



# NCCI's Update on PEO Performance

Presented by;

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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](http://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

Source: “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.”

Source: “Contingent Workers: Workers’ Compensation Data Analysis Strategies and Limitations,” forthcoming in the American Journal of Industrial Medicine



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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.



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Moreover, there's a second part to this story.

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.





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

**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

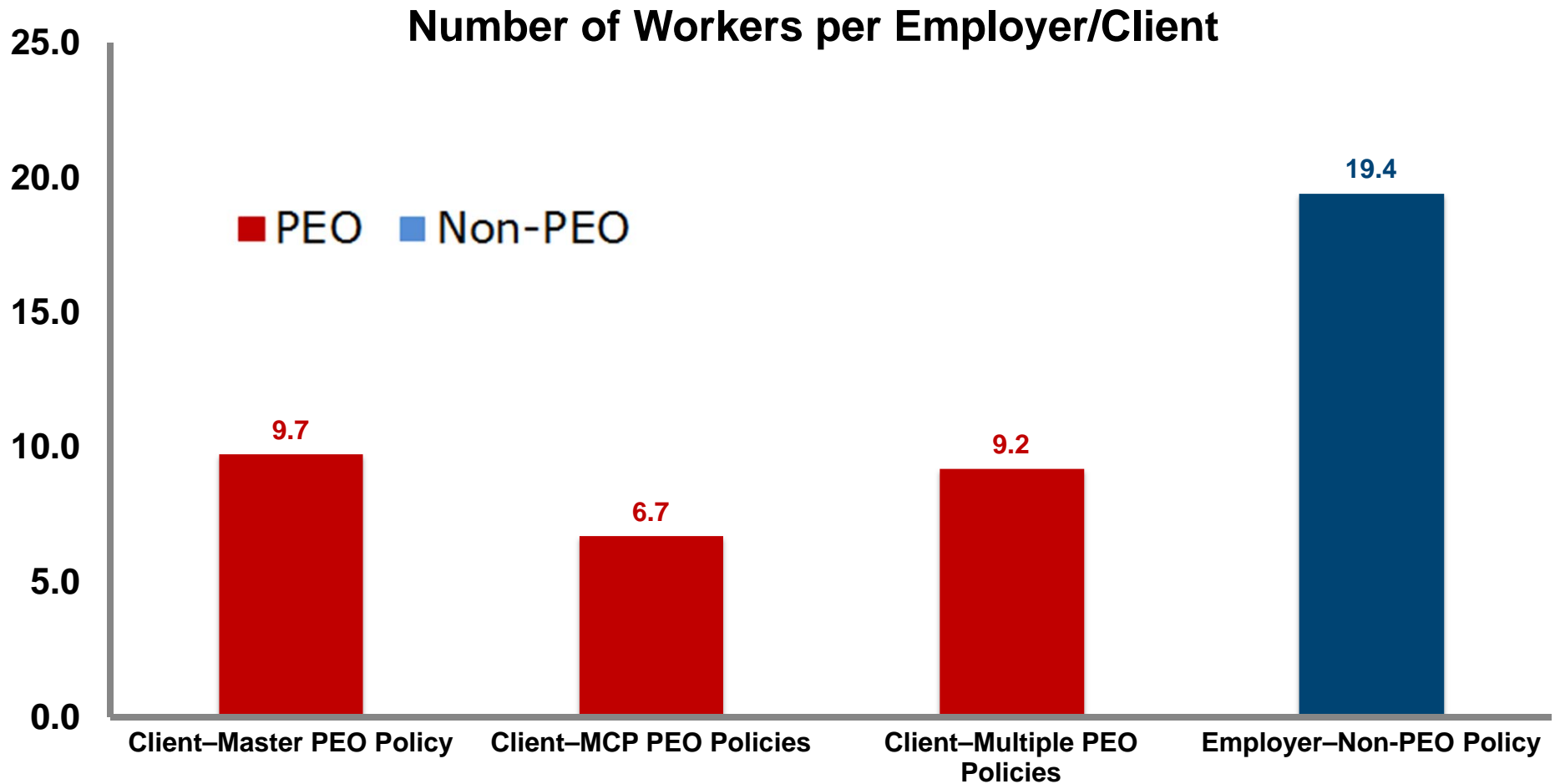
## What Were the Initial Findings?





# PEOs in the WC Market

# PEO Clients Appear to Be Small Businesses



# 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

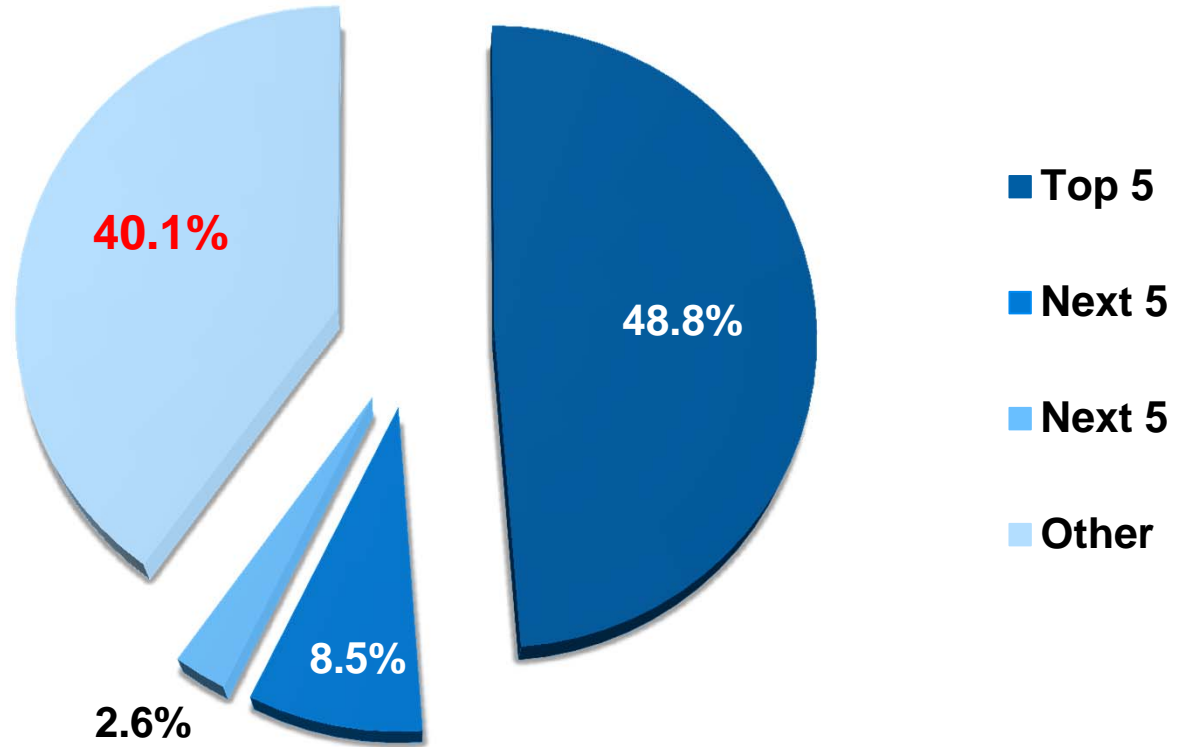


# Workers Compensation Data Suggests That the PEO Market Is Highly Concentrated



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

Policy Year 2009 Data







2013 Annual Issues Symposium

# PEO Loss Experience (@2nd Report)

trends property/casualty sustainability  
underwriting safety healthcare regulat  
legislation workforce trends profitabilit  
workers comp networking regulations

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**AIS**  
Annual Issues Symposium  
2013

