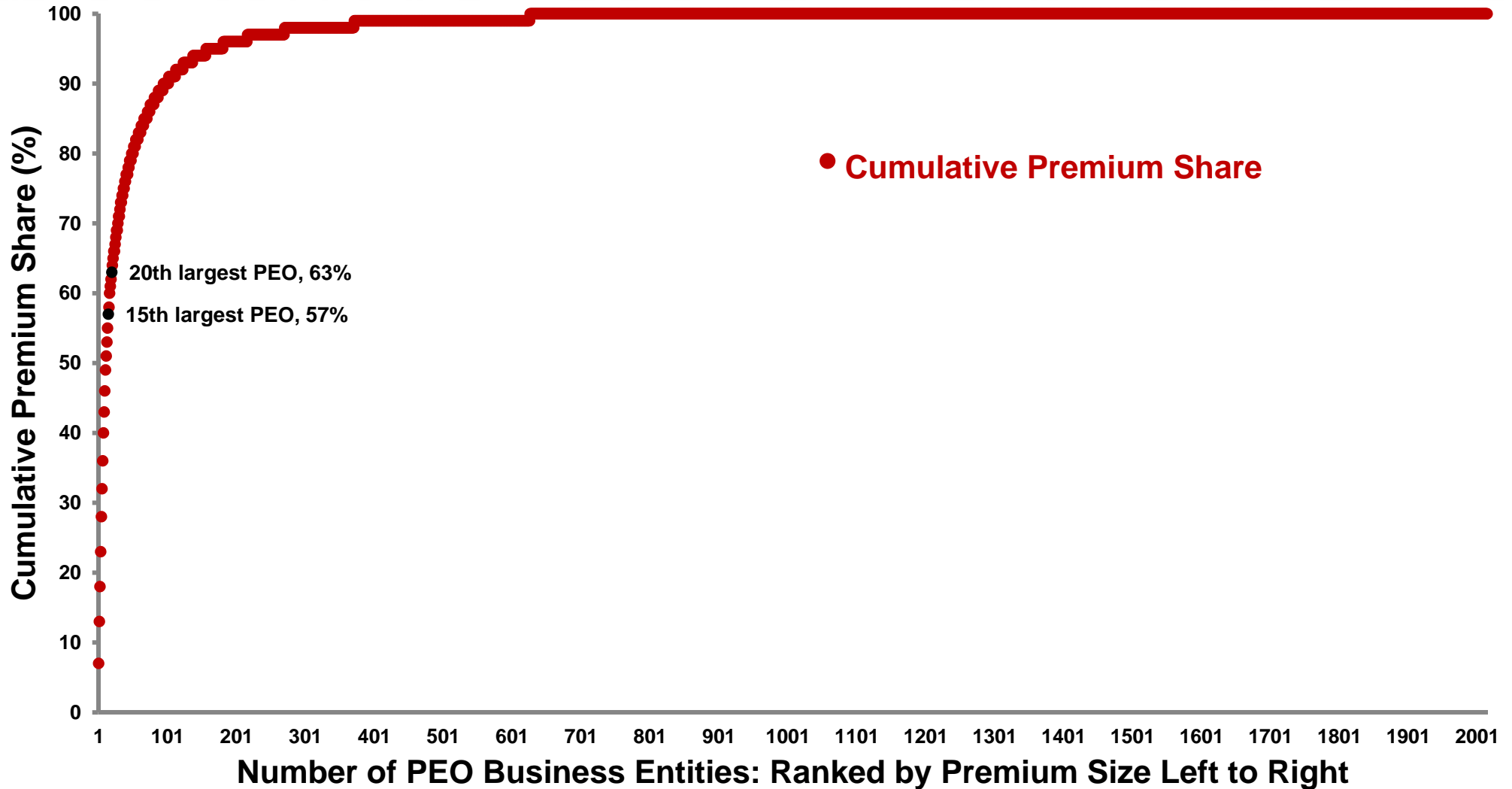
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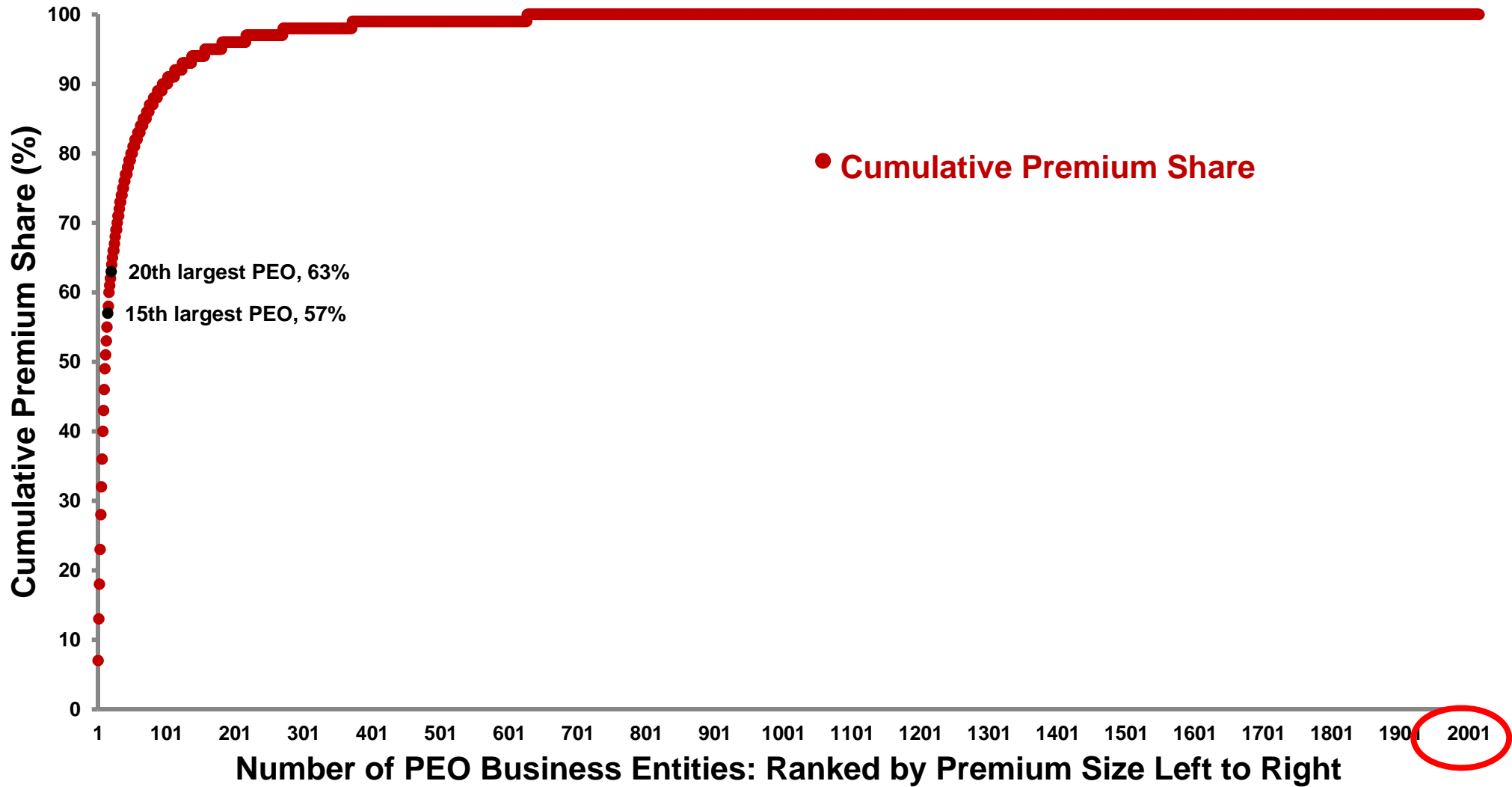
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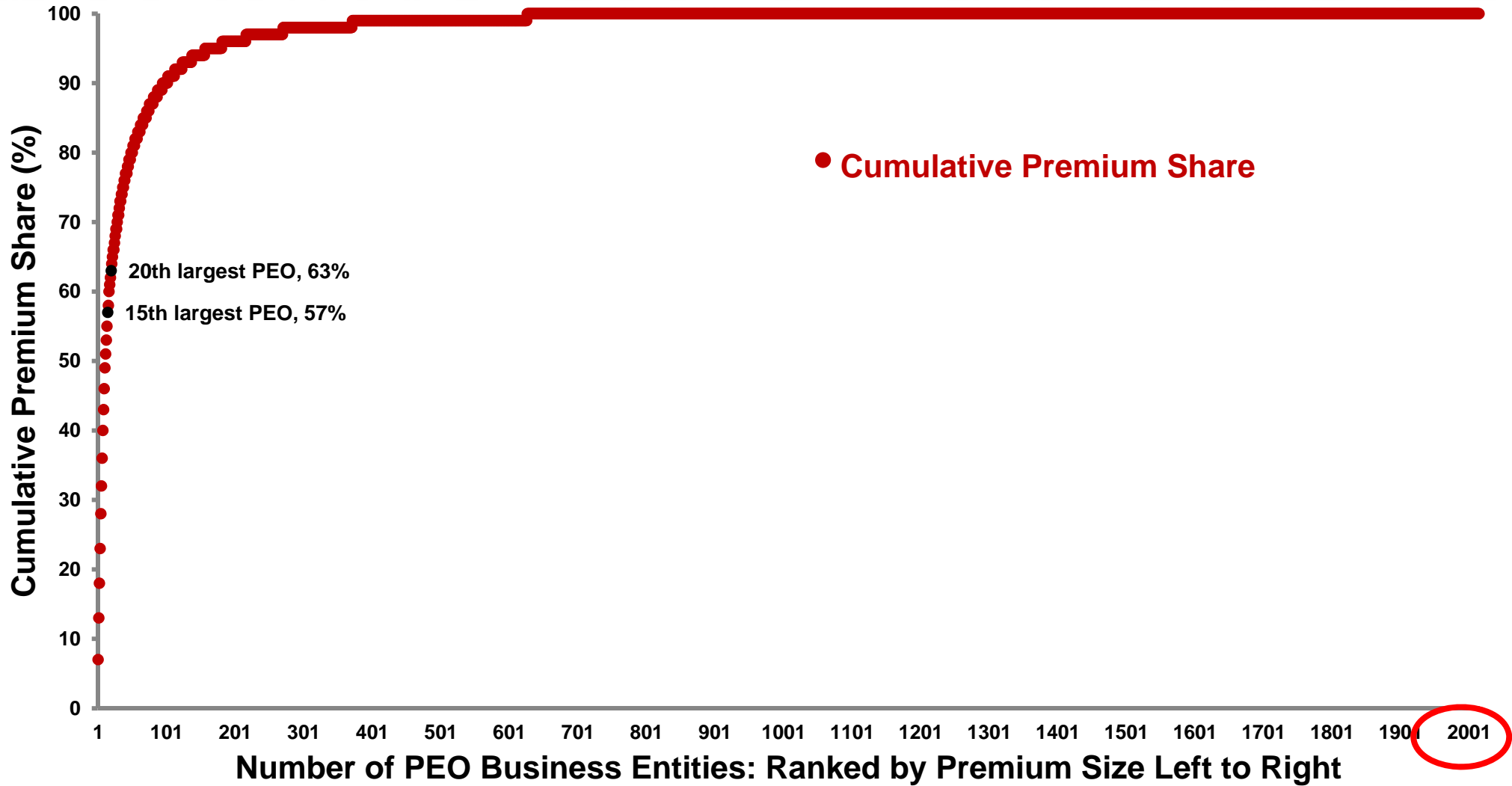
