NCCI’s Update on PEO Performance

Presented by;
Mona Carter
Senior Division Executive
and
Harry Shuford
Practice Leader and Chief Economist
August 20, 2013
Evolution of WC & PEO

- Multi-Employer model vs Standard Workers Comp model
- Need for Clarity and Compliance
- Data Reporting (POC and Experience Rating)
- Voluntary vs Residual Market Activity
- Desire for effective integration of Client level information
Meeting The Challenges

- Standardized Definitions and Terms
- Developing Policing and Regulatory Guidelines
- Insurance regulators, Industry and PEO Industry working together for understanding
- States improvement of systems for integrating information
- Enhanced requirements and reporting of Individual Client data
Don’t Just Speculate, Investigate!

The Story Behind NCCI’s PEO Study

Harry Shuford
Practice Leader and Chief Economist
August 20, 2013
The Story Behind the PEO Study

• **Why a Study of PEOs?**
  Public Health Professionals Planning a NIOSH Conference

• **What Have People Been 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

• **More Feedback**
  Even More Investigation
The Story Behind the PEO Study

But First - Something for the Uninitiated:

What Are Typical PEO Services?

Who Are the PEO Stakeholders?
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)
What Are PEOs?
Why Are There Concerns?

Key Stakeholders:
• Workers
• Employers
• PEOs
• Regulators
• Insurers
• Ratemaking organizations
The Story Behind the PEO Study

What Are The Concerns?
The Story Behind the PEO Study

Planning for a NIOSH Conference

“Use of Workers’ Compensation Data for Occupational Safety and Health”

June 19-20, 2012
Contingent Workers and Alternative Work Arrangements
A Concern of Public Health Professionals

“Contingent Workers: Workers’ Compensation Data Analysis Strategies and Limitations,”

forthcoming in the American Journal of Industrial Medicine

Contingent Workers and Alternative Work Arrangements
A Concern of Public Health Professionals

“The BLS identifies four categories of alternative employment arrangements, which may or may not involve contingent work:

1) independent contractors, consultants and free-lance workers, who may be either self-employed or wage and salary workers;

2) on-call workers who are called to work only as needed;

3) temporary help agency workers who are paid by a temporary help agency, regardless of whether the worker considers the job to be temporary; and

4) workers provided by contract firms, who are working for a contract company, usually work for only one customer, and usually work at the customer’s worksite.”

Contingent Workers and Alternative Work Arrangements
A Concern of Public Health Professionals

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The Story Behind the PEO Study

Planning for a NIOSH Conference

Contingent Workers, including:

- Independent Contractors, Consultants, & Free-lance Workers
- On-call Workers
- Temporary Help Agency Workers
- Workers Provided by Contract Firms
- Other Alternative Work Arrangements
The Story Behind the PEO Study

Employee Leasing and PEO Arrangements are considered to be “alternative work arrangements.”
The Story Behind the PEO Study

• What Are People Saying About PEOs? Much of It Is Speculation
Some Specific Regulatory Concerns

• Regulatory Concerns and PEOs:
  • Worker risk exposure/lax workplace safety
  • Lack of clarity and/or access to workers compensation benefits
  • Interference with employer compliance with state WC proof of coverage process
  • Inadequate OSHA reporting
Some Specific Workers Comp Ratemaking Concerns

Workers Comp Professionals Also Have Expressed Concerns about PEOs.

• Concerns about PEO Behavior and Ratemaking:
  • Underreporting or misclassification of payroll
  • Underreporting of workplace injuries
  • Poor loss experience
  • Adverse impact on residual market results
  • Avoidance/distortion of experience rating mods
Some Specific Regulatory Concerns

Workers Comp Professionals Also Have Expressed Concerns about PEOs.
Some Specific Regulatory Concerns

Workers Comp Professionals Also Have Expressed Concerns about PEOs.

Experience indicates that at times monitoring of compliance with proof of coverage for PEO clients and tracking first report of injury can be challenging.

However, a review of the literature suggests that there is little solid research addressing many of the remaining issues.

That is, much of it appears to be speculation on worst case scenarios.
Some Specific Regulatory Concerns

In the spirit of the theme of the NIOSH conference NCCI’s economists decided to

Use workers compensation data to investigate the impact of PEOs on NCCI’s ratemaking.

Not only would this shed some light on some internal discussions;

It also should provide regulators and public health professionals a better understanding of their own concerns.
Some Specific Regulatory Concerns

If something is subject to empirical analysis:

Don’t just speculate, investigate.
Some Specific Regulatory Concerns

Moreover, there’s a second part to this story.
Some Specific Regulatory Concerns

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Researchers often discover that if their research findings vary from the conventional wisdom they must deal with an ongoing string of challenges.

Our analysis of PEOs has been once such study.

This has been a good thing; it increased the scope of our analysis and strengthened our overall findings.
Some Specific Regulatory Concerns

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Researchers often discover that if their research findings vary from the conventional wisdom they must deal with an ongoing string of challenges.