# 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

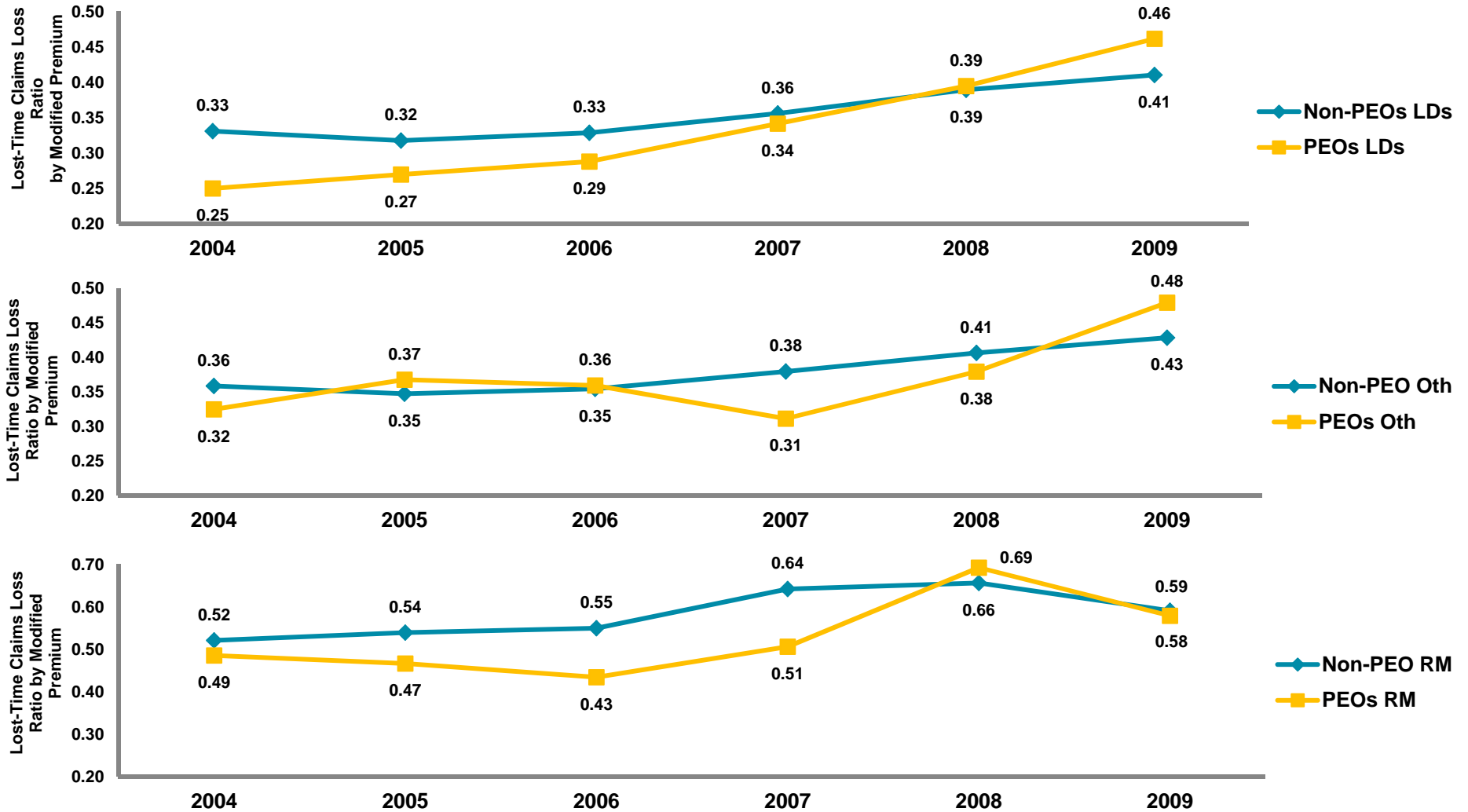
Residual Market: 25 NCCI ratemaking states

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



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



# 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





2013 Annual Issues Symposium

# This Was Not the End of The Story Behind the PEO Study

trends property/casualty sustainability  
underwriting safety healthcare regulat  
legislation workforce trends profitabilit  
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# 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?





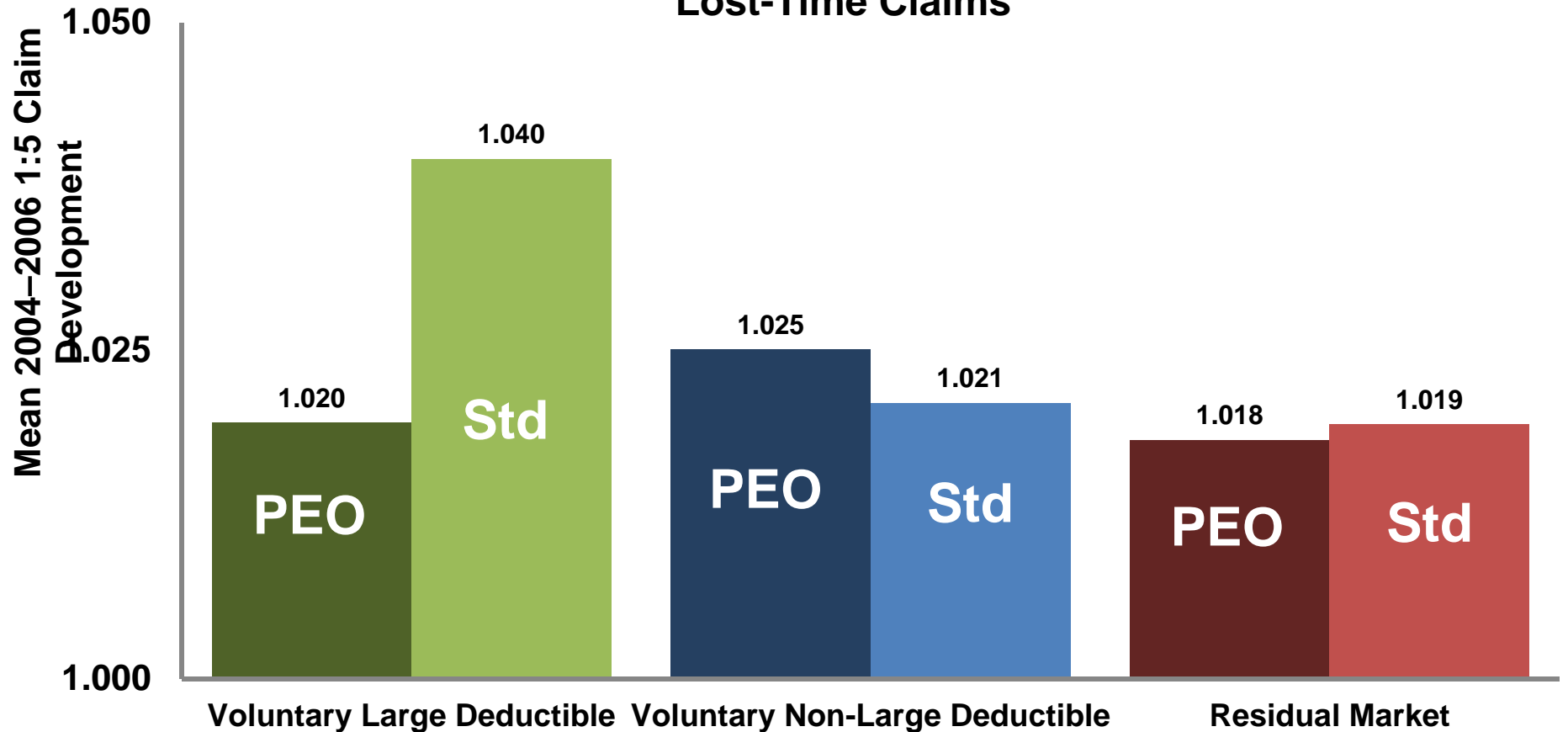
# **Could the Observed Favorable Loss Experience of PEOs Reflect Delays in Claims Reporting by PEOs?**

