How Risk Managers Take Control Of Their Workers’ Compensation Programs: The Advantages Of Unbundling

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Executive Summary

Control.
It’s a word that seems to show up more frequently in risk management discussions when insurance premiums start rising.

Sophisticated risk professionals, however, take control of their workers’ compensation programs in all types of markets. While harder markets may raise the noise level around self-insurance solutions, and the need for risk managers to “control their own destinies,” risk professionals who are on top of their games are taking control in other ways.

By unbundling their large-deductible workers’ compensation and casualty insurance programs, demanding transparent pricing of all the services they buy to contain their workers’ compensation loss costs, and setting performance-based guidelines for providers of claims-handling services, they can maximize the value of those services, potentially lowering their cost of risk well before carriers start to transition to higher premium levels.

Bundling vs. Unbundling: What’s The Difference?

Under a bundled program, the insurance company provides coverage as well as claims handling and loss control services to the insured. Such a company will have its own army of claims adjusters, who jump in to take the first notice of each occurrence on Day 1, moving forward to work through all aspects or administration, analysis, negotiation and ultimately settlement.
A risk professional using an unbundled strategy buys a policy that does not include claims management services from a carrier. An insurance carrier underwrites the policy, but a separate unaffiliated TPA administers the claims.

In contrast, under an unbundled program, the carrier is mainly providing risk transfer mechanism of insurance coverage, while professional third-party claims administrators (TPAs) who are unaffiliated with the insurer handle the claims management process. In other words, a risk professional using an unbundled strategy buys a policy that does not include claims management services from a carrier. The insurer provides all other policy management services, including filing coverage with the state and data to the reporting agencies (such as the National Council on Compensation Insurance) and applicable state government agencies. The insurer also issues certificates of insurance if the employer needs them for customers or vendors.

The risk manager negotiates a separate contract for claims management services with a TPA (or with more than one outside vendor) to perform claims-handling tasks for each individual claim, such as: initial communications (three-point contacts with employer, claimant and physician), investigation, medical bill reviews, utilization reviews, reserving, subrogation analysis and collection, fraud detection, coordination of return-to-work goals with physician and employer, and litigation management, among other things.

In many cases, unbundled programs are also large-deductible programs, which may have deductible amounts on the order of $100,000 per occurrence or higher. Under large-deductible programs, the insurer pays every claim, and then seeks reimbursement from the insured for claims below the deductible amount. In practice, the insurer may agree to allow the policyholder to fund its own claims within the deductible, typically by providing funds directly to a TPA who administers the claims to avoid dollar-trading.

Because the insurer takes on credit risk under a large-deductible plan—essentially the risk that the insured will not be financially capable of funding or reimbursing the insurer for claims that the insurer is contractually obligated to pay—the insurer will require the insured to post collateral in the form of a letter of credit, cash, a surety bond, a trust or some combination of those.
In some respects, the concepts of unbundling and large-deductibles go hand-in-hand because a key goal of both is that of closely managing claim outcomes to lower insurance premiums, and ultimately the total cost of risk. An organization that implements a large deductible program “is taking a calculated risk” that its claims management efforts are going to meet or exceed their historical loss experience and outperform similar companies in the industry—that the premium saved by choosing a higher deductible will exceed claim payouts within the deductible.⁹

With the insured becoming directly responsible to pay claims within the deductible (by reimbursing the insurer or through a funding mechanism), the insured employer will have a vested interest in keeping a watchful eye on the people who are managing those claims—something that is less likely to be possible when carrier personnel, with direct allegiance to the carrier, handle the claims. Insureds who unbundle claims-handling activities to TPAs can set precise guidelines, crafting measurable performance standards that their TPAs will be expected to achieve. In some situations, they may even have TPA personnel working on site in their offices to facilitate seamless communications.¹⁰

A large-deductible program can be put in place for a single line of insurance, such as workers’ compensation, or for a combination of lines. For example, an insured that opts for a large-deductible casualty program for workers’ compensation, automobile liability and general liability together, would only have one collateral requirement, but would need to ensure that the TPA has solid skills in all three lines.
Carriers that require insureds to bundle services with risk transfer might point to simplicity as a key benefit, and in fact, experts say that unbundling is not easy—or necessarily appropriate—for every organization that purchases workers’ compensation insurance. The risk manager will need to conduct a search and hire its own third-party administrator. This means not only managing the proposal and selection processes, with the help of his or her broker, but also negotiating the claim contract, including any performance guarantees, and administering it on an ongoing basis.

