"...Whether to Buy Insurance or to Self-Insure——
A Problem in Corporate Risk Management"

An Honors Thesis (ID 499)

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INTRODUCTION

The risk manager in a corporation has available to him several means of handling risk including avoidance, transfer, reduction (loss prevention), and assumption. The following is an analysis of self-insurance, which is a form of risk assumption, and deals with the issue of whether or not to self-insure. The requirements for a self-insurance program will be discussed along with a presentation of the pros and cons of the concept.

There are several points of view concerning the exact definition of self-insurance. It is not really insurance, and yet, the technique is not considered risk assumption by some experts in the field. For those who think of self-insurance as risk assumption or risk retention, as it is sometimes called, the application is to loss exposures not covered by insurance. If insurance is used above a certain deductible, the amount of the deductible is the self-insured portion of the insurance program.¹

A distinction has been made between self-insurance and risk retention, and this difference is the concept of funding.¹

Self-insurance involves the funding of dollars in order to pay long-term claims, whereas risk retention is financed through the working capital of the firm. If there is no formal method of funding, then the concept is risk retention instead of self-insurance.2

Still another perspective is the difference between insurance, self-insurance, and assumption. Insurance is the transfer of risk to a commercial insurer while self-insurance is found when the corporation performs the same functions as the insurance company. Risk assumption is regarded as non-insurance and any losses are paid out of working capital. The firm does nothing about the risk and charges any losses to current expense.3

It is clear that the concept of self-insurance varies somewhat among insurance professionals. Even though the definitions of this risk management technique are different, the term, self-insurance, is the most common and widely accepted. For the analysis that follows, it will be assumed that self-insurance is a form of risk assumption, and for the most part, it deals with the establishment of a funding program.


REQUIREMENTS FOR SELF-INSURANCE

There are many requirements that must be met before a risk manager can instigate a self-insurance program. Statistical records, loss prevention, claims services, and administrative ability are among the prerequisites to consider. Funding and investment procedures are also of importance.

A firm must possess a reliable record of loss statistics that date back a minimum of three years and preferably five years or longer. These figures can be obtained from insurance carriers. The records must be accurate in order to predict future losses and determine the size of the fund that will be set aside for payment of losses incurred in the future. Another advantage is to have a large number of risks involved so that simultaneous losses are not possible. It is also good to have risks that are homogeneous in nature and value in order to make the calculations of probable loss more accurate. A good example of this would be a grocery store chain.

Loss prevention is required. The manager of corporate risk must do in-depth research studies in the area of engineering. Reducing risk is a key ingredient in any risk management program. This is perhaps the first step


5Greene, p. 76.
in developing self-insurance, and after this comes the analysis of the pros and cons of the technique.\(^6\)

The whole aspect of a claims department must be investigated. There are large costs surrounding the development of claims service. The volume of claims expected determines the size of the staff, and there is a need for these people to be trained, especially in the area of liability and workmen's compensation. There is an advantage to bringing in experienced personnel and then acquainting them with one's specific business. When frequency of claims is involved, the corporation would benefit by having its own claims department. When the claims are severe as opposed to frequent, it would be more economical to have a small staff and hire an independent adjusting firm on occasion.\(^7\)

Another important requirement is a formal method of funding money for the payment of future claims. Accompanying the funding program should be a sound and formal method of investment. The return on investment essentially reduces the value of the claims.

In worker's compensation, claims will be paid over a period of time, and the company must hold the money in a fund in order to make future payments. Some claims are

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\(^7\) Greene and Swadener, pp. 125-126.
denied, others are contested, some go to court, and most will be paid. A liability case may last up to six years. A company must be prepared to settle claims whenever they take place.\(^8\) It should also be mentioned that commercial insurance must be used while the fund is being built up. As the self-insurance fund increases the amount of insurance will be reduced and finally eliminated.\(^9\)

Other main requirements are in the areas of administration and managerial ability. A number of forms and other legal manuscripts must be filed in various states. This task could be time consuming and difficult for the self-insurer whereas the insurance company has the expertise to make this a simple job.