## **An Actuarial Type Examination of PEO Loss Development**



# PEO Claim Development Versus Non-PEO Claim Development

## 1:5 Report Claim Development Lost-Time Claims

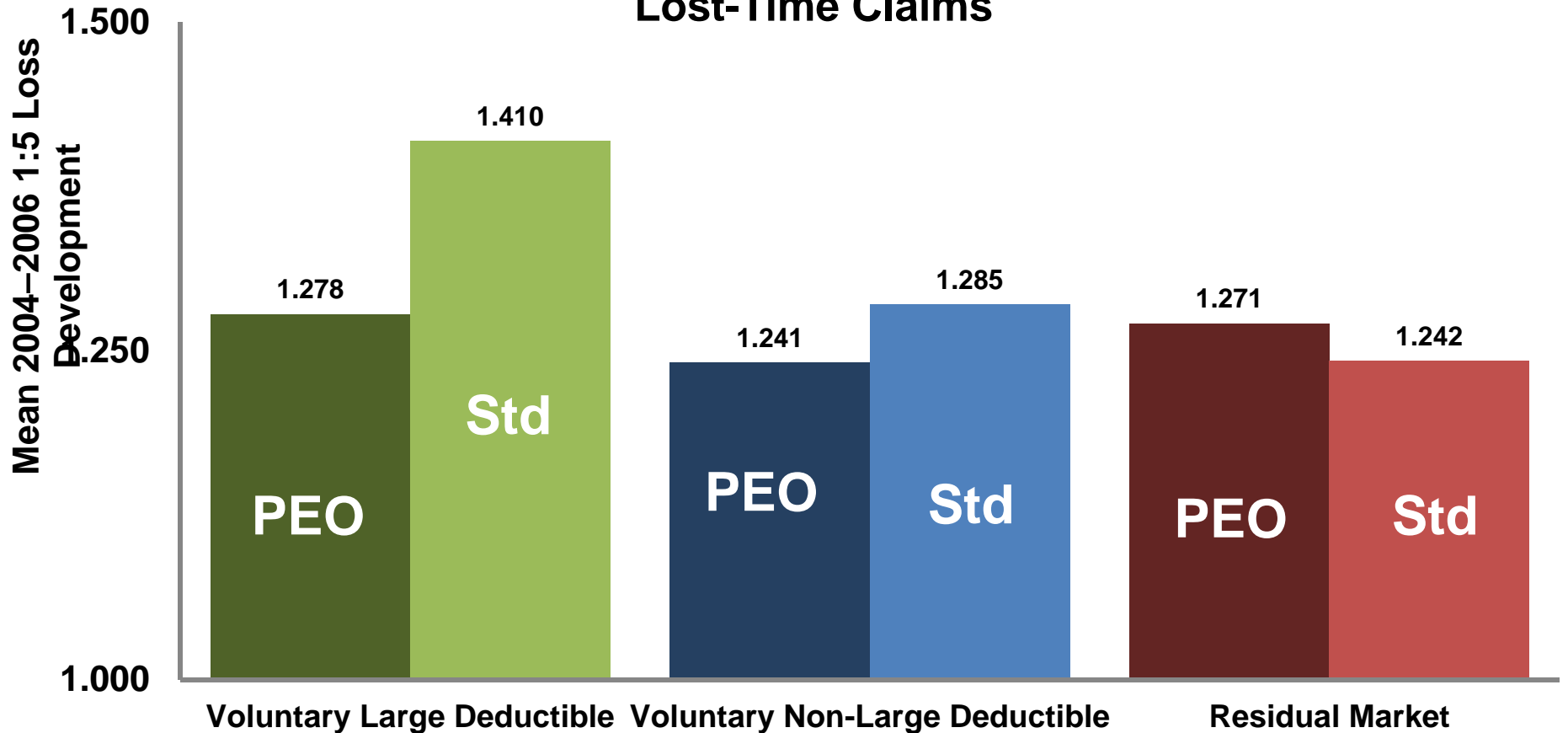


NCCI is not the residual market plan administrator in TN, TN, MO, and NE



# PEO Loss Development Versus Non-PEO Loss Development

## 1:5 Report Loss Development Lost-Time Claims



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



