

WHAT IS A WORKERS' COMPENSATION DEDUCTIBLE?

Deductibles are a form of risk sharing in which the insured takes on a base layer of claim payment responsibility, in exchange for credit applied to their workers' compensation premium.

WHAT ARE THE BENEFITS OF A DEDUCTIBLE PLAN?

For insured – lower premium. For carrier – lower exposure to risk. Also, the insured has a stake in their claims, so in theory, they will have a higher focus on safety to prevent incidents.

HOW DOES A DEDUCTIBLE WORK?

The insurance company will process and pay the claim and then bill back the deductible responsibility to the insured. Carriers generally want to control the claims process so as to limit the value of a claim and ensure the claim is handled properly to avoid litigation and/or unnecessary expenses.

ARE DEDUCTIBLE PLANS ALWAYS AVAILABLE?

No, deductibles are only offered by some carriers and are regulated by the state the insured operates in. Some states only allow for certain deductible levels. Generally, they are only considered for middle market accounts or higher (over \$100K premium) – although there are exceptions.

Carriers will not want the deductible amount to exceed 50% or so of annual premium, as they still need to collect premium for operating expenses, potential severe claim exposure, etc. The insured will have to provide financial statements as part of the underwriting process, to prove they are financially capable of taking on claim payment responsibility.

WHAT IS A SMALL DEDUCTIBLE? A LARGE DEDUCTIBLE?

A small deductible is generally \$1K, \$5K, \$10K, \$25K per accident. A large deductible can be upwards of \$100K, \$250K, \$500K, etc. per accident. The higher the deductible, the greater the insured's responsibility, the lower the carrier's risk, and therefore, the greater the deductible credit and the lower the annual premium charge.

CONTACT

For more information, please contact your local RT Specialty WC broker or underwriter.

WHAT ARE THE TYPES OF DEDUCTIBLE PLANS?

- **Per accident** - The amount the insured will be responsible for out-of-pocket per accident (regardless of number of claimants).
- **Per claim** - The amount the insured will be responsible for out-of-pocket per claim (individual employee injury – there can be multiple claimants involved in one accident).
- **Medical only** – This only applies to medical only claims (first dollar coverage for indemnity claims).
- **Indemnity only** – This only applies to the indemnity portion of claims (first dollar coverage for medical payments).
- **Aggregate** – This is the maximum an insured will be responsible for in an annual term. For example, if an insured has a \$5K per claim deductible with a \$20K aggregate:
 - First claim is \$6,000 – Insured pays \$5,000, carrier pays \$1,000, aggregate is reduced to \$15K.
 - Second claim is \$2,500 – Insured pays \$2,500, carrier pays \$0, aggregate is reduced to \$12.5K.
 - Third claim is \$10,000 – Insured pays \$5,000, carrier pays \$5000, aggregate is reduced to \$7.5K.
 - Fourth claim is \$20,000 – Insured pays \$5,000, carrier pays \$15,000, aggregate is reduced to \$2.5K.
 - Fifth claim is \$10,000 – Insured pays \$2,500 (aggregate is met), carrier pays \$7,500.

The deductible has been met for the term, so all claims are paid at first dollar by the carrier for remainder of the term.

HOW TO COMPARE GUARANTEED COST PRICING TO DEDUCTIBLE PRICING:

Using the example of a 5-year loss picture, review how much of each claim would historically be the insured's responsibility had the deductible been in effect at the time. Then add the average out-of-pocket claim cost to the deductible quote premium.

- **Example:** The average out-of-pocket cost over 5 years would have been \$100,000 per year. Deductible quote is \$400,000. Guaranteed cost quote is \$550,000.

If the insured paid their average of \$100,000 out-of-pocket + \$400,000 premium, they are still potentially saving \$50,000, compared to first dollar coverage at \$550,000. There is a potential of \$50,000 to \$150,000 savings (if a "no loss" year). A deductible may make sense here.

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WHY MIGHT AN INSURED NOT WANT A DEDUCTIBLE, EVEN IF IT APPEARS TO OFFER SAVINGS?

Deductibles require cash flow flexibility. Some insureds prefer a fixed installment schedule for premium payments to fit their monthly budget. With guaranteed cost coverage, there are fewer fluctuations in insurance expense.

With a deductible, premium payments are still due on a fixed schedule or monthly reported plan. However, when claims are filed, the insured will need liquid funds to pay the claims below their deductible level. Some insureds may see this as a cash flow advantage. Since they are paying less in fixed premium, they have more cash flow available, until a claim occurs.

WHAT TYPE OF LOSS HISTORY WOULD BE BETTER SUITED TO CONSIDER A DEDUCTIBLE?

From an insured's perspective, a clean loss history, or low frequency / high severity claims history, would be better suited for a deductible because their exposure is limited, should trends continue.

However, from the insurance company's perspective, a high frequency claims history would be better suited, so the insured is taking on a higher level of responsibility and has a stake in each individual claim. If the deductible is higher than the insured's average claim cost, the exposure for the carrier is highly limited.

WILL THE USE OF A DEDUCTIBLE AFFECT AN INSURED'S EXPERIENCE MOD?

The short answer is no. The use of a deductible should not affect an insured's [experience modification](#). Claims are still reported to the rating bureau at full value, regardless of which party pays for the claim.

LOC REQUIREMENTS

Carriers require a letter of credit (LOC) at the time of binding a deductible quote to show the insured has funds available to pay claims. This explains why carriers want to review financials to determine financial adequacy of the insured. Methods the carriers use to determine the LOC amounts vary but generally it is a multiple of the expected losses or the deductible credit applied to the premium.

Please reach out to RT Specialty's knowledgeable [workers' compensation team](#) for additional information regarding deductibles and other work comp related questions.

CONTACT

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