In some instances certificates of insurance are required necessitating the use of a fronting company at a high cost. Another question to consider is whether additional coverage can be obtained on top of the self-insurance plan or does the market require underlying coverage which could make the cost of self-insurance too high. Of greatest concern is the amount of time that key executives will have to devote to administering a self-insurance operation.\(^10\)

With any organization, success is obtained through quality management. The risk manager must have a good

\(^8\)Greene and Swadener, p. 124.
\(^9\)Greene, p. 76.
understanding of the severity and frequency of the risks involved, and he must make sure that the potential loss is not greater than the company can afford. He must be a planner because a lack of planning is dangerous. Being ignorant of possible losses is really unplanned self-insurance, and this is not good.11

Money management is another item of importance. The amount of the premium paid to the insurance company should be evaluated to see if it is profitable to have this particular cash flow in the company's hands rather than in the insurance company's possession.12 It must be remembered that proper control over cash flows is an excellent financial tool for increasing profits.

In order for a self-insurer to be successful, there should be a minimal amount of financial difficulties, if any at all.13 Therefore, a strong financial position is another requirement. Given financial stability and the management's philosophy towards the handling of risk, each corporation will determine its own self-insurance limits, or stated another way, the size of a loss that can be accepted.

The chief financial officer in a corporation has a very good idea of what amount of loss would be detrimental to the company. He is a good source for discovering the

11Warren, p. 2.
13Greene, pp. 76-77.
risk retention ability of the company because this individual knows the internal financial factors involved, whether they be current or long-term in nature.

Annual income can be used to determine limits. Few companies actually establish reserves to handle self-insured losses. When a loss does occur, the payment comes from the working capital. Therefore, the flow of funds is a good measure for determining the ability of a firm to pay claims. A suggested risk retention level is 1/10 of 1% of annual income for an individual loss. This is based on past experience.

Another method to calculate specific limits is the Daenzer Formula which states that the minimum risk retention level should be 1% of revenues + 1% of free surplus. 14

In regard to the requirements, then, a corporation is ready for a self-insurance program when its insurance department does a better job than an insurance company. 15

14 Warren, p. 5.
15 Greene and Swadener, p. 122.
TECHNIQUES

The technique of using large deductibles has come about because corporate risk managers have become more aware of the many benefits that self-insurance can provide. They are becoming more knowledgeable and sophisticated, and as a result, risk managers can handle many risks without purchasing insurance from a commercial insurer. But with their increased expertise, many still rely on intuition. For example, out of three deductibles from which to choose, a risk manager will choose the middle priced deductible because he doesn't want to be too daring or too conservative. 16

It must be recognized that at some point, excess coverage must be purchased because no corporation can assume risk to the maximum potential loss. With self-insurance the lower level claims are retained. A risk manager can choose between deductibles, such as, $10, $15, $25, or $50,000 for example, and the deductible chosen becomes the self-insured portion of the insurance program.

This technique is similar to the technique that insurance companies use. They retain a certain amount of a firm's risk and then find additional coverages from reinsurers. The self-insurance method by-passes the primary insurer. 17

16Warren, pp. 2, 4.
17Greene and Swadener, p. 123.
APPLICATION

Application of these deductibles is as important as determining the deductibles themselves. Many small companies will purchase insurance for minor, frequently occurring losses and ignore the infrequent catastrophic losses. For example, they will insure such items as small equipment, glass, theft, etc., and the liability limits for the company are set too low. Low value property should be self-insured within the limits that a company can afford.

It should be noted that property values are relative, in that what is low value for one corporation may be of high value for another. Automobile material damage would be an ideal type of property to self-insure in a medium size organization, and certain kinds of equipment and machinery would be good self-insured items in a large corporation. Cargo shipments are often included in a blanket cargo insurance coverage, but these could easily be self-insured because they are often of low value.

Workers' compensation is another area where self-insurance is common. The benefits are relatively moderate and are established by law. Few cases are of serious nature, but when claims are substantial, they can be paid over a number of years. The frequency is high, but the losses are predictable in nature which helps the funding procedure to be more accurate.
As mentioned before, the risk involved with company owned automobiles falls nicely into the category of self-insurance. With regard to physical damage, collision and comprehensive losses are frequent but not severe in nature. If insurance coverage is used, the premiums are relatively high. Therefore, a significant amount of savings could be obtained if a program of self-insurance is administered.  