The ability to consider an unbundled program increases as a risk management department evolves, according to Donald W. Wright, Jr., senior vice president of Willis North America in Tampa, Fla., who notes that a company that doesn’t have a risk management department may not be a good candidate for unbundling. When everything is with the carrier, it is a nice easy process, he says. In contrast, when an insured decides to unbundle the insurance coverage from the claims handling, its risk management department takes on a responsibility for greater oversight of the claims-management process to realize the benefits of unbundling.

“It is extra work because now you have a separate entity to review,” Wright says, referring to the TPA. As the risk management “group becomes more sophisticated, beyond just a one-person shop, then they have more of the resources to do that oversight.”

“As companies establish formal risk management departments, they understand that this is an investment in helping prevent loss and limit loss—in helping to control claims dollars,” he says.
Assessing whether a workers’ compensation program qualifies for an unbundled approach comes down to understanding potential losses, not account-premium size. “The big picture is total cost of risk,” Wright says. “When we talk about premiums, we lose sight of the fact that the premium is not going to be the driver at a $1 million deductible. It’s the losses within that million that are the most expensive part to that client. The premium might not be much.”

“When you start to get into the multi-million-dollar loss pick range, and 90-plus-percent of your total cost of risk is your losses, you want to have as much focus on that as possible,” he says.

**Tips For Risk Managers: Setting TPA Performance Standards**

In addition to claims reviews and claims audits, risk managers can make sure their TPAs live up to the service promises by building performance guarantees into their contracts.

- Under a performance guarantee, a TPA exceeding a pre-determined level of performance may receive a bonus payment above the contracted service fee; TPAs failing to meet such guaranteed service levels may incur penalties—reductions in their contracted fees.¹
- For performances guarantees to work, outcomes that trigger bonuses and penalties, contracts should clearly document measurable goals² as well as who will assess whether the targets have been achieved.¹
- A sample guarantee might say, “The TPA will meet [agreed upon] servicing standards 90 percent of the time [and] will be paid 1 percent of the contractual amount for each percentage point [above] 90 percent.”¹
- Contracts can include specific measurable goals, such as: reducing the average number of lost days per claim by certain amount; lowering litigation percentages to a specified level; raising the percentage of claims in managed care networks; reducing the average cost per claim by a certain percentage.²
- For performance guarantees to work, activities being evaluated must be clearly understood by both parties. A provision that requires three-point contact (with employer, employee and medical provider) within 24 hours may not be precise enough if adjuster thinks contact by letter is enough, while the risk manager seeks voice-to-voice contact.¹

**NOTES:**

¹ Rebecca Shafer, “Tips When Considering a Performance Guarantee with your TPA,” at www.ReduceYourWorkersComp.com
Risk Management Evolution: Control Is Key

The benefits of unbundling have been debated for decades. A risk manager for a large food manufacturer asked about the subject back in 1996 worried that insurance company claims handlers might not have her company’s best interests at heart under a bundled setup. “Insurers may be less prone to consider a client as a claims administration client. Insurers may focus instead on ‘an insured client,’” she said. She went on to explain that “TPAs may be more amenable to doing things the client’s way. [They are] a little less uniform in their approach” than insurance company claims handlers who are more apt to have “specific written standards,” than to “accept the clients definitions.”

A risk manager’s perception that the carrier “is thinking of itself, not me and my interests” can be particularly acute for insureds with large-deductible programs. There may be a sense that the insurance company claims department handles “insured” claims that breach the deductible amount aggressively, while paying less attention to those where the insured’s money is at risk (those within the retention).