# Were PEOs Responsible for Three Recent Insurer Insolvencies?

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

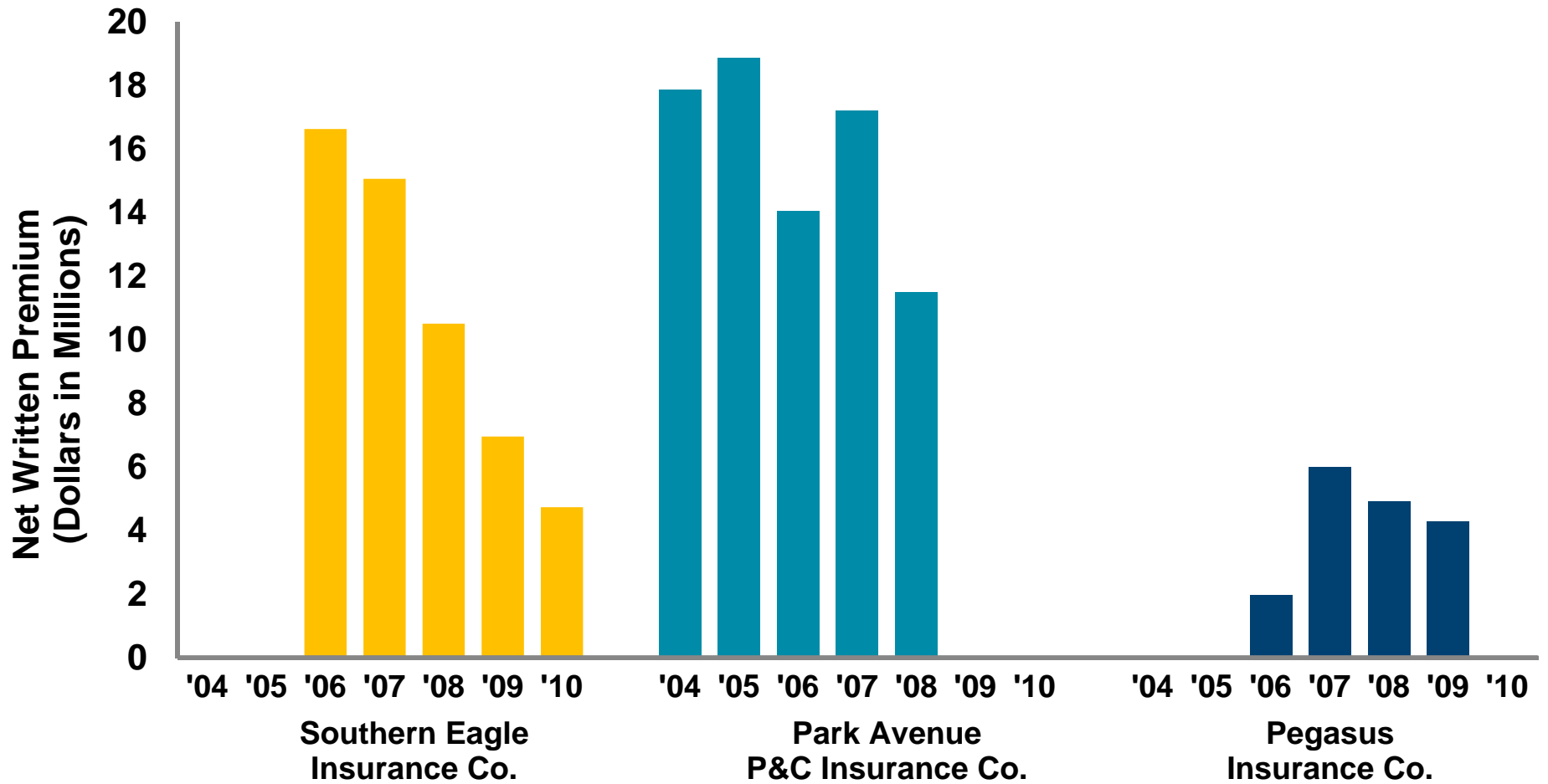


# PEOs and Recent Three Insurer Insolvencies 2009 Through 2011

- 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



# Premium Declined for All Three Insolvencies During Recession



# 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			
	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**