REASONS WHY SELF-INSURANCE IS USED

Because of the savings, tightening insurance markets of the 60's and 70's, and the lack of coverages at reasonable prices, self-insurance has grown and become more popular in recent years. In 1975 it was predicted that in five years property and casualty self-insurance would increase by 50% as a result of corporations' attempts to cut costs. It was also stated that employee benefits self-insurance would probably double during the same period. These conclusions were from a survey of more than 900 major corporations. Full-time risk managers made up 56% of the survey's participants.

The percentage of total insurable risk retained within a company will increase to more than 10% for property, casualty, and employee benefits, according to the

18Warren, pp. 1-3.
study. More than one half of the corporations that responded to the survey have expanded deductibles, safety programs, and loss prevention. Specific figures were as follows: increased self-insurance 45%, captive companies 13%, and higher deductibles 31%. It was found that the amount of self-insurance was higher in companies which had full-time risk managers. These were the larger companies with excess of $250 million in annual sales and at least 4,000 employees worldwide.19

The reasons why self-insurance is used are numerous, and a good place to start is with the insurance industry itself. Premiums are high and some coverages are difficult to obtain for several reasons. With a liability risk, there is an unknown quantity of potential loss. Also, the industry has an insufficient amount of applicable statistics for some uncommon risks. When unknowns are involved, an insurance company will be conservative in its selection of insureds and charge higher premiums in order to compensate for unusually large claims that may occur. The legal and social environment has also contributed to large judgments which result in higher premiums. Furthermore, there is a shortage of capital in the insurance industry in addition to rising inflation which means insurers will have an increasing demand for capacity.20

20Shifrin, p. 10.
Market conditions are tighter in the industry at the present time than at any other previous time because of the rapid growth of business and its insurance demands. As a result of these demands, the market's capacity has been depleted. This means that requested insurance will be denied or that rates will be very high unless the corporation is a good risk. Therefore, by eliminating the insurance company, the middle-man, costs can be reduced.21

Cost saving is the motivation behind avoiding commercial insurance. If a firm doesn't purchase insurance, it will save about one dollar for every dollar of loss. The major cost is related to selling commissions which account for about 10-20% of the premium. On the average approximately two times the annual premium is held by the insurance company in reserves. A corporation could keep premium dollars in its own reserves and invest those funds just as an insurance company does.

Another situation raises another question. Insurers usually don't write insurance with $1,000, $5,000, or $10,000 deductibles. The self-insurer must purchase insurance over a minimum retention of $100,000. This means that a company must absorb $100,000 on each loss before it is considered large enough to self-insure.

21Greene and Swadener, p. 127.
With this kind of policy, the insurers can keep to a minimum the number of self-insurers. Why shouldn't medium size and smaller companies have the right to self-insure if it will result in savings? The insurance industry argues that retrospective rating plans give the same flexibility as deductibles.

Many organizations that have been fully insured by an insurance company worry about losing the services that an insurer can provide, such as fire prevention, boiler inspection, claims adjusting, and legal counsel. These services, however, can be provided by outsiders and many times will be better than the services provided by the insurer.

One advantage with self-insurance is the increased awareness by the management for loss prevention. Companies are more diligent in their efforts to control losses. With insurance from a commercial insurer, there is often a sense of security that causes management to be complacent in loss prevention.

Workers tend to be less eager about making a claim against their own employer as opposed to an insurance representative, and as a result, workmen's compensation claims usually decrease in frequency.

Also, when drivers or supervisors are charged directly or indirectly with accident results, there is a reduction in auto and truck accidents.

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22Warren, pp. 3, 7.
With an insurance plan, the insured has no say in the area of claims. The self-insurer can create and develop his own claims staff and enhance their skills, or the risk manager can hire independent adjusting firms on contract. The control of claims administration is a major factor in obtaining the type of adjusting that best benefits the company. With a claims adjuster who is responsible to the self-insured, the company has control over whether or not to settle and for how much.

The corporation can resist claims where there is potential for an undesirable precedent to be established. However, the company may be lenient in the payment of claims in order to maintain good relations with the employees. The self-insured can be lenient or resist depending on the situation and what is best for the firm.