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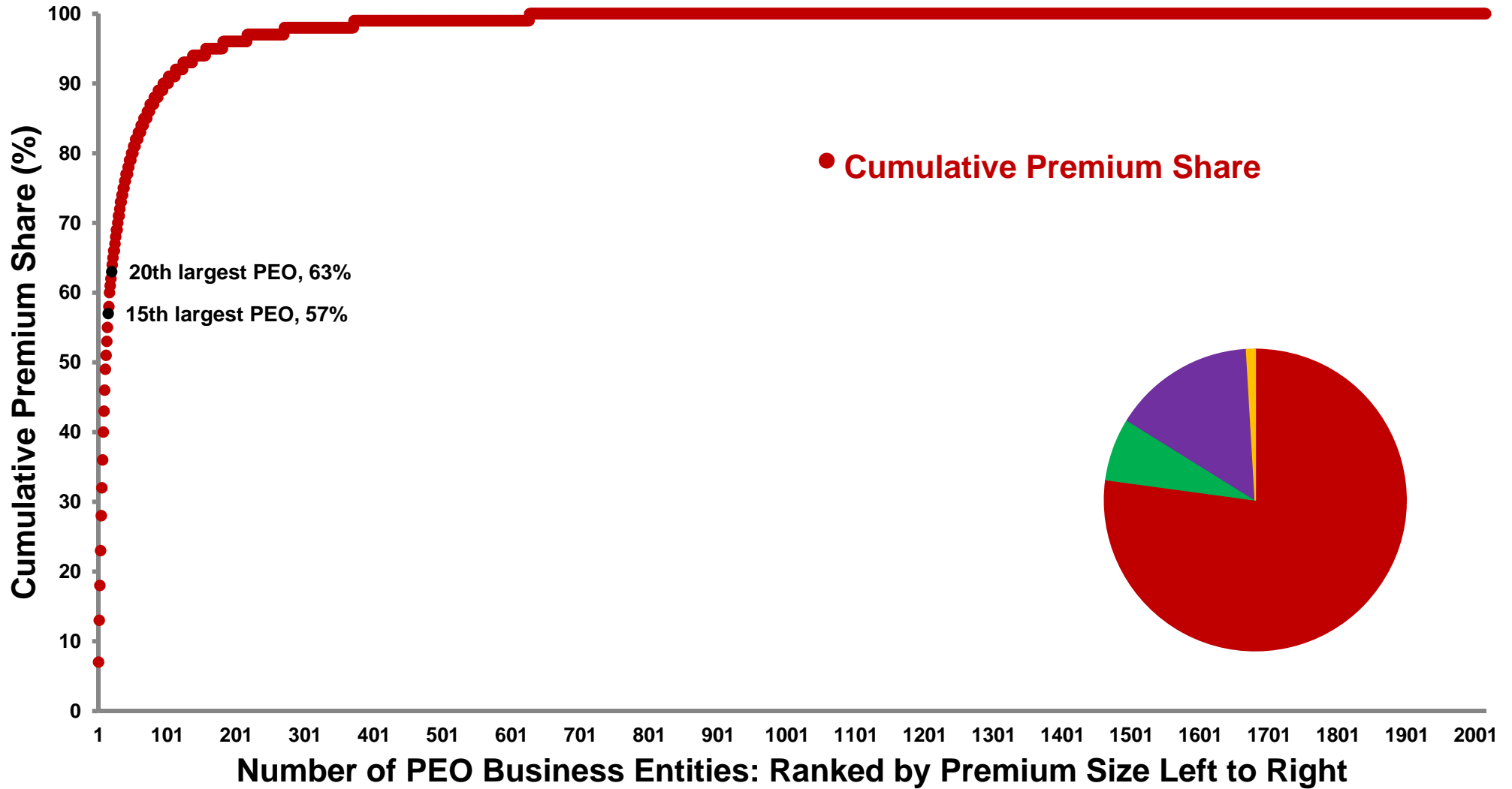
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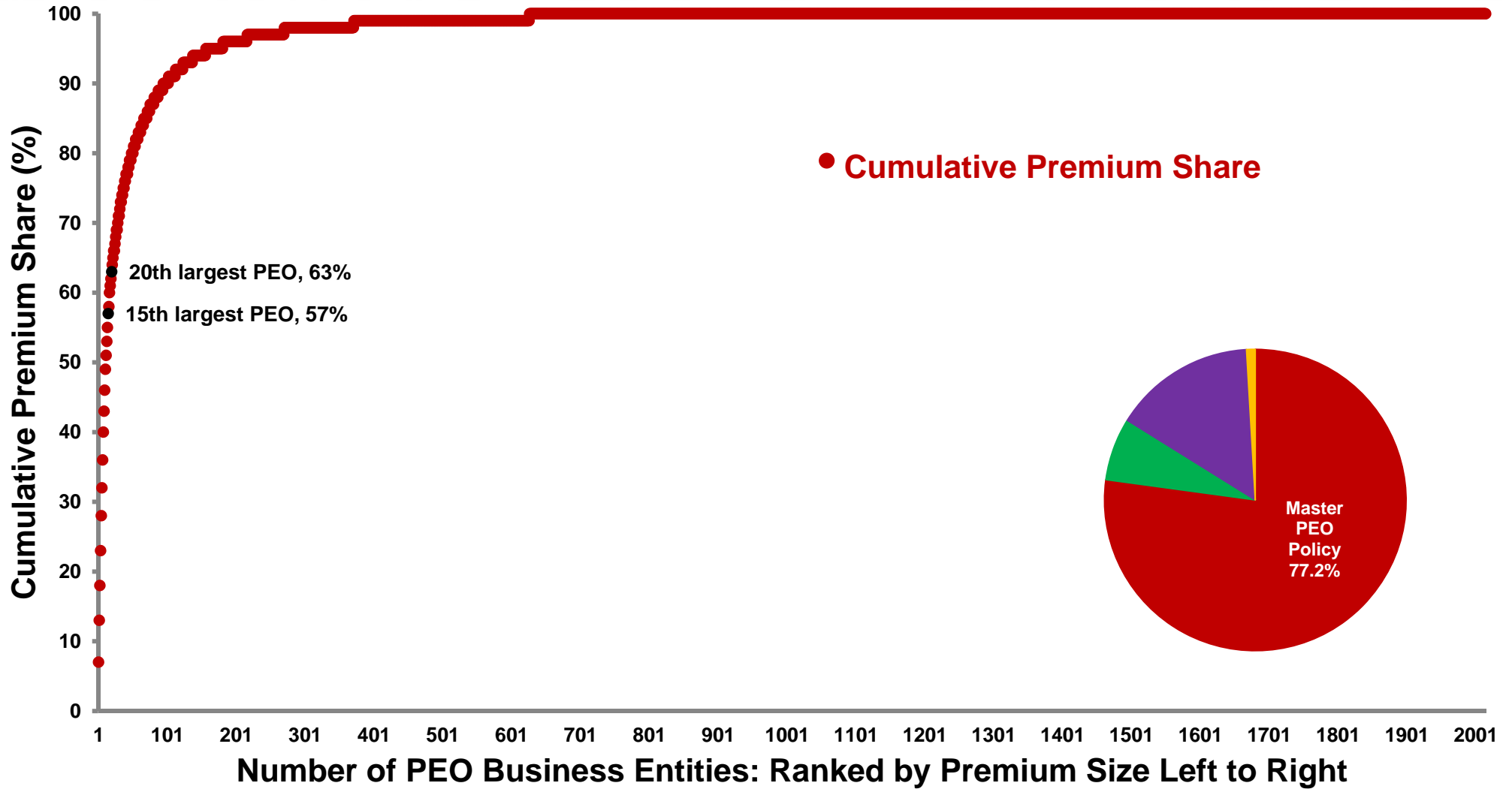
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