Tips For Risk Managers: Selecting An Unbundled Carrier

Considerations for choosing among unbundled carriers for large-deductible workers’ compensation programs, beyond competitive pricing, include:

- **Financial stability.** Do they have the ability to stand behind their commitments? Are they A-rated?
- **Flexibility.** Do they have a broad choice of approved TPA? How flexible are they in allowing the insured to choose the claims administrator?
- **Longevity and consistency.** Are they committed to the workers’ compensation line? Do they have a stable underwriting approach? If they’re not as competitive on pricing as other carriers in the current market, do they have a reputation for pricing stability over time?
- **Industry expertise.** Do they truly get the risk? Are they comfortable with the risk of firms in your particular industry?
- **Collateral requirements.** Are they flexible with regard to collateral? Can the insured choose a large-deductible casualty program with one collateral requirement for three casualty lines (workers’ compensation, auto liability and general liability)?
- **Business relationship.** Do they value business relationships?
- **Relationship with TPAs.** Do they support and complement TPA services, with necessary expertise in handling catastrophic claims (that exceed the deductible), while striving not to compete or conflict with TPA claims administration otherwise?
- **Loss control services.** Do they offer online safety and risk control assessments, loss prevention training? At what cost? Do they have relationships with quality loss control vendors, allowing for discounted service offerings to your company?
Willis’ Wright hears the same messages from his clients in 2012, but says the concerns have been around for a while and that proclivities to unbundle have not simply emerged in connection with recent reports of a hardening workers’ compensation insurance market. Reporting that the majority of his accounts have been unbundled for the last six years or more, Wright characterized the moves to unbundle as “an evolution” for his clients. They “perceive they have greater control. The TPA then works for them.”

The claims consultant who is employed by a carrier works for that carrier, so there may be a perception that a conflict of interest exists, Wright says. With unbundling, clients exert control—“you-report-to-us type of control”—and that means there is not even a potential conflict about whose interest to serve first.

“With a TPA, it’s not their money,” he says, contrasting the situation where a carrier has to pay on a loss. “In theory, there should never be any conflict” in either situation, but clients say they experience a higher level of service through unbundled TPAs “because the TPAs realize they could be fired.”

“It’s harder to terminate the carrier and the [bundled] claims administrators, if it’s all one. That’s a lot of work.”

The Bundling Balancing Act & The Need For Flexibility

Jay Enloe, director of claims and risk administration for O’Reilly Auto Parts in Springfield, Mo., says that his company, a specialty retailer of automotive aftermarket parts with 52,000 employees and 3,859 stores in 39 states, has a large-deductible workers’ compensation program, which has been unbundled since 2005. “The reason we did that was it gave us the ability to utilize the most beneficial partner for each aspect of the program,” Enloe says.
An advantage of an unbundled program “is just the general flexibility of the program,” Enloe believes. “Bundled providers are not always flexible in allowing you to use your choice of defense counsel, surveillance vendor or managed care provider,” he says, adding that having that type of flexibility is particularly beneficial on a large-deductible program “where for all intents and purposes the money you’re spending is all your money.”

Similarly, Gus Aivaliotis, Senior Vice President of Large Casualty for Safety National, an unbundled carrier, says it comes down to a matter of choice for the insured, noting that a risk manager who focuses on bundled carriers might be faced with the task of choosing between one that offers the right type of insurance program and another that fits better in terms of meeting its claims handling expectations. Without the ability to cut and splice the two, he or she must decide which ideal overrides the other, he notes.

“Instead of having to balance those things and pick one company,” the risk manager can separate these into different functional areas with an unbundled approach. “In an unbundled model, you’re buying an insurance program from a carrier, and then you’re actually selecting very specifically the TPA that’s the best fit for you as a risk manager. What is their specialty? Where are they located? What are their qualifications?”

“Instead of having to buy all-in—the insurance coverage, claims handling, and loss control,” —you can tear apart a program,” seeking a specified level of competency of every portion of that program, Aivaliotis says.