Another reason for self-insurance falls in the area of tie-ins among insurance lines. Insurance for workmen's compensation and public liability is often written by the same insurance company because this simplifies claim adjusting for a loss that may involve both areas. Underwriting workmen's compensation is more desirable than public liability from an insurer's point of view. An underwriter will probably not want to write liability without workmen's compensation, or he will charge an excessive premium for having liability
coverage only.

This situation makes it impossible for a company to know what it is paying in either line, but several large companies do not self-insure workmen's compensation in fear of losing liability coverage. It is difficult to find a market for liability coverage alone. Therefore, large corporations that want to achieve savings through self-insurance and do not want to pay the cost of an insured plan may be forced to establish a self-insured liability program.

Public liability was never self-insured until recently because bodily injury liability involved a court case and the exposure was too great. This is changing because of the increased control in handling claims, excessive premiums (restricted market), and the realization that the benefits of self-insurance also apply in the area of liability as they do in property insurance.

With a liability insurance policy the insurer has the right to settle claims as he sees fit. Many insureds do not like this arrangement and would rather have control over the claims adjusting and the legal defense.23

23Ibid., pp. 3-5, 7.
The following are two objective tests that compare insurance with self-insurance. The first is the simplest approach and is called the Direct Dollar Comparison. It compares the net insurance premium with the total cost of self-insurance, but this method is not very effective. It does not consider the time value of money and the long payout period involved in workmen's compensation and public liability. It is interesting that this approach does show self-insurance as 10-20% less expensive.

The Cash Flow Comparison is a better and more reliable approach. In this comparison, all the costs of an insurance policy and self-insurance must be determined. Each payment is discounted, usually between 5-8%, to the beginning of the policy period. Dividends and other returns must also be considered. An example of this comparison follows. Assume $110,000 premium, a $10,000 dividend, and losses of $65,000.

<table>
<thead>
<tr>
<th>Time (mos)</th>
<th>Premium Payment</th>
<th>Present Value At 7%</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>$27,500</td>
<td>$27,500</td>
</tr>
<tr>
<td>3</td>
<td>27,500</td>
<td>27,039</td>
</tr>
<tr>
<td>6</td>
<td>27,500</td>
<td>26,585</td>
</tr>
<tr>
<td>9</td>
<td>27,500</td>
<td>26,139</td>
</tr>
<tr>
<td>24</td>
<td>(10,000)</td>
<td>(8,734)</td>
</tr>
<tr>
<td></td>
<td>100,000</td>
<td>98,529</td>
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</table>
## SELF-INSURED COSTS

<table>
<thead>
<tr>
<th>Time (year)</th>
<th>Payments</th>
<th>Present Value At 7%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Legal Fees</td>
<td>$2,500</td>
</tr>
<tr>
<td>0</td>
<td>$2,500</td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>Bonds &amp; Fees</td>
<td>7,000</td>
</tr>
<tr>
<td>0</td>
<td>12,000 Excess Insurance</td>
<td>12,000</td>
</tr>
<tr>
<td>0</td>
<td>Safety</td>
<td>3,500</td>
</tr>
<tr>
<td>1</td>
<td>21,450 (33% of Incurred)</td>
<td>20,047</td>
</tr>
<tr>
<td>2</td>
<td>19,500 (30% of Incurred)</td>
<td>17,032</td>
</tr>
<tr>
<td>3</td>
<td>9,100 (14% of Incurred)</td>
<td>7,428</td>
</tr>
<tr>
<td>4</td>
<td>4,550 (7% of Incurred)</td>
<td>3,471</td>
</tr>
<tr>
<td>5</td>
<td>2,600 (4% of Incurred)</td>
<td>1,854</td>
</tr>
<tr>
<td>6</td>
<td>1,950 (3% of Incurred)</td>
<td>1,299</td>
</tr>
<tr>
<td>7</td>
<td>1,950 (3% of Incurred)</td>
<td>1,214</td>
</tr>
<tr>
<td>8</td>
<td>1,950 (3% of Incurred)</td>
<td>1,135</td>
</tr>
<tr>
<td>9</td>
<td>1,300 (2% of Incurred)</td>
<td>707</td>
</tr>
<tr>
<td>10</td>
<td>650 (1% of Incurred)</td>
<td>330</td>
</tr>
<tr>
<td></td>
<td>90,000</td>
<td>79,517</td>
</tr>
</tbody>
</table>