# 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

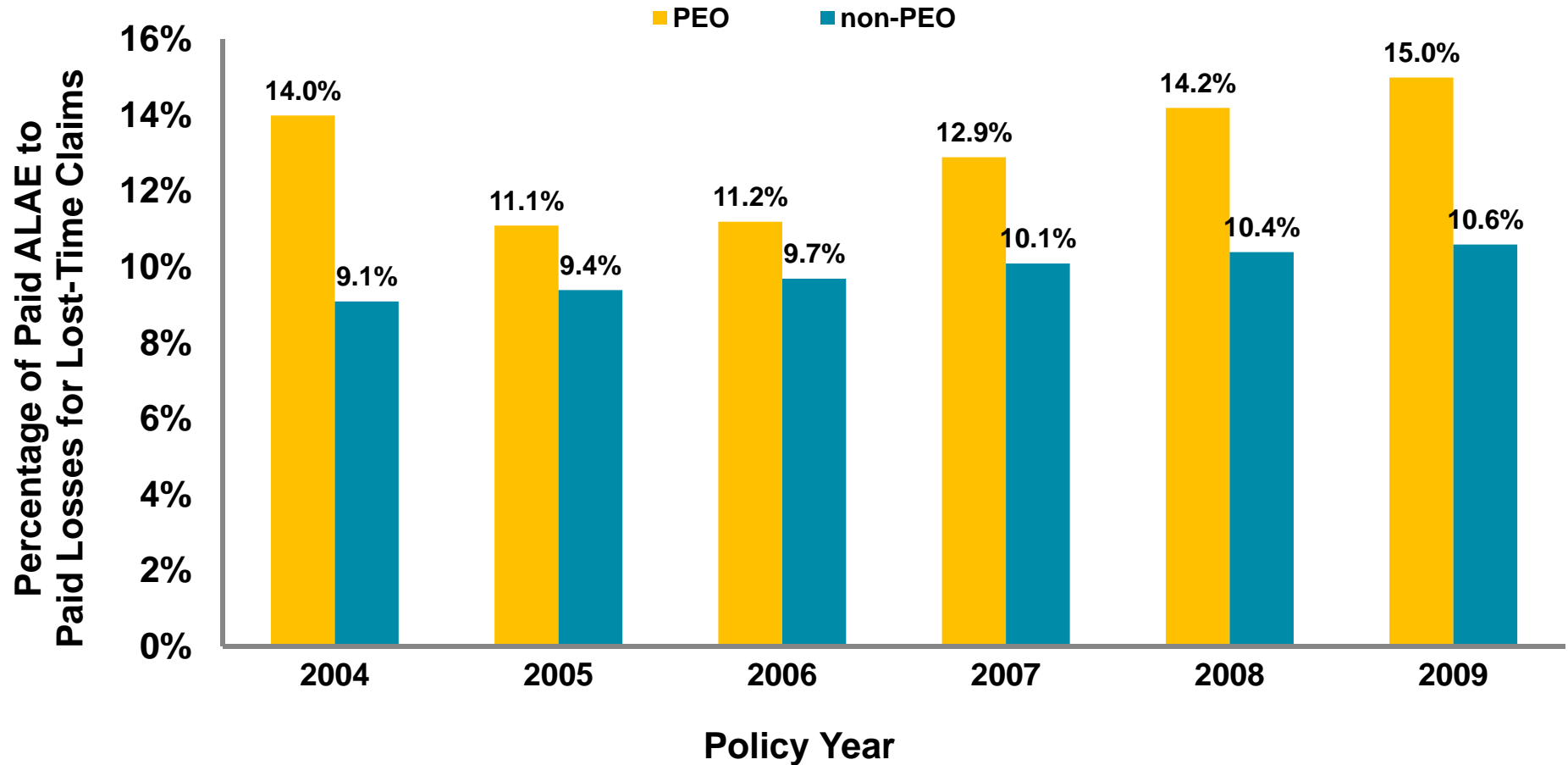


# Attorney Involvement and ALAE

- 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



**Evidence Is Consistent with the Allegation:  
There Likely Is More Litigation Associated  
with PEO Claims**

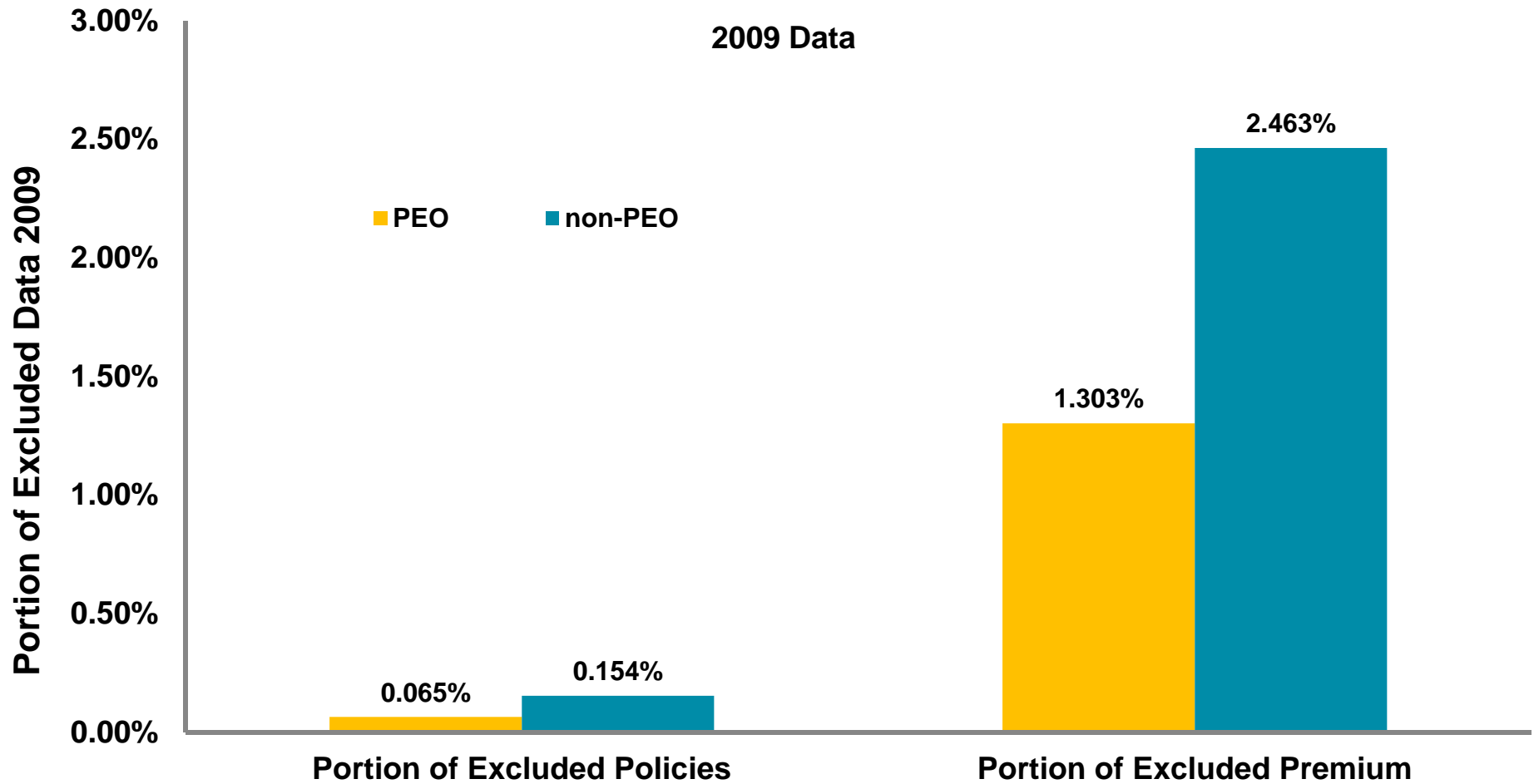


## **Allegation:**

# **PEOs Have More Data Excluded Because of Quality Concerns**

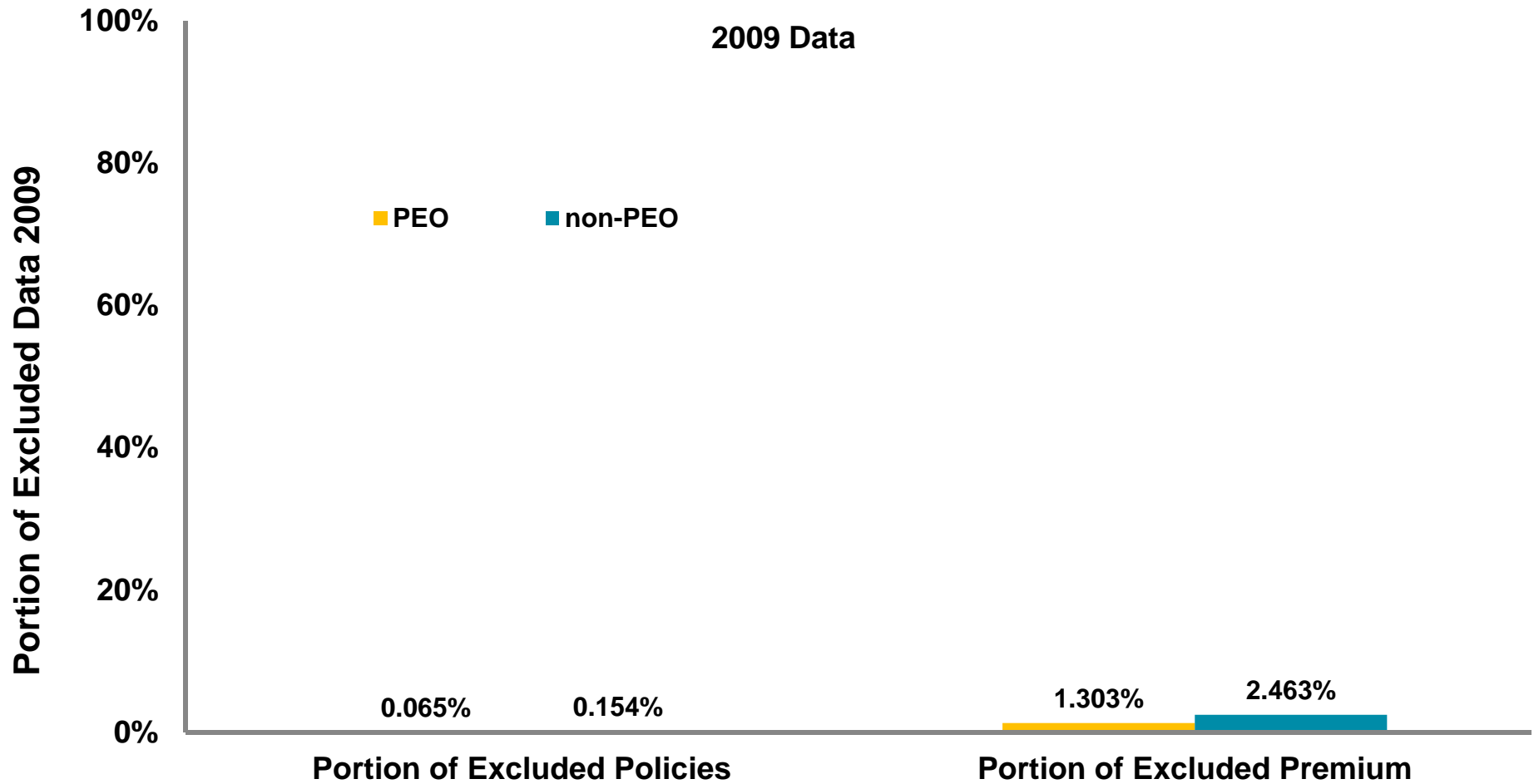