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That’s the real story behind this PEO study.
The Story Behind the PEO Study

With All of This Interest Why No Prior Investigation?

It Turns Out that It Was Major Undertaking.
The Story Behind the PEO Study

The Process:

- Education – learn about the issues
- Information – get the data needed to analyze the issue
- Analysis and Conclusions
- Get Pushback on Results
  Typically: “But you didn’t look at ...”

So repeat the process:
- More Education
- More Data
- etc
The Story Behind the PEO Study

Lots of learning as we developed the data
Linking Policy and Unit Reporting Systems

• Started With Unit Data
  • Premium
  • Claims detail

• Proof of Coverage (POC)
  • to Identify PEOs in the unit data
  • NCCI’s PEO team

• 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 NAIC 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

What Were the Initial Findings?
PEOs in the WC Market
PEO Clients Appear to Be Small Businesses

Number of Workers per Employer/Client

- **Client–Master PEO Policy**: 9.7
- **Client–MCP PEO Policies**: 6.7
- **Client–Multiple PEO Policies**: 9.2
- **Employer–Non-PEO Policy**: 19.4

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 of the voluntary market
  • 2 to 6 percent of the residual market

• Great State Variation

• In PY 2009:
  • Florida—6 percent of voluntary market
  • Arizona—30 percent of residual market
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

- Top 5: 48.8%
- Next 5: 40.1%
- Next 5: 8.5%
- Other: 2.6%

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.
2013 Annual Issues Symposium

PEO Loss Experience (@2nd Report)
PEO Loss Experience Is Comparable to Non-PEO

• Frequencies are higher by number of workers
  • Indicating that underreporting 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 underreporting or misclassifying payroll is not apparent in the data

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
Residual Market: 25 NCCI ratemaking states
  AK, AL, AR, AZ, CT, DC, GA, ID, IL, IN, IA, KS, MS, MO, NE, NV, NH, NM, OR, SC, SD, TN, VT, VA, and WV are included
NCCI is not the residual market plan administrator in IN, TN, MO, and NE
Comparable or Lower Loss Experience

@2nd Report

Lost-Time Claims Loss Ratio by Modified Premium

Non-PEOs LDs
PEOs LDs

Non-PEO Oth
PEOs Oth

Non-PEO RM
PEOs RM

Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI
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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
This Was Not the End of The Story Behind the PEO Study
The Story Behind the PEO Study

External Push Back!

Required More Investigation
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 loss ratios?

Allegations

• 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”
Could the Observed Favorable Loss Experience of PEOs Reflect Delays in Claims Reporting by PEOs?
Could the Observed Favorable Loss Experience of PEOs Reflect Delays in Claims Reporting by PEOs?

An Actuarial Type Examination of PEO Loss Development
PEO Claim Development Versus Non-PEO Claim Development

1:5 Report Claim Development
Lost-Time Claims

Voluntary Large Deductible
Voluntary Non-Large Deductible
Residual Market

Mean 2004–2006 1:5 Claim Development

- PEO
- Std

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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PEO Loss Development Versus Non-PEO Loss Development

1:5 Report Loss Development
Lost-Time Claims

Mean 2004–2006 1:5 Loss Development

<table>
<thead>
<tr>
<th></th>
<th>Voluntary Large Deductible</th>
<th>Voluntary Non-Large Deductible</th>
<th>Residual Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>PEO</td>
<td>1.278</td>
<td>1.241</td>
<td>1.271</td>
</tr>
<tr>
<td>Std</td>
<td>1.410</td>
<td>1.285</td>
<td>1.242</td>
</tr>
</tbody>
</table>

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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Were PEOs Responsible for Three Recent Insurer Insolvencies?

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
Premium Declined for All Three Insolvencies During Recession

Net Written Premium (Dollars in Millions)

- Southern Eagle Insurance Co.
- Park Avenue P&C Insurance Co.
- Pegasus Insurance Co.
PEOs and Recent Three Insurer Insolvencies

Using Annual Statement data:
• Loss reserve analysis
• Non-admitted assets and receivables for large deductibles
## Southern Eagle Reserve Adequacy

### Southern Eagle Development w/ASB Tail

<table>
<thead>
<tr>
<th></th>
<th>Paid Method</th>
<th>Paid+Case Method</th>
<th>(Dollars in Thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>$ (933.32)</td>
<td>$ (268.80)</td>
<td>$ (1,686.31)</td>
</tr>
<tr>
<td>2006</td>
<td>$ (1,228.88)</td>
<td>$ (492.16)</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>$ (653.88)</td>
<td>$ (43.01)</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>$ (523.01)</td>
<td>$ (62.89)</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>$ 162.90</td>
<td>$ 851.36</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>$ (484.43)</td>
<td>$ 303.51</td>
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</tr>
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</table>