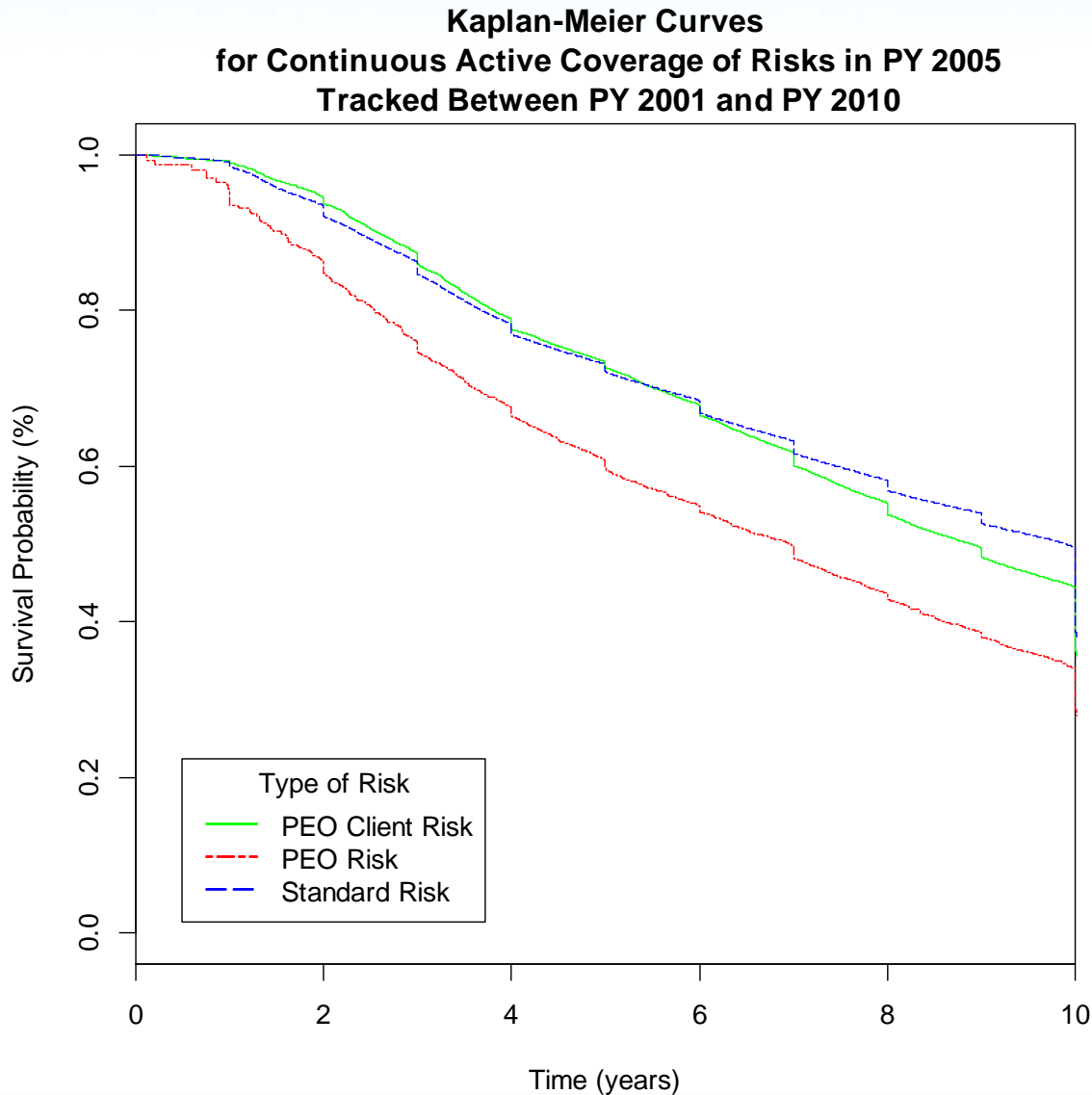
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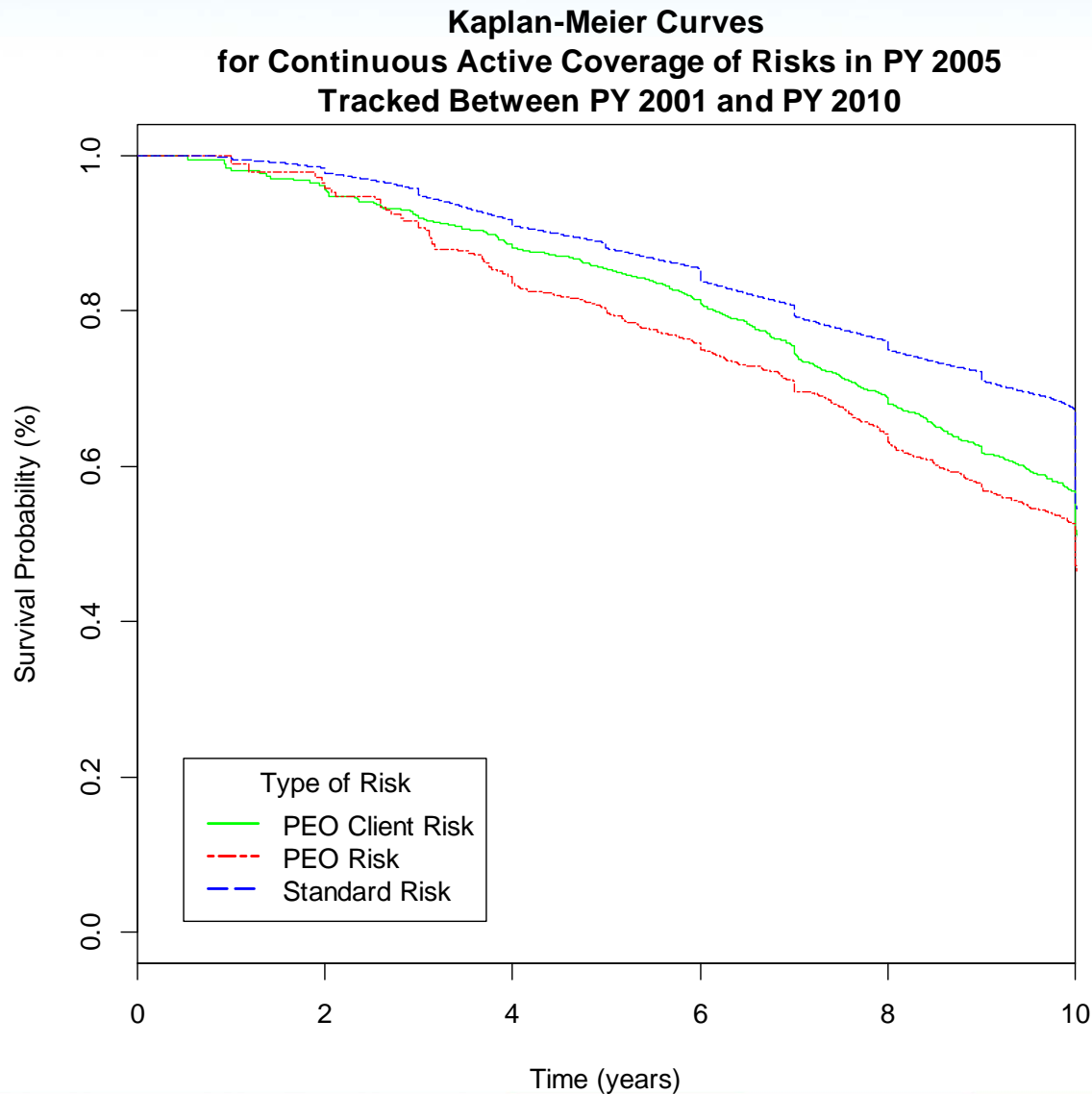
What Is the Survival Rate of PEOs? Single-State PEO Risks Do Not Fare Well



Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI
NCCI 36 ratemaking states with WV excluded
Analysis is conducted on risks with a policy in PY 2005; All risks are tracked over the period from PY 2001 to PY 2010 (inclusive)
Active continuous coverage prior to PY 2001 does not contribute to the length of active continuous coverage (i.e., "Time")

What Is the Survival Rate of PEOs?

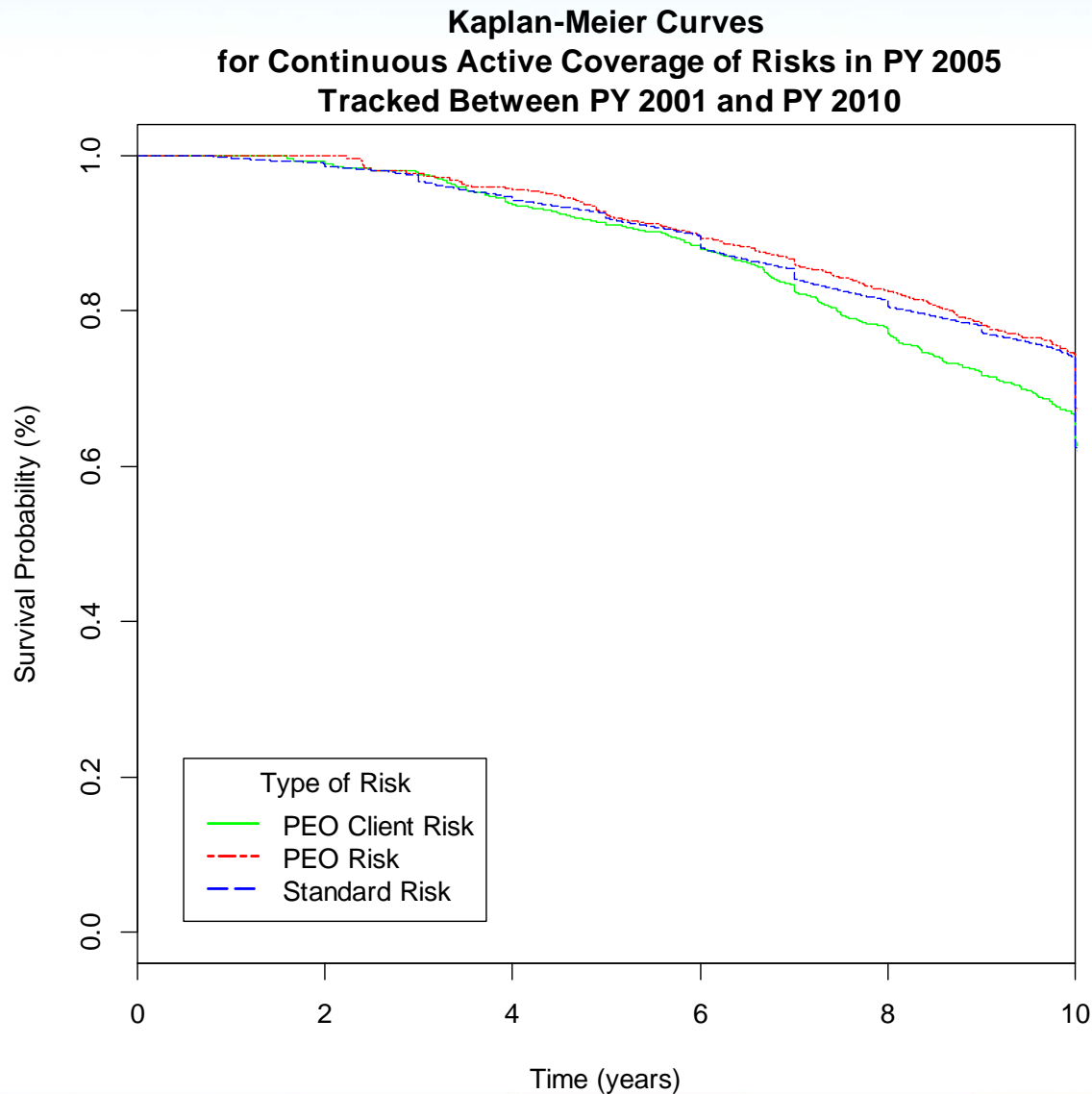
Two- to Three-State PEO Risks Fare a Bit Better



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What Is the Survival Rate of PEOs?