# PEOs Have a Lower Portion of Excluded Data Versus Non-PEOs





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



# PEO and WC Experience Rating System

## A “Front” for “Mod Washing”?

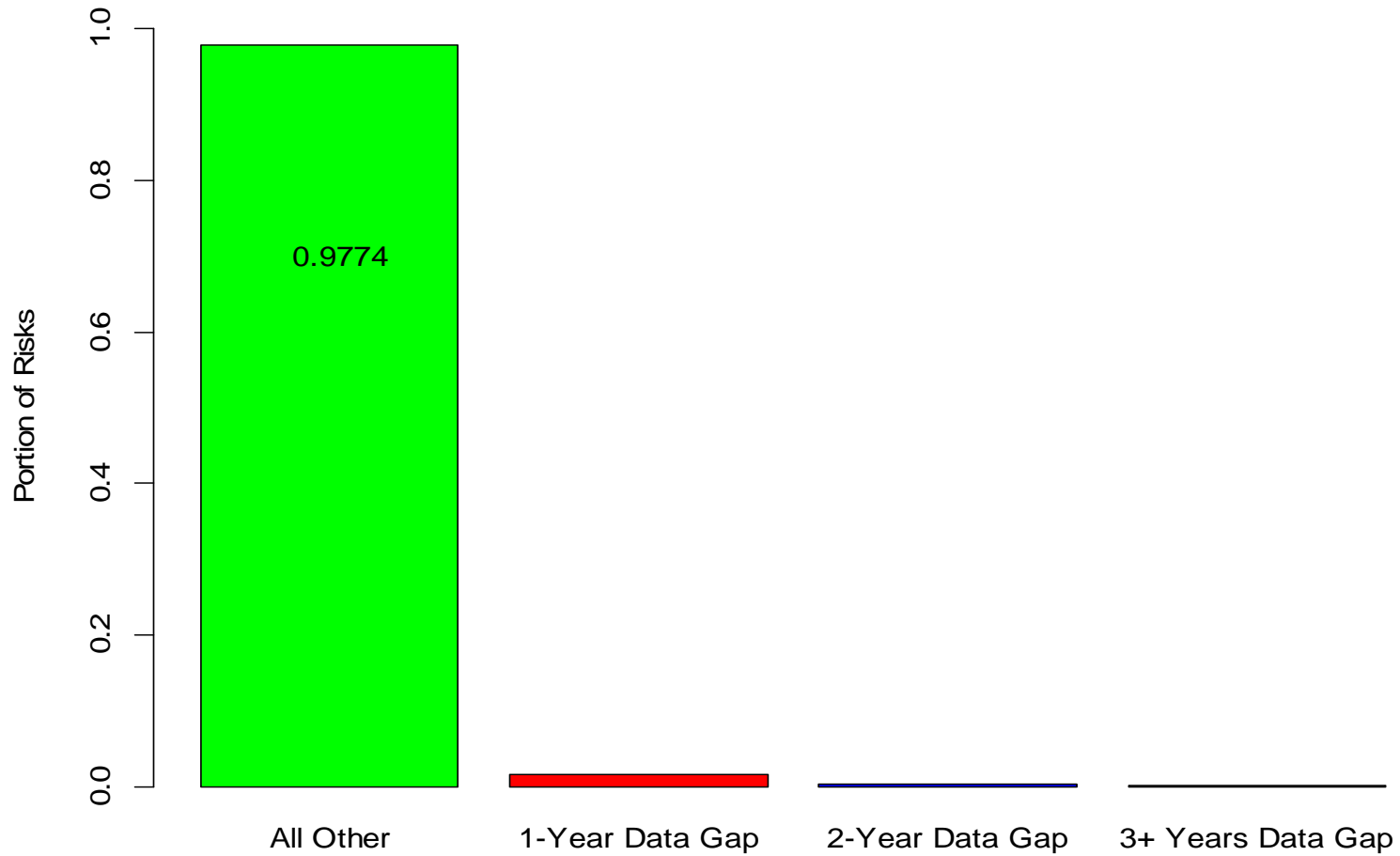


## PEO and WC Experience Rating System

**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



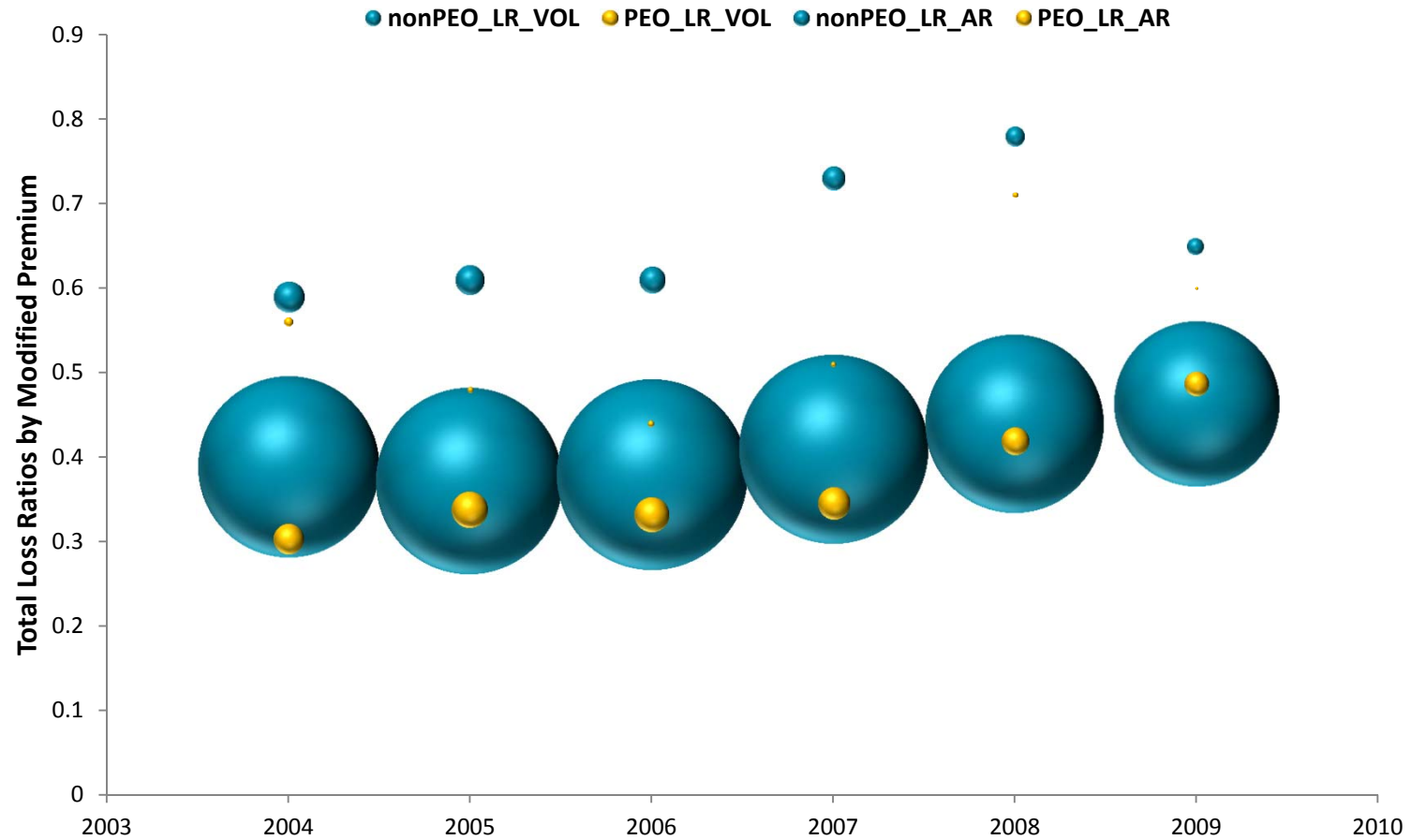
# PEO Loss Experience in VOL and AR Markets