### ASB Development

<table>
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<th></th>
<th>Paid Method</th>
<th>Paid+Case Method</th>
<th>(Dollars in Thousands)</th>
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</thead>
<tbody>
<tr>
<td>2005</td>
<td>$ (933.32)</td>
<td>$ (268.80)</td>
<td>$ (8,281.84)</td>
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<tr>
<td>2006</td>
<td>$ (1,429.03)</td>
<td>$ (642.64)</td>
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<tr>
<td>2007</td>
<td>$ (1,012.29)</td>
<td>$ (213.03)</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>$ (2,438.56)</td>
<td>$ (1,080.88)</td>
<td></td>
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<tr>
<td>2009</td>
<td>$ (3,675.99)</td>
<td>$ (1,461.34)</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>$ (2,441.25)</td>
<td>$ (966.54)</td>
<td></td>
</tr>
</tbody>
</table>

**(Surplus) 2010** $8,763.00
The Story Behind the PEO Study

More Feedback

Even More Investigation
Allegation:

There Is More Litigation in PEO Claims
Why More Litigation for PEOs?

Allegations

• Prompt Handling of Claims Is Important:
  • Geographical separation between PEO and client and injured worker is a potential problem

• 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

Percentage of Paid ALAE to Paid Losses for Lost-Time Claims

<table>
<thead>
<tr>
<th>Policy Year</th>
<th>PEO</th>
<th>non-PEO</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>14.0%</td>
<td>9.1%</td>
</tr>
<tr>
<td>2005</td>
<td>11.1%</td>
<td>9.4%</td>
</tr>
<tr>
<td>2006</td>
<td>11.2%</td>
<td>9.7%</td>
</tr>
<tr>
<td>2007</td>
<td>12.9%</td>
<td>10.1%</td>
</tr>
<tr>
<td>2008</td>
<td>14.2%</td>
<td>10.4%</td>
</tr>
<tr>
<td>2009</td>
<td>15.0%</td>
<td>10.6%</td>
</tr>
</tbody>
</table>

Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI
Evidence Is Consistent with the Allegation:

There Likely Is More Litigation Associated with PEO Claims
Allegation:

PEOs Have More Data Excluded Because of Quality Concerns
PEOs Have a Lower Portion of Excluded Data Versus Non-PEOs

Portion of Excluded Data 2009

- PEO: 0.065%
- non-PEO: 0.154%

Portion of Excluded Premium 2009

- PEO: 1.303%
- non-PEO: 2.463%

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

![Bar chart showing the portion of risks for different data gaps.]

- All Other: 0.9774
- 1-Year Data Gap
- 2-Year Data Gap
- 3+ Years Data Gap

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

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").
PEO Loss Experience in VOL and AR Markets
Matched Exposure at Class Code Level
Over Time PEO Exposure in AR Shrank
Matched Exposure to PEO Class Codes by State and by Policy Year

Total Loss Ratios by Modified Premium

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Differences in Loss Ratios Across States

Matched Exposure at Class Code Level
State Variation in Loss Ratios: Large PEO States
Ordered from Left by Share of PEO in the State
Bubble Size Reflects Share of Premium Across All States
Policy Year 2005

Source: Workers' Compensation Statistical Plan, NCCI. Policy Year 2005
State Variation in Loss Ratios: Large PEO States
Ordered from Left By Share of PEO in the State
Bubble Size Reflects Share of Premium Across All States
Policy Year 2009

Source: Workers Compensation Statistical Plan and Workers Compensation Policy data reported to NCCI, for Policy Year 2009
State Variation in Loss Ratios: Small PEO States
Ordered from Left By Share of PEO in the State
Bubble Size Reflects Share of Premium Across All States
Policy Year 2005

Source: Workers Compensation Statistical Plan data and Workers Compensation Policy data reported to NCCI, for Policy Year 2005
Non-PEO exposure matched to PEO exposure at class code level by state by policy year
State Variation in Loss Ratios: Small PEO States
Ordered from Left By Share of PEO in the State
Bubble Size Reflects Share of Premium Across All States
Policy Year 2009

Source: Workers Compensation Statistical Plan and Workers Compensation Policy data reported to NCCI, for Policy Year 2009
Differences in Loss Ratios Across States

Voluntary Vs. Assigned Risk
Relatively Comparable within a State

Varies Across States
Loss Ratios Typically Well Below 100%

Matched Exposure at Class Code Level
PEO Size and Loss Experience
Matched Exposure at Class Code Level
Loss Ratios for Individual PEOs
Organized by Size of PEO
Matched Exposure at Class Code Level
Many More Small PEOS
Greater Variability in Loss Ratios
Policy Year 2007  @2nd Report

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

PEO Business Entity with premium below 5,000 dollars are excluded due to concern of data reporting and challenge in tracking. This excludes 0.04 percent of premium along with 0.004 percent of losses, therefore, there is not material impact to the analysis.
Salience* and PEO Loss Ratios

Workers Comp and Public Health Professionals Are Aware of and Have Concerns about PEOs.

Although Not Material in Terms of Market Share,

The Large Number of Small PEOs with Poor Claims Experience and Loss Ratios Will Be Noticed and Remembered.

* Salience: “an item that stands out relative to neighboring items.”
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
Questions