Large Multi-State PEO Risks Outperform the Market

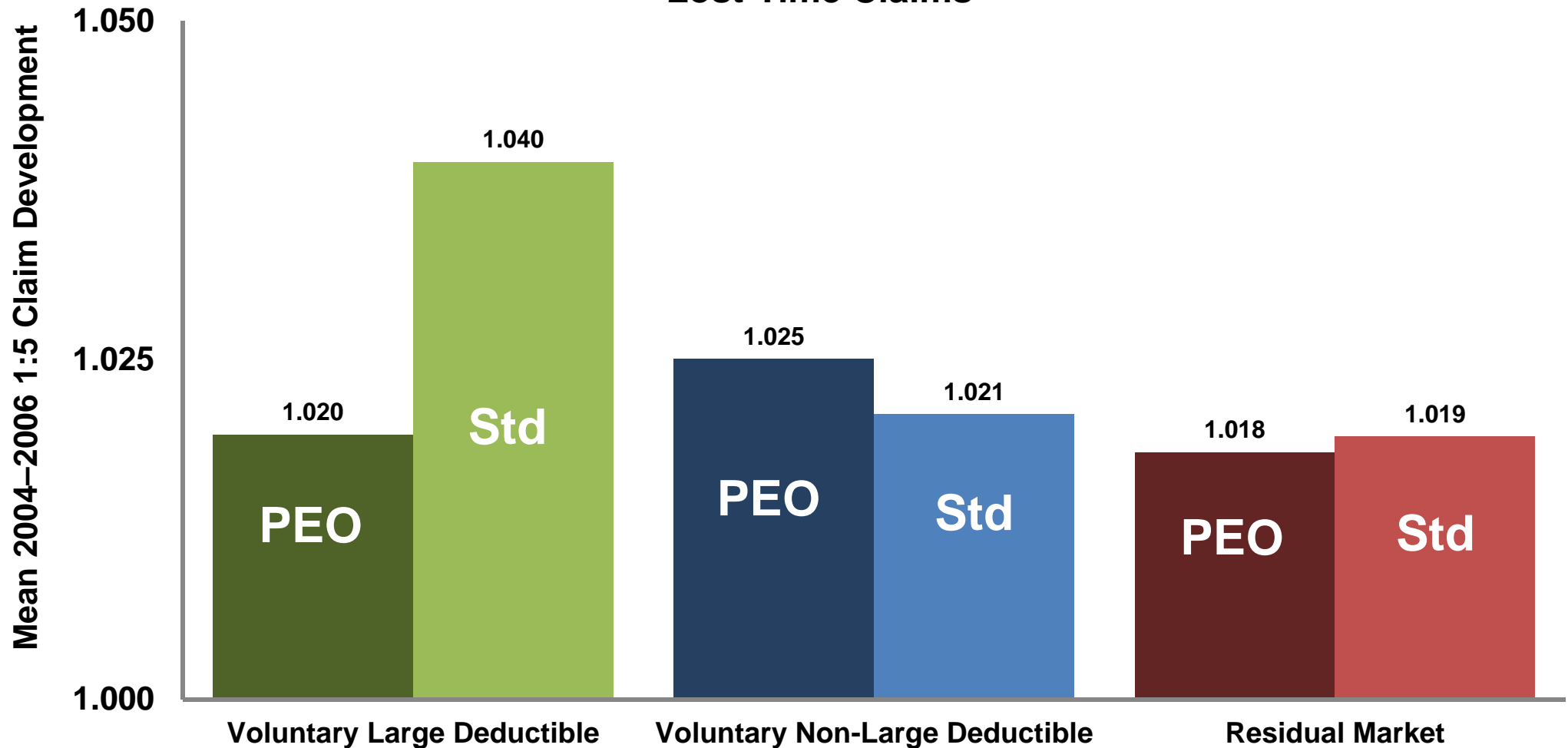


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PEO Loss Development

PEO Claim Development Versus Non-PEO Claim Development

1:5 Report Claim Development Lost-Time Claims



Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI

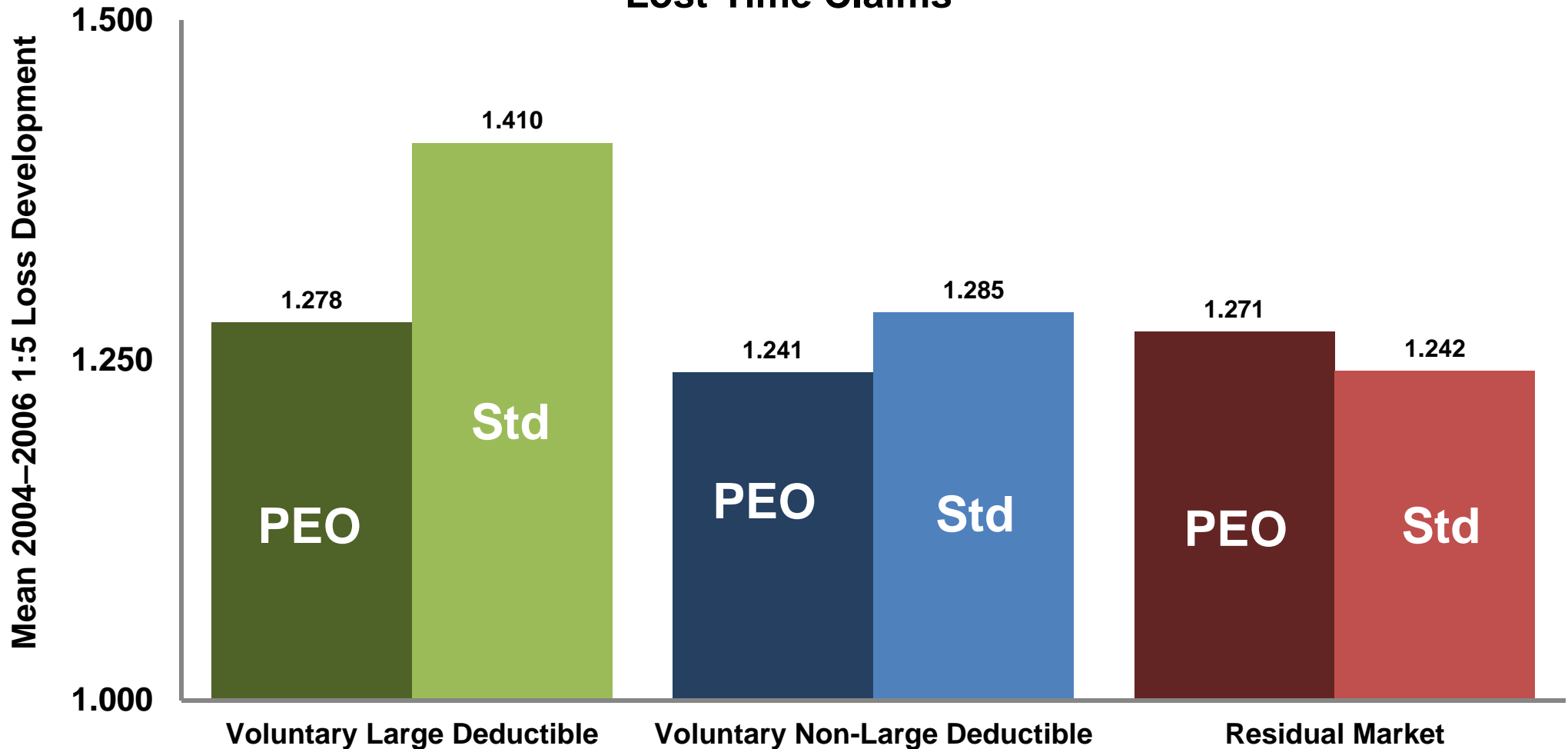
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Recent Three Insolvencies and PEO

**An Issue Raised in Florida—
Two of the Insurance Companies Domiciled in Oklahoma**

PEOs and Recent Three Insurer Insolvencies 2009 Through 2011

- Great Recession: Client Base Shrank
 - Small businesses are PEO clients
 - In the US, more than 200,000 small businesses vanished between early 2008 and 2010
- Insurer Business Models Are a Factor
 - In the year prior to insolvency, virtually all of the premium for each of the three carriers was produced by PEO workers compensation insurance policies
 - Park Avenue established in 1986
 - Pegasus in 1980
 - Southern Eagle (2005) was a captive insurance company