While some risk managers choose an unbundled approach so they can customize items, such as attorney selection, or vendors such as special investigation units, subrogation, and managed care, others may want to manage loss reporting for specific injury types of or circumstance beyond what is normally required by carriers. They may request a lot of customized reports sent to them for a variety of claims metrics.
Unbundling can even be pushed further down the chain, as risk managers opt to separate workers’ compensation medical management services from the list of claims-handling tasks, contracting separately with managed care companies.\textsuperscript{15} Willis’ Wright, however, says that that possibility has been talked about (with regard to nurse case management, in particular) more than it has been utilized. Research conducted by Intracorp in 2008 showed that risk managers at companies with 5,000 or more employees were evenly split on the question of whether they unbundled claims-handling from specialty medical management services or leave them bundled.\textsuperscript{16}

(\textit{Editor’s Note: Workers’ Compensation expert Rebecca Shafer, president of Amaxx Risks Solutions, provides tips for spotting potential sources of cost leakage under either scenario—using a single TPA or multiple claims service providers—in her ReduceYourWorkersComp.com blog.\textsuperscript{17}})

Flexibility has another meaning for risk managers, who note that when they choose the most basic level of unbundling—unbundling the insurance program from claims services—it is easier to change carriers should the need arise. Carrier changes may be induced by the need to find lower-priced coverage or by a totally different consideration, like an organizational change for the insured, such as the integration of a large acquisition that forces a reexamination of the insurance coverage piece.

“From the insurance perspective, all you are purchasing is the actual coverage. If you need to change insurance providers, it has very little impact on your claim administration,” Enloe says. In addition, “if you need to replace a claim administrator, since it’s unbundled, it has very little impact on the insurance relationship,” he says, noting that O’Reilly Auto Parts has changed carriers three times and its TPA once over the course of the last seven years, with organizational, collateral considerations, and pricing prompting the moves.
Curt Reno, assistant vice president-casualty at Safety National, notes that the unbundled carrier has a large number of approved TPAs, which means that potential insureds who want to move their insurance programs away from other bundled carriers can usually stay with their existing TPAs (if they choose to do so). In most instances, the TPA is going to be listed among the 25–30 national TPAs that Safety National has preselected and vetted for its workers’ compensation insureds.

Reno says that in the infrequent situation where the potential insured has been contracting with a TPA that is not on already approved list, the carrier will go through a due diligence process to assess whether or not to add it to the list. During the vetting process, the carrier will ask the same questions that a risk manager would: What’s the competency of the TPA? What are their service standards? How good are their technology and reporting capabilities?

Risk managers face a different type of hurdle when they move from bundled insurance programs to unbundled ones—or from one bundled program to another—because the runoff of existing claims incurred under the prior bundled policies continues to be handled by the claims department personnel of the prior carrier. In many cases, claims remain open for years after an insured moves the program, and often insureds get the sense that their runoff claims are being ignored.18

“Once you’re no longer somebody’s active client, you’re definitely not top priority. That’s the reality of the situation,” Wright says. The risk manager might consider moving those claims over to the TPA under an unbundled program or the claims department of the new bundled carrier, but that comes at a cost, he says. “You’ve already paid for [coverage and services for] the life of that claim, so do you want to incur another cost by moving them all to your new claims handler?”
In other painful scenarios, the bundled carrier might go out of business, Wright says, highlighting the advantage of being able to move carriers under unbundled programs. “That is simply [moving] the paper—the actual contract on a risk. But all the work, the claims handling and the adjusters, none of that changes. It’s just a different carrier to which is gets reported.”

“If you need to part ways with a carrier, it doesn’t upset all your claims-handling work. You don’t have to reinvent that wheel.”

Hidden Bundling Costs & The Need For Transparency

Hidden markups ambiguously embedded in the cost of claims services are another issue that risk managers have with bundled carrier insurance programs. In particular, they point to a “cost-of-savings-charge” imposed for bill review services.

