



How to assess the suitability of self-funding workers compensation programs

Description

Workers' compensation ensures vital protection for employees facing job-related injuries or illnesses. While most employers rely on traditional insurance to manage these claims, many are now considering self-funding as a cost-effective alternative. This shift allows employers to assume direct financial responsibility but also introduces complex risks that require thorough assessment and strategic planning.

In this article, we aim to provide a comprehensive framework for assessing the suitability of self-funding workers' compensation programs.

Understand what self-funding workers' compensation involves

Self-funded workers' compensation is a model in which the employer assumes financial responsibility for employee injury claims. This includes directly covering medical expenses, rehabilitation, and lost wages. While it can offer greater control and potential cost savings, it also comes with higher financial risk. To succeed, employers need robust systems for claims management, legal compliance, and workplace safety.

Prescient National notes that there's a range of workers' compensation insurance products tailored to fit each employer's risk profile and appetite. However, many choose to work with third-party administrators (TPAs) to manage these responsibilities professionally.

To assess if self-funding is suitable, employers must examine applicable laws, evaluate risks, and review financial health. Those exploring this option and looking to [learn more](#) should understand the operational and compliance demands involved. Consulting experts and using industry-specific data ensures informed, strategic decision-making for long-term success.

Evaluate the financial strength of your business

A self-funded workers' compensation program requires strong financial stability. Your business must ensure sufficient cash flow and reserves to handle both routine and unexpected, high-cost claims. It includes catastrophic injuries that may lead to long-term disability or costly treatments.

Poor financial planning can lead to legal penalties, employee dissatisfaction, or even bankruptcy. Employers should factor in the cost of stop-loss insurance to guard against major losses. Managing claims internally or through a third-party administrator also adds administrative complexity.

When evaluating financial strength, it's important to consider how existing claims impact long-term costs. According to Aon, about 12% of a company's claim volume accounts for 88% of total expenses. These are often legacy open claims, and resolving them sooner can significantly improve the organization's financial outlook.

How should a company prepare its financial statements to support self-insurance approval?

To gain self-insurance approval, companies must provide audited financial statements showing strong liquidity and stable cash flow. Essential documents include balance sheets, income statements, and cash flow reports. These should reflect the company's capacity to manage claims and ensure financial stability.

Analyze claims history and risk profile

Understanding your company's past claims data and overall risk exposure is critical when evaluating self-funding for workers' compensation. A consistent pattern of low-frequency, low-severity claims may suggest your organization is a good candidate. Conversely, a history of costly or frequent incidents could make self-funding financially risky.

Investopedia reports that [high-severity claims](#) cost significantly more than average claims. In contrast, low-severity claims are generally less expensive than the average. These cost estimates are typically derived from historical claims data.

Analyzing trends in injury types, affected departments, and seasonal fluctuations helps forecast future liabilities and inform safety improvements. A comprehensive risk profile also includes assessing industry-specific hazards and workforce demographics.

How often should a company re-evaluate its risk profile when self-funded?

A self-funded company should re-evaluate its risk profile at least once a year. Quarterly reviews or assessments after major incidents are also advisable. These evaluations support safety improvements, financial readiness, and compliance with changing regulatory and operational requirements.

Consider administrative and compliance responsibilities

Self-funding workers' compensation demands more than just financial strength. It also requires a robust administrative setup to manage complex processes. This includes claim management, coordination with medical providers, oversight of return-to-work programs, and completion of regulatory filings, either internally or through a TPA.

According to the SPBA, [about 60%](#) of US workers with non-federal health benefits are covered by plans using the Third Party Administration (TPA). This trend reflects the growing reliance on TPAs for managing employee benefit programs. Many of these arrangements use the insurer's administrative services only (ASO) model to fulfill TPA functions.

Self-funded programs must comply with state-specific laws, meet reporting deadlines, and adhere to documentation standards. Failure to meet these requirements can lead to heavy penalties or loss of self-insured status. To avoid this, businesses must hire knowledgeable staff or partner with experienced compliance professionals.

Should businesses build an in-house claims team or outsource to a third-party administrator?

Businesses should weigh cost, expertise, and scale when deciding between an in-house claims team or a third-party administrator (TPA). While in-house teams offer control, TPAs bring specialized knowledge and regulatory experience. For most mid-sized companies, outsourcing to a TPA ensures efficiency, compliance, and reduced administrative burden.

Weigh the long-term cost benefits and risks

Self-funding workers' compensation offers long-term savings by eliminating premiums and supporting customized safety initiatives. However, it also introduces risks. These include unpredictable claim costs, administrative burdens, and the potential financial strain of severe or catastrophic workplace injuries.

Moreover, according to EBRI, self-insured health plans are exempt from complying with state health insurance laws. This includes avoiding state-mandated requirements for reserves, benefits, claims, and premiums. As a result, administration becomes simpler, and overall expenses can be reduced for employers.

Know when third-party insurance or hybrid models are better

Self-funding provides flexibility and cost-saving opportunities. However, it may not suit every business model. Organizations with high turnover, unstable cash flow, or limited claims experience may find traditional or hybrid insurance models more practical.

Hybrid models like large-deductible or partially self-funded plans blend aspects of self-insurance and traditional coverage. They provide cost control while maintaining a level of risk protection. This approach allows businesses to manage expenses without fully exposing themselves to large claims.

These options can help businesses transition toward full self-insurance over time or maintain coverage stability during uncertain periods.

Making better choices for your workers' compensation strategy

Evaluating the suitability of self-funding workers' compensation demands a comprehensive assessment of financial strength, risk profile, administrative capacity, and long-term cost-benefit analysis.

While offering potential advantages, it necessitates robust risk management and a thorough understanding of associated responsibilities. The decision ultimately hinges on a strategic alignment with an organization's unique circumstances and risk tolerance.

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