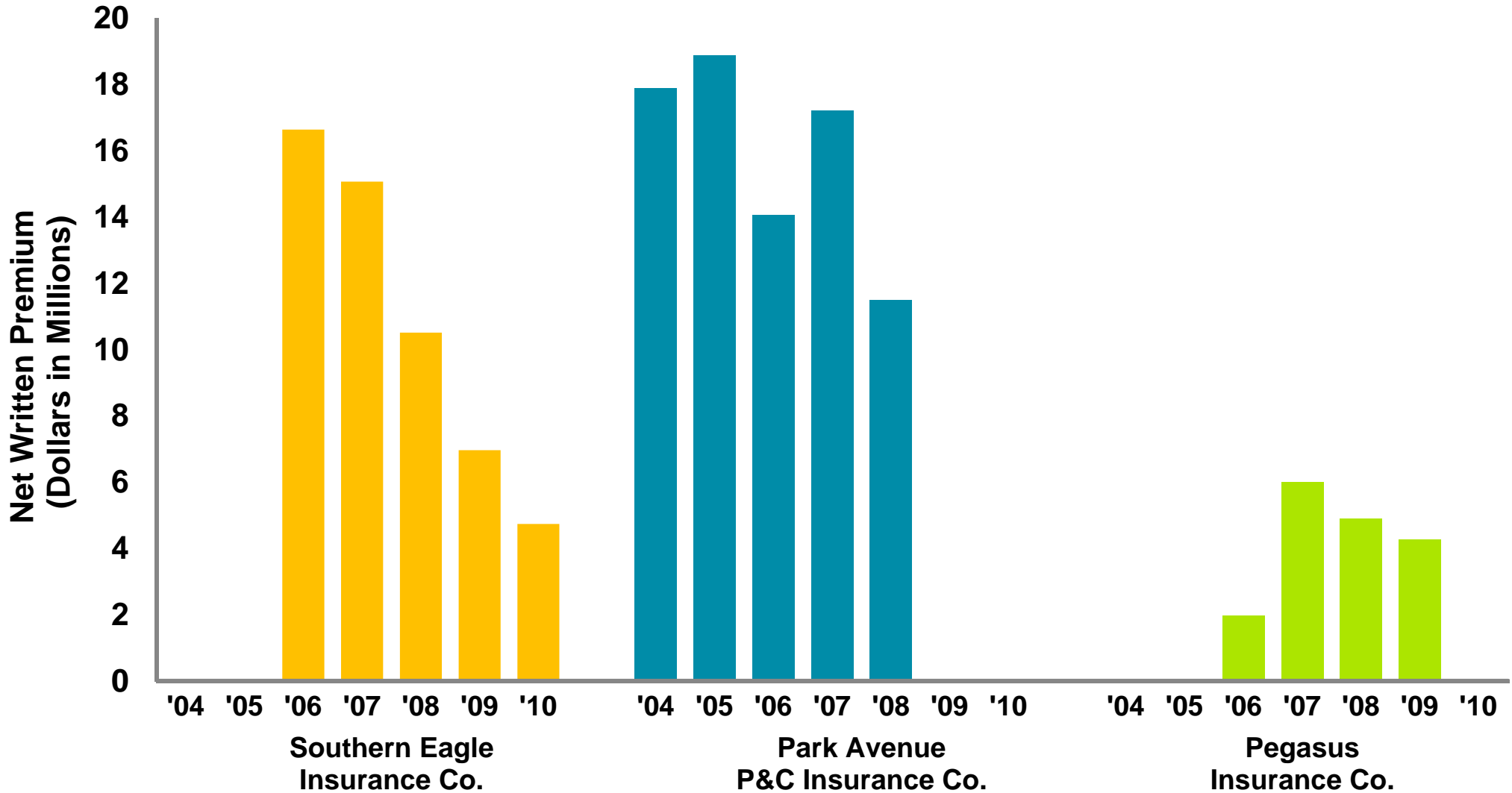
Source: NAIC Annual Statement Data

PEOs and Recent Three Insurer Insolvencies

Using Annual Statement data:

- Loss reserve analysis
- Non-admitted assets and receivables for large deductibles

Premium Declined for All Three Insolvencies During Recession



Source: NAIC Annual Statement Data

Southern Eagle Reserve Adequacy

Southern Eagle Development w/ASB Tail			
	Paid Method	Paid+Case Method	(Dollars in Thousands)
2005	\$ (933.32)	\$ (268.80)	\$ (1,686.31)
2006	\$ (1,228.88)	\$ (492.16)	
2007	\$ (653.88)	\$ (43.01)	
2008	\$ (523.01)	\$ (62.89)	
2009	\$ 162.90	\$ 851.36	
2010	\$ (484.43)	\$ 303.51	

ASB Development			
	Paid Method	Paid+Case Method	(Dollars in Thousands)
2005	\$ (933.32)	\$ (268.80)	\$ (8,281.84)
2006	\$ (1,429.03)	\$ (642.64)	
2007	\$ (1,012.29)	\$ (213.03)	
2008	\$ (2,438.56)	\$ (1,080.88)	
2009	\$ (3,675.99)	\$ (1,461.34)	
2010	\$ (2,441.25)	\$ (966.54)	

(Dollars in Thousands) 2010

Surplus \$ 8,763.00

Source: NAIC Annual Statement Data and NCCI *Annual Statistical Bulletin (ASB)*

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Assertion: There Is More Litigation in PEO Claims

Why More Litigation for PEOs?

Assertions

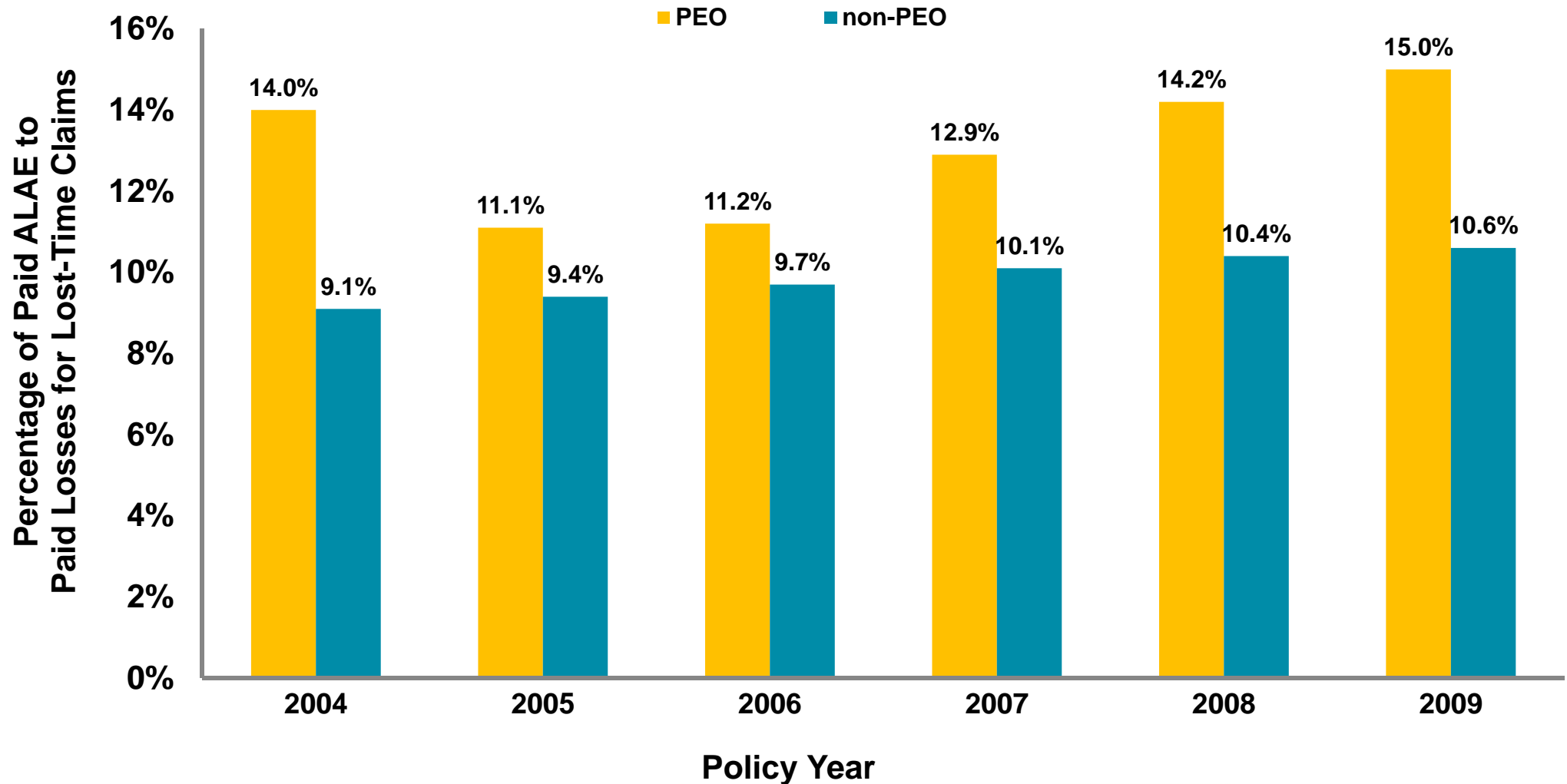
- Prompt Handling of Claims Is Important:
 - Geographical separation between PEO and client and injured worker
- Inconsistent Policy Data:
 - Claims class codes may not line up with policy exposure class codes
 - Large number of client class codes and churning of PEO clients

Attorney Involvement and ALAE

- Allocated Loss Adjustment Expense (ALAE)
 - Accumulation of expenses incurred in investigating and settling claims, assignable to specific claims
 - Examples: legal fees, adjusting fees, court costs, medical costs containment expenses, services required by law or insurance regulation
- NCCI data:
 - Paid ALAE in IDB

