# LOSS PORTFOLIO TRANSFERS FOR SELF INSURED WORKERS COMPENSATION LIABILITIES

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Loss Portfolios Transfers (LPT) are one of the financial transactions that are available to self-insured employers to reduce their liability. An LPT is a financial transaction which enables a company to transfer their known and unknown liabilities to other, qualified carriers. This transaction is separate from the excess insurance policies which they may have in place.

Companies who have retained liability for certain claims exposures will begin to understand that there is a clear difference between claims which are more recent than those which have been in existence for a period of time.

When a self-insured employer has determined the amount of risk they will retain per claimant or in the aggregate, they will also have determined the amount which will flow into their excess insurance carrier, if they have purchased that cover. After a few years, those liabilities which have been retained by the employer will grow and accumulate. Given the duration and predictability of the workers compensation liability tail, owning those claims for 20 to 30 years may become daunting.

LPTs are basically reinsurance agreements where employers (risk bearers) can transfer their liabilities to another carrier. That assuming carrier will take on the financial and legal responsibility of those liabilities through closure. As with any other workers compensation carrier, those assuming carriers are obliged to manage those claims in accordance with the laws in the relevant state(s) to the claims.

The proposition of transferring liabilities does not mean that an employer needs to consider transferring their entire block of claims. The process can be extremely surgical. As an example, imagine that an employer is in the business of building homes.

They operate in three states and have employees of all ages performing a variety of tasks; construction, administration, and management.

Over time, claims will be submitted for head injuries, back strain, fractured vertebrae and burns (among others). Some of these injuries will heal and the employees will return to work. Others, whether severe or not will continue for many years.

Some of these claimants were relatively young and some were older when they were injured. At some point the employer will begin to think about the amount of time, money and energy that will be spent on these long tail claims. The employer is comfortable that the company (a third-party administrator - or TPA) who was hired to manage these claims has been doing so properly.

However, the employer is still looking at a payout on claims and related expenses for an additional 15 years or so.

It is at this point that the employer has two options;

- continue to fund and manage the claims. By doing so, they risk the chance that the claimant's prognosis will worsen and medical costs will escalate.

- Pursue a loss portfolio transfer where they can carve out some or all of these claims and transfer them to another carrier.

The employer is now at a point where they can review their loss runs and decide the best route forward.

Imagine that the loss run has 500 claims on it. These claims have loss dates spread over the last 10 years. The nature of the injuries on these claims varies, as does the age and prognosis of the claimants. Even though the employer has set aside enough money to pay these claims, she realizes that some of that capital could be utilized for other things (not to mention her time).

The employer can now take the loss run and carve it up for further review. She can look at all claims by loss or injury code. She can look at all claims incurred between the first and seventh year of the program. She can also separate claims by state. By performing this exercise, the employer has now adjusted the risk horizon and decided what part of that is no longer of interest to her.

Once the employer has decided that all back-injury claims that occurred over 3 years ago are no longer ones she wants to retain, she can place those on a separate list and begin discussions of transferring them through an LPT.

## HOW DOES THE LPT PROCESS WORK?

Buyers of runoff liability are each unique. Some are focused on larger and more complex lines of business while others are focused on very specific lines and dollar thresholds. It is important that the buyer be comfortable that the counterparty is appropriate. The intent of the transaction will be to relieve the seller of any ongoing liability for those claims which are being transferred. In exchange, the seller will transfer the corresponding assets along with the liabilities at issue. The buyer will usually require a risk premium.

After both parties have agreed and signed a Non-Disclosure Agreement, the initial due diligence process begins. An introductory call between buyer and seller will allow for a better understanding of the seller's intention.

It will also allow for any questions about the size and complexity of the portfolio, as well as the timeline to accomplish everything from start to finish.

Over the next few weeks, the buyer will review the claims run as well as payment history and reserve calculations. The excess cover wording will be examined as well. Recent actuarial reports and claims audits will be reviewed.

When the buyer has reached a comfort level with the portfolio, they will submit a non-binding offer. This will give the seller an indication as to whether the transaction will provide the solution they require for a reasonable price.

Once the non-binding offer has been understood and found to be acceptable by the seller, the buyer will then continue with a more thorough due diligence process. In addition to a detailed claims audit, where relevant, the buyer will interview the claims adjusters, law firms, investigators, large case managers and pose additional questions to the employer.

Actuarial triangles which have been provided by the seller will be reviewed and compared to the buyer's own actuarial analysis. This entire process may take a few months.

After a complete review, the buyer will propose a final and binding offer to the seller. This is typically limited to some contingencies, including a window of time.

Once agreed, the buyer will submit a contract for the transfer of the liabilities.

It should be noted that whereas an LPT may relieve one of financial obligations regarding noncore or aged liabilities, they almost always have a cap, or maximum aggregate limits on what they will pay out. There are well known market examples of where that cap has been reached, and the continuing liabilities then reverted to the original carrier. The carrier chosen as reinsurer may have to put up large trust funds to provide 'credit for reinsurance' security for your balance sheet, should they not already be sufficiently accredited.

Finally, you would need to be as confident as possible in the solvency of your chosen reinsurer, for under an LPT, insolvency on the part of the reinsurer would cause those liabilities to bounce back onto your balance sheet. Consequently, the assertion can be made with confidence that an LPT provides financial relief (up to the level of the cap in the agreement), but not legal finality.

As mentioned before, since buyers each have their unique ability and appetite when it comes to various loss portfolios, companies who are considering an LPT should research which company is best for their potential LPT. ■

John West began his career working in A&H, excess workers compensation and Medical Stop Loss. He then move over to P/C in 2000. Managing a team of 35 consultants, his focus was on exposure analysis and reinsurance collections. Transitioning to runoff liability transactions, John worked for companies in London, Paris, and New York. He is currently a partner in his company, Apetrop.

Apetrop provides risk transfer mechanisms and related services to self-insureds, captives and RRGs and traditional insurers. We provide effective runoff liability solutions. We are also an approved captive manager in Vermont.