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



# Differences in Loss Ratios Across States

## Matched Exposure at Class Code Level

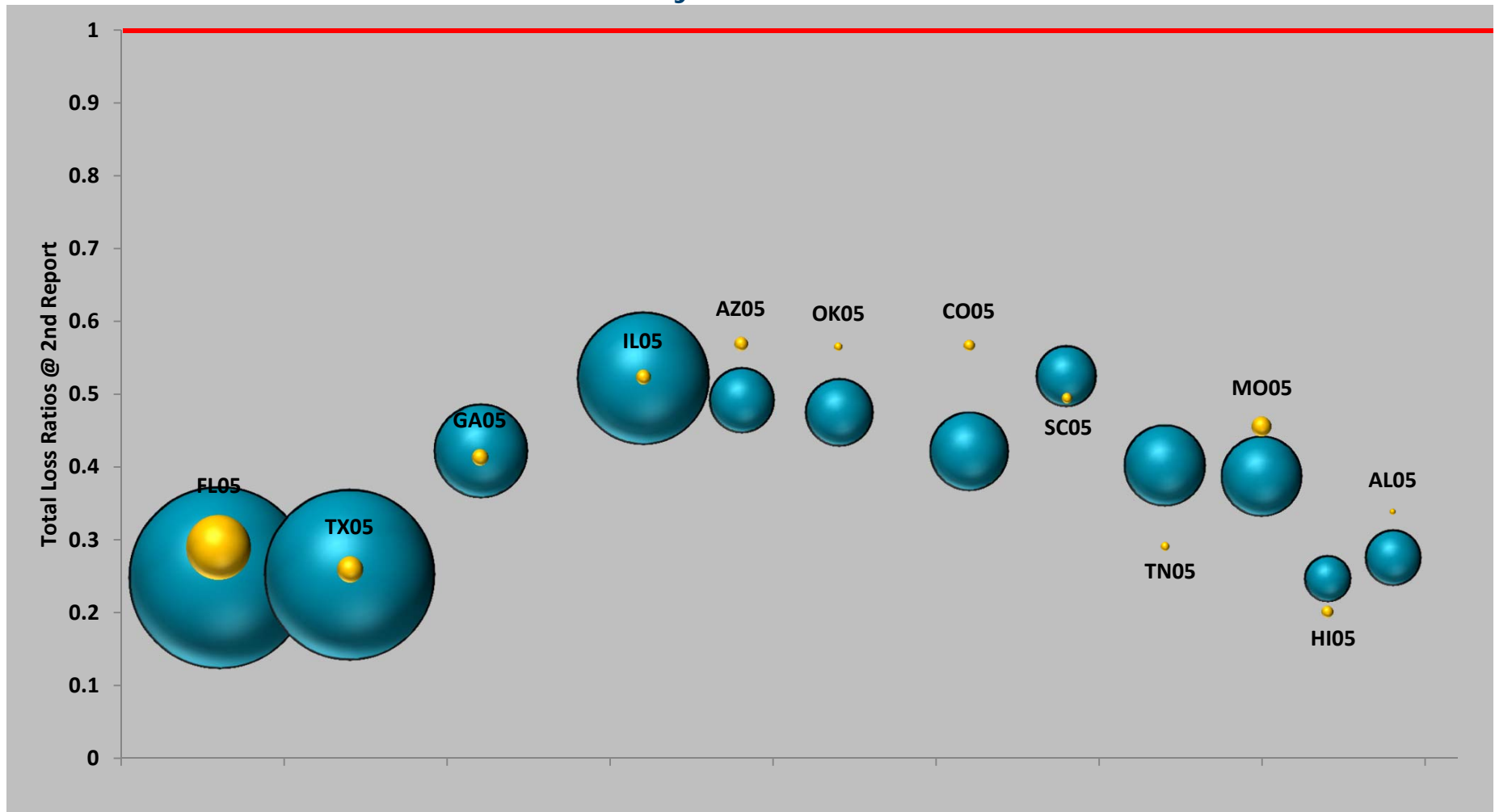


# State Variation in Loss Ratios : Large PEO States

Ordered from Left By Share of PEO in the State

Bubble Size Reflects Share of Premium Across All States

Policy Year 2005



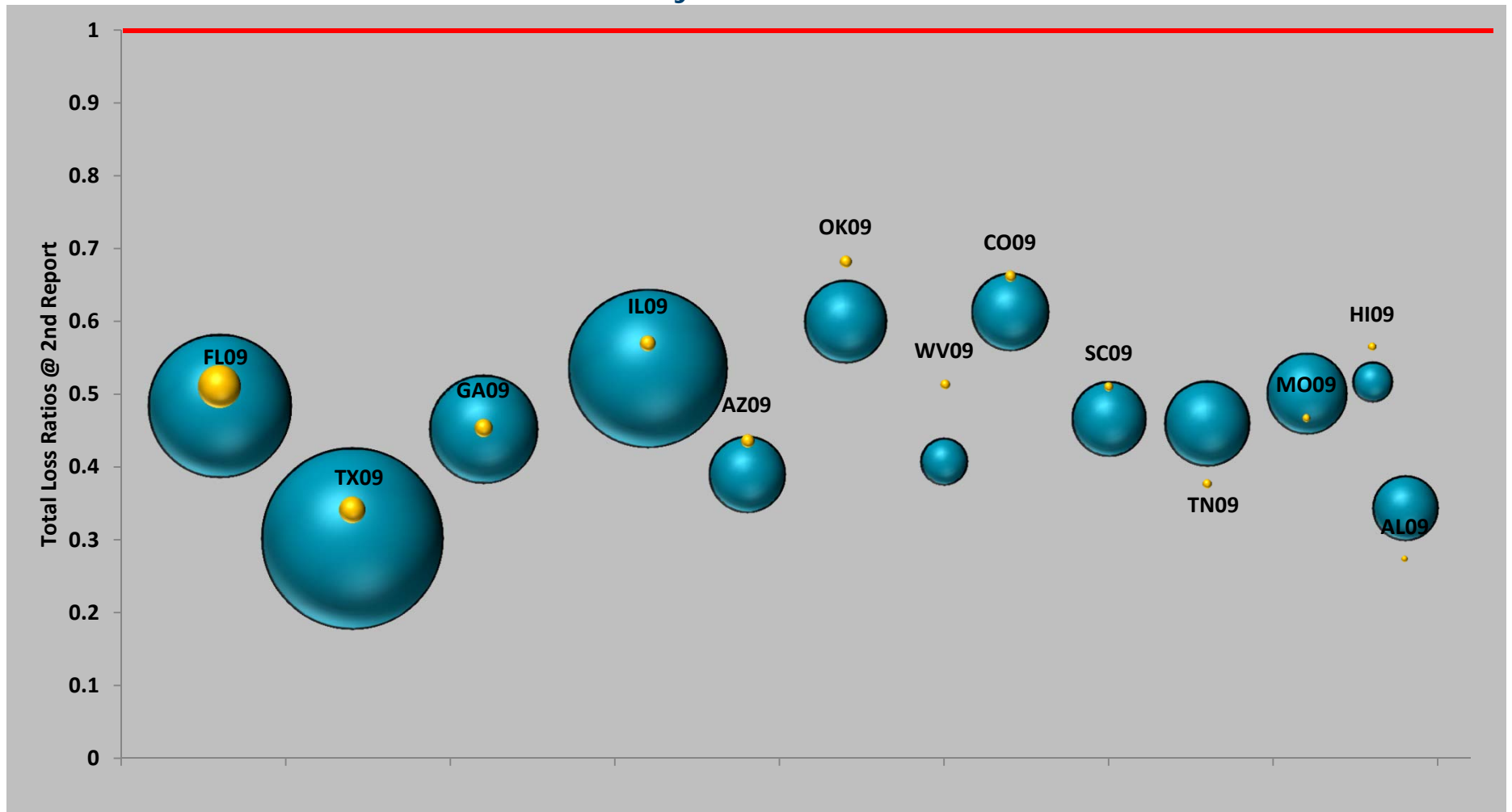


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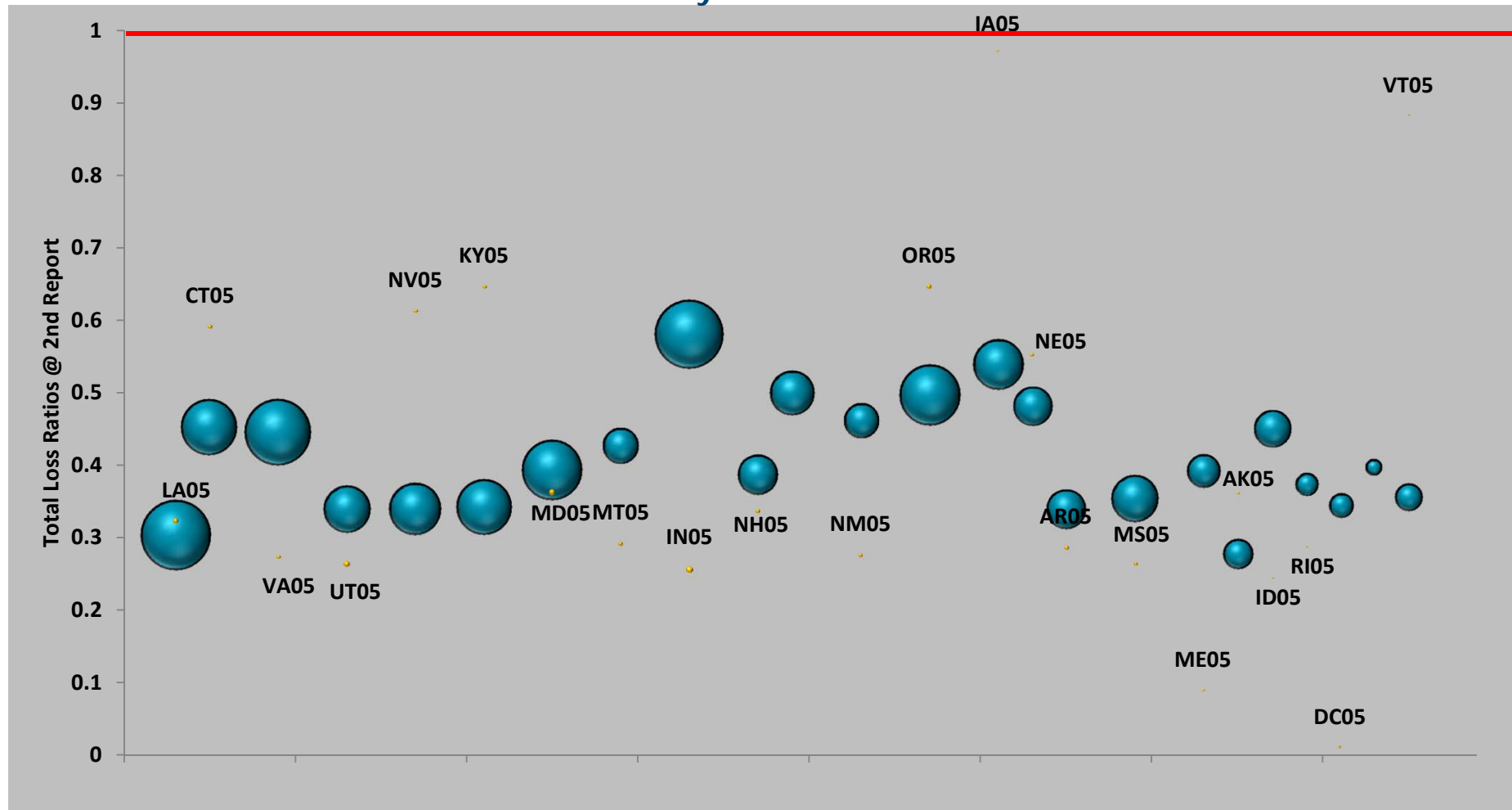