PEO Claims ALAE Costs Are Slightly Higher Relative to Losses

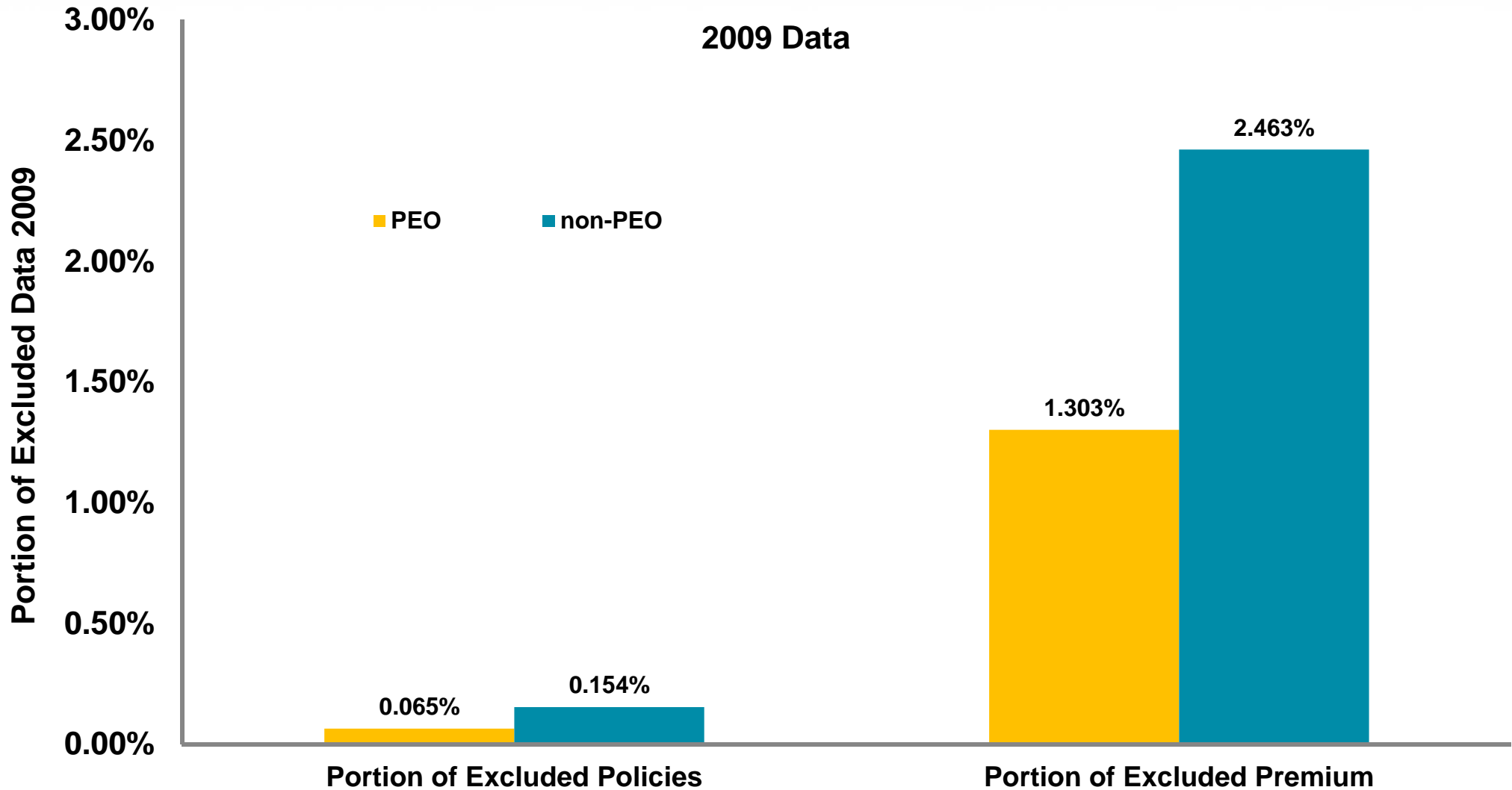
Reporting Period Paid ALAE/IND+MED @2nd Report



Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI

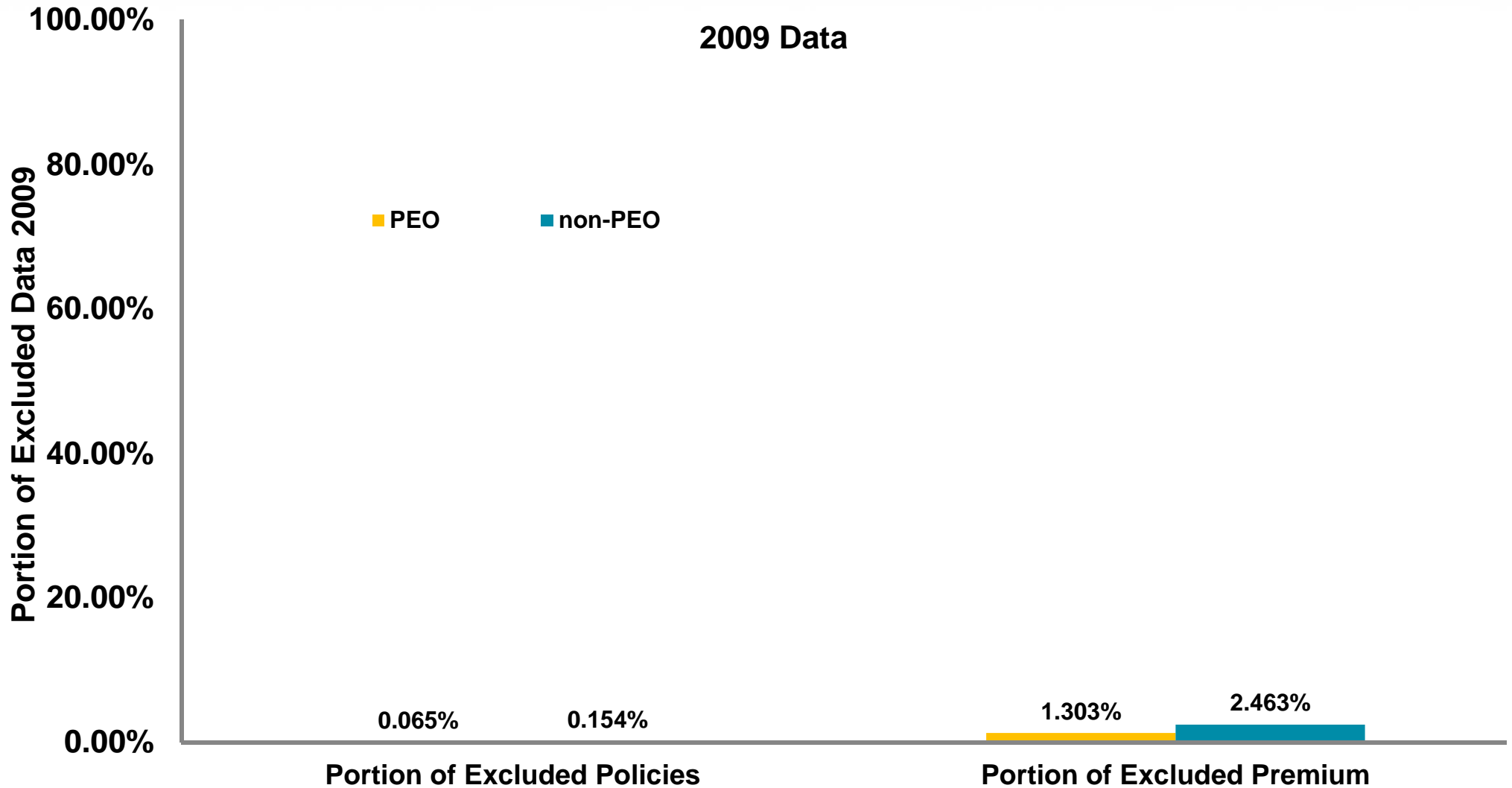
**Assertion:
PEOs Have More Data Excluded
Because of Quality Concerns**

PEOs Have a Lower Portion of Excluded Data Versus Non-PEOs



Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI
Exclusion indication from NCCI Class Ratemaking data