(10% less than unadjusted premium costs) (19% actual savings over insurance)

Notice in this example that the cost of the self-insured program is approximately 20% less than the insurance policy.\textsuperscript{24}

## CAPTIVES

Captives have become popular in recent years as a formalized method of self-insurance. A question to consider is, "What can a captive do for the firm that a funded self-insurance reserve cannot?"\textsuperscript{25}

\textsuperscript{24} Ibid., pp. 4, 5.

A captive is a subsidiary corporation that insures the risks of its parent. An industry captive is owned jointly by several firms in a single industry. An example of this type is the Oil Insurance Limited of the petroleum industry. The industry captive can obtain economies for the members by reaching markets that individual firms cannot reach. Underwriters are more willing to write insurance for a captive than writing for many separate, smaller accounts.26

There are several reasons for establishing captives. Premiums paid to an insurance company receive tax consideration while corporate allocations to a self-insurance fund for future losses are not pretax business expenses according to the IRS. Captives headquartered outside the U.S. have made it possible for companies to treat their self-insurance allocations as premiums.

They pay a premium tax that is less than that paid by domestic companies. Other factors include: use of allocated capital until loss occurs, lower insurance cost, broader types of coverage, all risk without exclusion, and higher limits at a more reasonable price in the area of reinsurance.27

26Warren, pp. 6,7.

Fuqua Industries has organized a captive company and has used self-insurance. Management is pleased with its success in the midst of inflation, higher legal settlements, and increasing costs in general.

Robert S. Spencer, Vice-President-Insurance and Risk Management, Fuqua Industries has made the following remarks.

Our brokers play a very definite and vital role in our program and will continue to do so. Their commission and fee income have not been reduced. They work with me and my staff as partners. They are innovative and constantly advise me of new methods to accomplish our joint goal of protecting Fuqua's assets from fortuitous loss. It's an expanded and increasingly valuable role they are fulfilling.28

He also said that self-insurance is not in the best interest of insurers. Premium dollars are being taken out of the domestic market, and insurers need these funds to increase surplus, capacity, and to finance their service function nationwide.

Three tax objectives in forming a captive are given below. Premiums should be deductible. The accumulation of investment income and underwriting income should be in a tax free environment which would allow reserves and surplus to grow at a faster rate. The last objective is for a captive to be easy to operate and to be in a location where there is

no heavy regulation. Presently there are 35 in Colorado and other states, 300 in the Cayman Islands, and approximately 730 captives in Bermuda. 29

Why is Bermuda so popular? The reasons listed below give a clear answer: close to the U.S., political and economical stability, British legal system and the English language, free currency convertibility, quick and easy formation of a captive, no regulation of investment, rates, and forms, income of captive not taxed for at least 25 years, and good legal, banking, accounting, and investment services. 30

Captive insurers popular in property and liability are becoming more popular in life insurance. Life insurance captives in 1967 and 1968 snatched about $10 million in premiums from insurance companies. It seems that captives are becoming more popular as risk managers become increasingly knowledgeable in this area. 31

The future development of captives in the U.S. and outside this country will depend on the position taken by the IRS on the flow of capital in and out of the U.S. and the tax applied to earnings obtained

29 Ibid., p. 45.
30 Graves, p. 36.
31 Greene, p. 78.
REASONS WHY SELF-INSURANCE IS NOT USED

There are a number of reasons for self-insurance, but there are just as many for not establishing such a program. The remaining portion of this study will be an analysis of the drawbacks to self-insurance.

One place to start in this area is with labor relations. Unions usually oppose self-insurance because the employer may discriminate in hiring and may not hire employees who are disabled and handicapped. Employees may tend not to make a claim against their own employer, but they may antagonize the self-insurer.\(^3^2\)

In borderline cases, the employer would have the responsibility to make the final decision. If his decision is not satisfactory to the employee, the employer will be blamed and not the insurance company. This situation could result in reduced employee morale.