Wright explains that carriers might review a bill for medical services amounting to $100,000 that should have been $10,000. A lot of carriers would take 27 percent of that $90,000 in savings as a service fee, he reports, contrasting the TPA approach which is to charge a flat fee, say $9, per bill or per-line item. “This was a way for [bundled] carriers to hide money, in effect,” Wright says.

Enloe agrees that with unbundled programs, risk managers are more readily able to identify how much money their providers are receiving. “Often, under a bundled program, there isn’t a high level of transparency of what you are paying or how much revenue and profit is being derived off your account,” he says.

Some bundled carriers are now “grudgingly” moving away from the savings charges and toward the more transparent per-bill approaches, but Wright reports that as they become more transparent, they demand more money up-front to recoup the hidden fees they can no longer collect.
Risk managers may be at the mercy of some subjective evaluations by bundled carriers of what constitutes specialized loss control service.

Aivaliotis says risk management concerns about lack of transparency in bundled programs can be even more basic. “You’ve got insurance programs spilling into claims handling, spilling into loss control, and the statement I’ve heard from dozens of risk managers is, ‘I never know what my bundled program is going to cost me in the end because I can’t isolate the cost of how much am I actually being charged for the claim handling.’”

There is a tendency for bundled carriers to load some claim-handling dollars into the insurance program by using a loss cost factor—a multiplier applied to ultimate losses, he says. In this situation, risk managers may not know what their claims are going to be, but the insurance company is charging for claims-handling services based on the size of the claims, leaving with risk managers with a fuzzy allocation of expected claims costs.

Risk managers have similar transparency issues with loss control services. Even if a bundled carrier discloses upfront that it has built X dollars into the overall price for loss control, the insurance buyers are uncertain about whether they’re getting as much service as they signed on for at policy inception—in part, because they are at the mercy of some subjective evaluations of what constitutes specialized loss control service.

A risk manager believing that he or she purchased a specified number of hours of loss control services, may be told by the carrier that the cost contemplated basic services, such as a site inspections, which are valued at $125 per hour. But if the insured requests ergonomics, the carrier may say it comes at twice the cost-per-hour because it’s highly specialized, cutting the service hours in half.

“Is $250 really the number,” Aivaliotis asks, echoing risk manager concerns communicated to him about carrier subjectivity in valuing the costs of their own employees delivering loss control services under bundled programs.
Tips for Risk Managers: Choosing The Unbundled TPA

Among the many questions a risk manager may want to ask to assess the strengths and weaknesses of potential TPA partners are:

• Which TPAs are approved by the unbundled carriers you are considering?
• Do their adjusters have strengths in the line of business for which you are contracting their services?
• If your large-deductible program is for three lines of business—workers’ compensation, automobile liability and general liability—can the TPA provide quality services for all three?
• Do the adjusters have experience in your industry? Look at resumes of adjusters and supervisors to whom they report. Ask for references from existing, past clients.
• Who is on the service team that will handle your account? Do you want a special team of dedicated adjusters (who handle only your company’s claims, perhaps on-site at your location) or designated adjusters (who will be specifically assigned to your account, but who may also work on other accounts)?
• Has the TPA had turnover issues? The ability to retaining experienced adjusters may be critical to your account.
• How does the TPA train its adjusters? Knowledge of medical conditions and treatment options, for example, will impact the cost of each claim.
• What is the geographic scope of the TPAs operations? Is there good alignment between the locations of the TPA’s offices and your offices?
• What are the caseloads per adjuster? Are they more than 150 for workers’ compensation, which could be too many to ensure appropriate attention to individual claims.
• What is my comfort level with the adjusters work product? Ask to review sample claim reporting.
• What resources does the TPA have available to help my injured employees quickly recover and safely return to work?
• How much do services cost? Is the TPA being fully transparent in disclosing charges or revenues derived from your account? TPAs may use ancillary vendors for medical-bill review or utilization, but if they screen vendors wisely and assure quality, then markups for their services may be worth paying— especially if the TPA can negotiate better vendor prices than the you can.
• Does the TPA have a specific medical network or preferred provider organization that it uses to generate discounts on services? Major national TPAs work with certain health benefit organizations that provide reduced costs for prescriptions and services. How much savings potential is there from the medical networks with which the TPAs participate?
• Does the TPA have subrogation, special investigation and litigation management capabilities?
• How realistic are the reserving practices? Deficient initial reserve estimates reserves can give rise to unwelcome surprises.
• How compatible are your systems with TPA systems? How quickly can you look at claims data?
• How good is the TPAs Risk Management Information System? Evaluate the ability of the RMIS to provide data analytics and reports that would be beneficial in understanding loss trends.
• How good are the TPA’s reporting capabilities to carriers and state agencies? What is the frequency of data errors in reporting?
• How often are audits performed internally? How often will you perform claims reviews and audits?
• Does the TPA have a track record of helping clients to identify process improvements and loss-control opportunities?
Unbundling Advantage: Taking Control Of The Ultimate Cost of Risk