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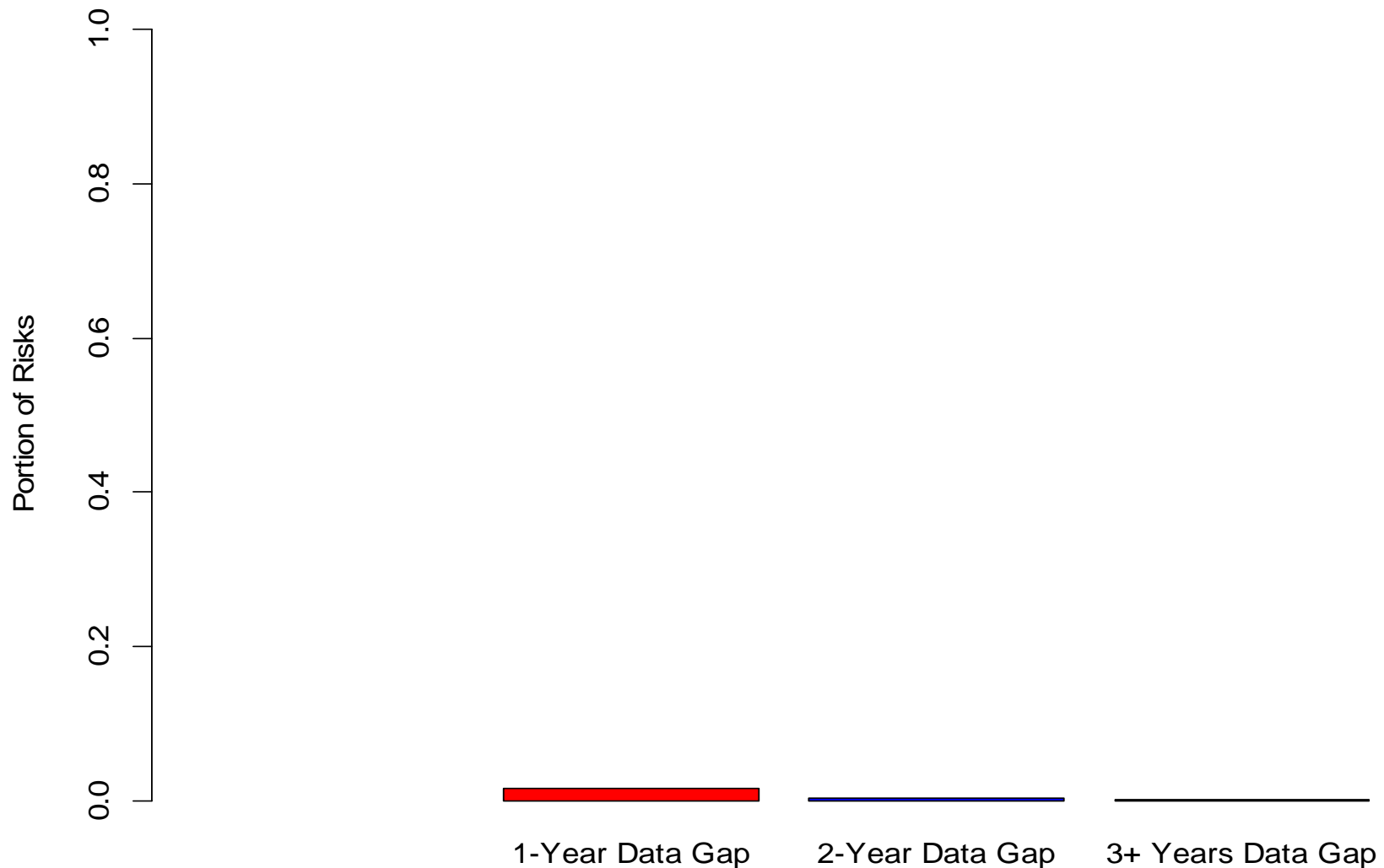
PEO and WC Experience Rating System

A “Front” for “Mod Washing”?

PEO and WC Experience Rating System

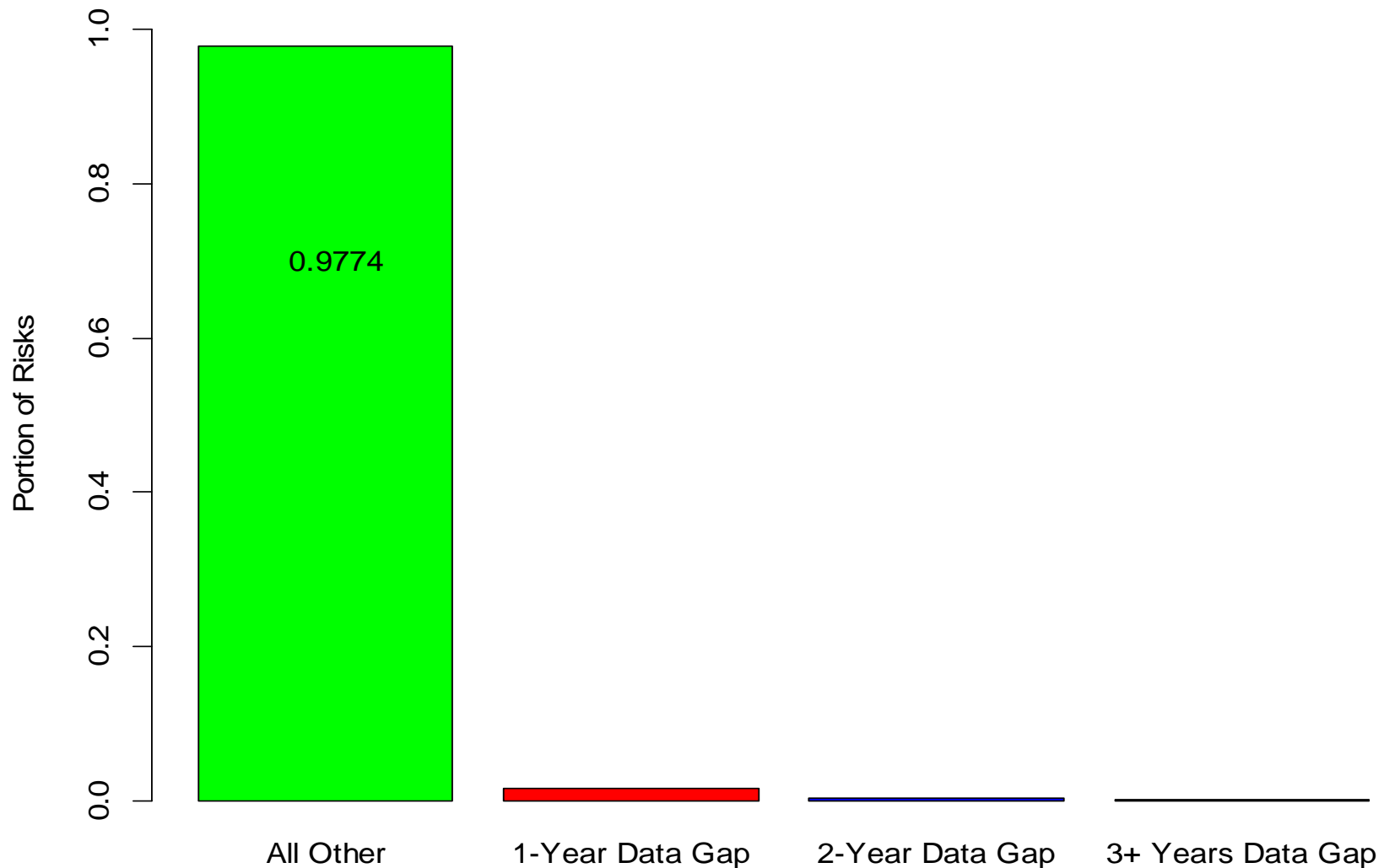
Approximately 90% of PEO Clients Do Not Qualify for Experience Mods

Only a Tiny Fraction of All Risks Disappear for Two to Three Years, Then Return



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Takeaway

Investigate Rather Than Just Speculate

- It Typically Will Be a Challenge
 - If it were easy, it likely would have been done
- Expect Resistance to Initial Results
 - Especially if the findings differ materially from the ex ante speculation
- Be Your Own Greatest Skeptic
 - Challenge your findings—you should know more about the subject than anyone else