\(^3^2\)Huebner, p. 593.

Also, agreements with unions sometimes could make it difficult for an employer to change to self-insurance. Cases have existed where the employer has been taken to court by the local union because the company changed to self-insurance.

There is usually no conversion privilege for health or life coverage. When an employee leaves the group, he will have no life or health conversion policies issued to him if he is uninsurable. For the above reasons, relations with labor could deteriorate.

Under the ERISA requirements (full disclosure), the employer must provide a booklet to the employees describing insurance benefits. With an insurance contract, the insurer is responsible for this, but with self-insurance the corporation must draft the necessary wording. This takes time and the self-insurer may not be equipped for this.34

Another aspect is the problem in providing adequate services. Two percent of the premium a corporation pays to an insurance company goes toward inspection, testing, and research nationwide which is organized, uniform and efficient. Self-insurance has no nationwide safety and claims organization. Self-insurers only have contracts through working arrangements

by outside service firms. Insurance companies also have service bureaus that provide statistics and investigations in fraud, and self-insureds do not.

An agency provides the service of recommending coverages that will protect the corporate interest. The self-insured must pay an outside safety and claims organization for this at a cost of about 10-15% of the standard premium. Insurance companies have more experienced and better trained personnel, especially in the technical medical field. They know the terminology and have an understanding of the law. 35

As stated before, self-insurers must purchase individual services that they would have received from the insurance company. These include such services as legal aid, actuarial talents, and loss prevention. When these costs are totaled, many times they either are the same cost or greater than the cost of dealing with an insurer.

This could also be inconvenient for the company in dealing with all of the services separately. It would be less complicated if all the services were combined into an insurance policy provided by an insurer. The insurer is a specialist and can handle these matters easily. 36

35_Fallacy_, p. 4.

36_Carver_, p. 72.
Specifically, a firm may want the services of an insurer for the inspection of steam boilers. This requires a person with specialized training, and it may be uneconomical for a corporation to hire a full-time inspector.

In the area of workmen's compensation, a company may want an outside firm to settle claims. With regard to employee morale, it would be an advantage to have a third party handle the claims. Any complaints would be against the insurer and not the employer, and this would result in better relations between management and labor.\(^{37}\)

In administering a self-insurance program, many hidden costs appear that were not foreseen. The executive supervision and clerical work related to self-insurance are often charged to another account in the accounting procedure. Therefore, this method of handling risk is not as inexpensive as it looks. Other costs include: record keeping, cost of distributing benefit payments, salaries of nurses and doctors, office supplies, artificial limbs, legal and medical fees, court costs, and rehabilitation programs.\(^{38}\)

Self-insurance means a number of details that management would have to deal with that would take them

\(^{37}\)Greene, pp. 78-79.  
\(^{38}\)Falkacy, p. 2.
away from their main business concern. Their main concern should be in their own line of business instead of insurance.\textsuperscript{39}

With the self-insurance fund and its investment, other problems are found. There is potential for an abnormal catastrophic claim to drain the company's reserves. High medical coverages are being written today with some being as much as $250,000. Another major drain on the reserves in a self-insurance fund is found when a claim is incorrectly paid. A lawsuit may follow, and the company must be capable of handling this potential expense which could be in the millions. Most companies could not manage such a loss.

The employer has the responsibility of investing the reserves with self-insurance. Sound investment is required because inadequate reserves could destroy the self-insured program. With the purchase of insurance, the investment expense is spread over a large number of accounts, and the responsibility is with the insurance company. The insurer must worry about whether the reserve is understated or overstated.\textsuperscript{40}

Funds in the reserve could be used in a better way. Firms may not want to set up a reserve for paying losses

\textsuperscript{39} Greene, p. 78.

\textsuperscript{40} Carver, pp. 71-72.
because the funds could be used within the firm or invested in non-liquid securities at higher interest rates.\(^{41}\)

The tax status of a fund set aside for future losses is not favorable. The amount paid into a self-insurance fund used for compensation and other benefits is not deductible from income as a business expense. The net premium of an insurance policy is equal to the premium minus the amount saved because of the tax deduction. There is an advantage with insurance because the premiums paid are tax deductible.