One subtle cost benefit of unbundled programs is a tax benefit. When claims handling services are built into an insurance program, the claims-handling portion of the premium is taxed as if its insurance dollars. By running claims through a TPA instead, insureds can avoid the tax on the claim expense portion of their insurance bills.19

Willis’ Wright says that while a big chunk of cost savings for insureds moving to unbundled programs comes from the elimination of the “percent-of-savings charges,” the more relevant, albeit less quantifiable, decline in the total cost of risk is attributable to control that insured can leverage over TPAs.

“You want the right adjusters handling your claims. If you have good adjusters in good jurisdictions, the theory is you’re going to save money because they’re settling them out at the proper amounts,” he said. They’re not overpaying, but they are also identifying problem claims.

Unbundling is well-suited to risk managers who believe they can significantly reduce their losses by working closely with a highly effective claims management partner. An unbundled approach allows a risk manager to find such a partner because it allows the employer to work with any independent claims administrator acceptable to its insurer.20

Unbundling: The Carrier-TPA Relationship

Once a risk manager decides to unbundle, he or she confronts the difficult task of selecting a TPA and prescribing service requirements. Unbundled carriers like Safety National take them part way through that process by vetting TPAs and providing approved TPA panels.
The TPAs have the direct contract with the customer, but it is almost a three-party transaction because the carrier has to approve the TPAs, Aivaliotis says. “We want to make sure they meet our high-quality standards,” he says. “We have executed master service agreements with TPAs that delineate claim-handling expectations, reporting requirements, standards for staffing, licensing, etc. Likewise, we expect the TPA to have a contract with the insured that addresses claim fees, service requirements and all other contractual obligations agreed upon.”

It is critical for an unbundled carrier to strike the right balance in the amount of TPA claim handling oversight. While TPAs are engaged in the day-to-day claims administration, the carrier is ultimately responsible for the claims. As such, an unbundled carrier should be viewed as a partner that is equally vested in ensuring optimal outcomes on the claims. Aivaliotis says that as part of Safety National’s oversight, approved TPAs are evaluated on five core competencies: investigations, reserving, claim handling, vendor oversight and reporting.

(Tips for risk managers facing the tasks of selecting TPAs and unbundled carriers are provided in accompanying sidebars.)

**Conclusion**

Unbundling is a viable alternative for employers who want the claims management flexibility of self-insurance without the entire administrative burden. While not as burdensome as self-insurance, unbundling requires more administration than traditional insurance and may require taking more risk through a large-deductible option.  

NOTES:

2. Ibid.
4. Ibid.
13. Ibid.
Risk managers who opt for unbundled programs view the ability to exert greater control over claim service providers as a primary advantage. Important ancillary benefits are increased pricing transparency and the flexibility to move their insurance programs when necessary and to customize the services of claims and loss control vendors.

Unbundling is best suited for sophisticated risk managers who believe that internal costs of additional administration and the increased risk of retaining losses below large deductibles will be more than offset by reduced losses within their retentions achieved through improved claims handling.23