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Policy Year 2005

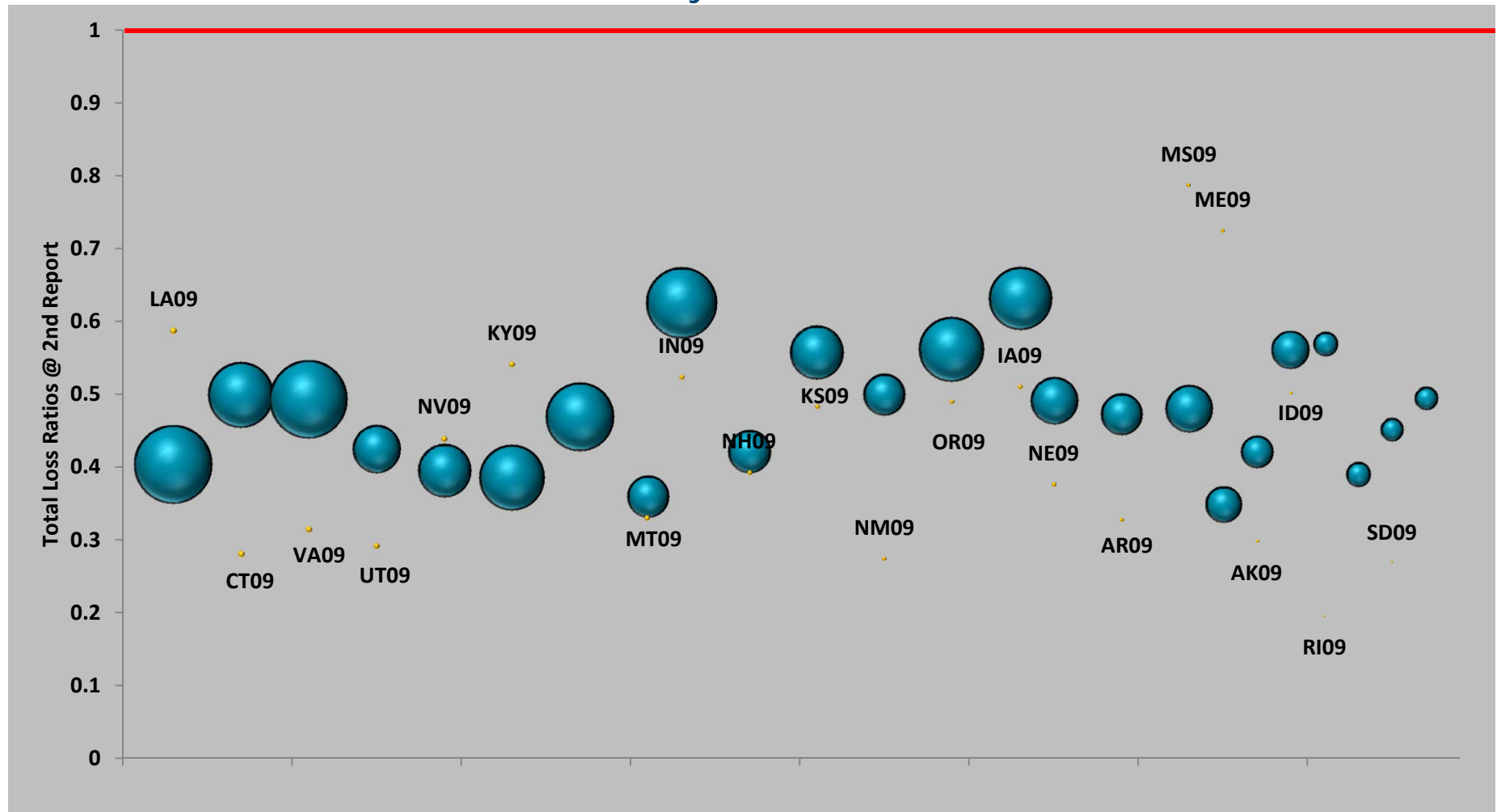


# State Variation in Loss Ratios: Small PEO States

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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

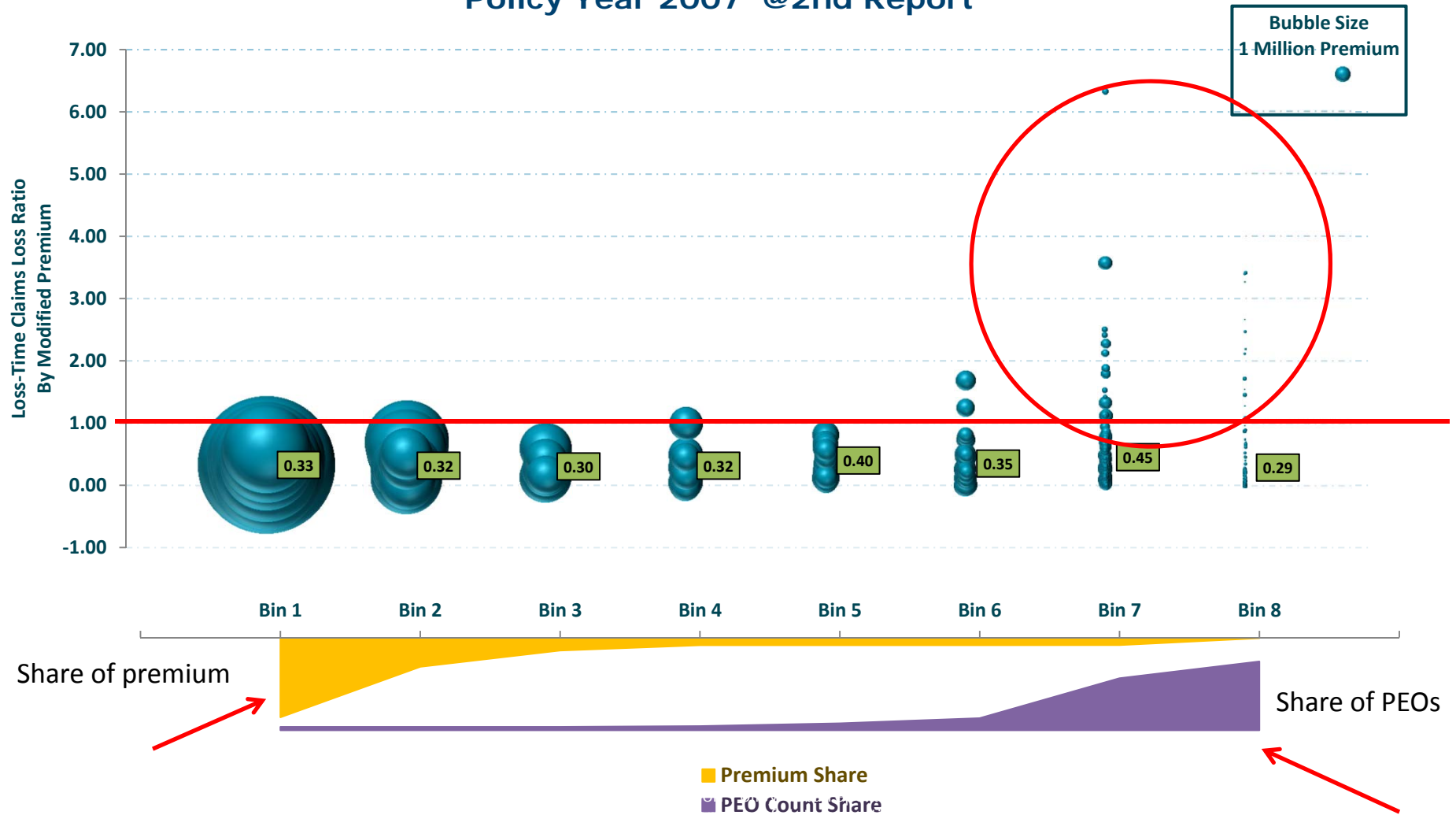
## Organized by Size of PEO

Matched Exposure at Class Code Level



# Many More Small PEOS Greater Variability in Loss Ratios

Policy Year 2007 @2nd Report



## **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