Some states tax self-insurers on the basis of the standard premium that would have been paid if the corporation purchased insurance, and many states have fee assessments on the self-insured program. Extended disability and death payments continue for years, but only the actual loss paid is considered as deductible for tax purposes.

The compensation laws tend to be in favor of the employees of an organization. The compensation act was created to protect employees, and insurance commissioners also tend to favor employees. If commercial insurance is the maximum form of protection

\(^{41}\)Greene, p. 79.
in the commissioner's mind, then self-insurance may be suspect. The commissioner may believe the self-insured program is an attempt to reduce costs with financial responsibility and the handling of claims being secondary in importance. He may also think that a corporation's only real saving would be in fewer losses which would mean more claims contested and turned down. If this is the case, the self-insured corporation would be in an unfavorable position with the state insurance commission. 42

Another disadvantage of self-insurance is in the area of group term life insurance. Estate tax deductions are allowed for life insurance benefits, but they are not allowed for self-insured death benefits. 43

There are several legal qualifications that a corporation must possess in order to establish a self-insured plan. An application must be filed that states balance sheet figures, a payroll report, a description of the business, and the name of an attorney who will represent the self-insured.

The self-insured must file the necessary forms to provide evidence of insurance, and this can be

42 Pailacy, pp. 5-8.
43 Carver, p. 73.
difficult for a company to do. Certificates of self-insurance are often not accepted in contracts, especially if an out-of-state contractor is involved. There is a penalty for failure to insure employees.\footnote{Fallacy, pp. 2-3.}

Complexities in legislation, such as, ERISA and national health insurance legislation create additional problems for the self-insured. With self-insurance the benefit department of a company is not usually capable of handling all the complexities and changes in the area of healthcare. Services of an insurance company could really help with this problem.\footnote{Carver, p. 72.}

There is more stabilization with commercial insurance, and the cost is predictable each year. Premiums paid provide a regular tax deduction also. With self-insurance profits may be high one year and drop the next if losses are incurred.\footnote{Greene, p. 78.}

The insurance industry is highly specialized and requires much knowledge and expertise in the handling of risk. Corporations need the professionals of the insurance industry to help meet their insurance needs.
Another advantage in purchasing insurance is the fact that costs are distributed over a volume of risks, and losses are predicted more accurately. The self-insured has a lack of concentration in every city, but the national insurance company is familiar with local laws and has local contacts. 47

Insurance companies have retro plans with the same advantages as self-insurance. There are plans that provide a step-by-step way to change to self-insurance and still use the services the insurance company provides. A risk manager can negotiate on a cost-plus basis, and then he can establish a claims-paid retrospective plan which is reasonable. With negotiated overhead costs in the insurance program, the benefits and advantages of self-insurance may be lessened from what they originally appeared to be. 48

CONCLUSION

From the previous discussion it is evident that the advantages and disadvantages of self-insurance carry similar weight. Therefore, it seems that the final decision of whether to buy insurance or to

47 Fallacy, pp. 1, 5.
48 Shifrin, pp. 14, 75.
self-insure depends on a corporation's own particular situation and financial strength because not every firm has the ability to self-insure.

In most cases a firm will have a mixture of self-insurance and commercial insurance with the intention of obtaining optimal returns and reduce risk to a minimum. This mix should be evaluated often in order to discover whether savings are being obtained and corporate objectives being reached.49

There is a need for self-insurance in our present free-enterprise system, if the only reason is to make the insurance industry aware of its obligation to provide quality insurance products and services to its customers. If the insurance industry was as efficient as it could be, the need for self-insurance would be reduced.

However, it seems appropriate to quote the words of Robert L. Shifrin, CPCU, in closing.

I am not defending the inefficiencies and the inequities that the insurance industry has forced on the American public over the past few years. However, I do not believe that the insurance industry is any less honorable than any other majority industry in the United States. We have a long way to go to improve our position, but before the whole industry is condemned and everyone becomes convinced that self-insurance is the answer, careful evaluation must take place. I am not in favor of throwing over years of accumulated wisdom and proven service without being sure that what follows is a better answer.50

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49 Greene, P. 82.

50 Shifrin, p. 75.
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