

PB 10-20

October 13, 2010

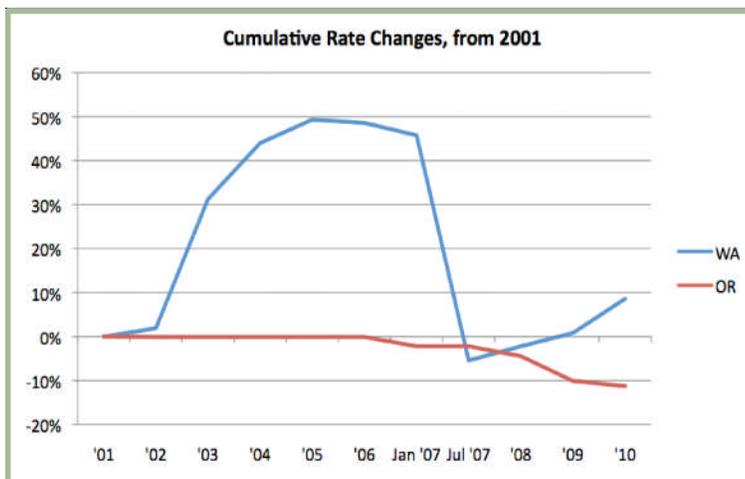
## INITIATIVE 1082: A CHOICE FOR INDUSTRIAL INSURANCE

### BRIEFLY

*Initiative 1082 would allow employers to choose private insurers for industrial insurance.*

Initiative 1082 would allow private insurance companies to offer workers' compensation coverage in a competitive market. Currently, employers must either self-insure (as do many large employers) or participate in the state fund administered by the Washington Department of Labor and Industries (L&I). Under the initiative, L&I would continue to administer a state fund, but employers would have private options, as they do in most states. Currently, Washington is one of four monopoly states.

Initiative proponents argue that competitive markets maximize efficiencies and give employers choices in obtaining coverage. They also say that private sector insurers have been able to promote better rehabilitation outcomes for injured workers while reducing employer costs.



L&I's record justifies the concerns that led to the initiative. According to a 2010 study by the National Academy of Social Insurance, in 2008, Washington paid the nation's second-highest workers' compensation benefits per covered worker, behind only West Virginia. (West Virginia also prohibited private industrial insurers until 2008, when it opened the market and the state fund stopped providing industrial insurance. In 2008, its state fund was still paying benefits for old claims.) Washington's benefits per covered worker increased 11 percent over 2007, while its total workers' compensation benefits paid increased 9.9 percent over 2007. Washington ranks third in the nation in benefits paid as a percent of covered wages.

L&I's annual rate changes vary considerably, but—excepting rate holidays—their cumulative impact trends up (compare this to Oregon, which has steadily decreased its rates). The rate increases have been understated by the agency's decision to charge less than the actuarially-recommended premium rates. Even with consistently escalating premium rates, the workers' compensation program is in danger of insolvency, foreshadowing even greater rate hikes in the future, according to a December 2009 audit.

### What I-1082 Does

The initiative permits private insurers to sell into the state workers' compensation market. Getting insurance from the state would remain an option for employers. When private firms enter the market, they would have to abide by the same laws and regulations that the state does. As the Office of Financial Management (OFM) notes, "Private insurers will be subject to the regulatory requirements of Title 48 RCW involving admission, financial, solvency and market analysis oversight." Further, according to OFM, "Private insurers will be subject to the unfair claims practices rules and statutes."

I-1082 would also require employers (including the state) to pay for the full amount of their employees' Medical Aid premiums. Currently, employers may deduct one-half of these premiums from their employees' pay, something no other state allows. (In 2009, employees contributed 27 percent of the total premium burden.) Additionally, the initiative would change the convention used to quote prices for insurance products from one based on hours worked to one based on total payroll. The benefit of this is comparability of Washington's price data with other states.

The insurance commissioner would regulate private insurers offering industrial insurance. The commissioner would be responsible for issuing certificates of authority to be industrial insurance insurers and for approving "a manual of classifications and rules, rating plans, policy forms and provisions, and a statistical plan which will provide data adequate for rate making."

Other provisions of the initiative address rates and the ability to pay dividends.

I-1082 creates an industrial insurance administrative fund to provide for the payment of expenses of the board of industrial insurance appeals and the insurance commissioner. Industrial insurance insurers would pay periodic assessments to cover administrative costs. Also, a joint legislative task force on private competition for industrial insurance is established to develop and propose legislation to conform current statutes to this initiative by Dec. 1, 2011.

The market would be open to private insurers effective July 1, 2012. Other provisions of the initiative, including the requirement that employers pay the full cost of employee premiums, are effective Dec. 2, 2010.

### **Fiscal Impacts**

OFM estimates that I-1082 would have a number of fiscal impacts on the state. First, it would reduce the industrial insurance premiums paid into the state's Industrial Insurance Trust Funds by \$821 million to \$1 billion in CY2013 and by \$1.1 billion to \$1.43 billion in CY2014. Currently, "employers pay premiums for no-fault industrial insurance coverage for their employees", and those premiums go to the trust funds. If I-1082 is approved, some employers would switch from using the state as their industrial insurance provider to using private industrial insurers. That switch would reduce the premiums paid to the state trust funds. Because OFM cannot know how many employers will switch, they provided a range of possible revenue effects. The trust funds would be left with \$619 million to \$805 million in CY2013 and \$828 million to \$1.37 billion in CY2014. State claims costs would decrease, corresponding to the reduction of premiums paid to the trust fund.

Additionally, state revenue is estimated to increase \$61 million to \$75 million over five years, while costs are estimated to increase \$179 million for the state and \$47.25 million for local governments over five years.

- State and local governments would have to pay the full cost of their employees' Medical Aid premium (currently, the state deducts one-half from employees' pay, and OFM assumes local governments do as well). OFM estimates that these costs would total \$99 million for the state and \$47.25 million for local governments over five years. (When employees are relieved of these premium costs, the state would be able to recoup some of its costs as it increases the share of healthcare premiums employees pay.)
- The Office of the Insurance Commissioner (OIC) will bear costs for regulation of private industrial insurance insurers. OFM estimates that

these costs over five years would total \$12.7 million. I-1082 would require private industrial insurance insurers to pay an assessment to cover OIC's administrative costs. The OIC estimates that the revenues for this purpose would total \$9.9 million over three fiscal years. Additionally, the initiative would require private industrial insurance providers to be licensed by the OIC, which estimates that revenues from "state license fees will be less than \$11,000 in FY 2013 and \$8,250 each fiscal year thereafter." Over the years 2011-2015, total state revenue from these fees is estimated at \$27,500.

- Taxes on insurers would include the insurance premium tax and the business and occupation (B&O) tax. OFM estimates that the range of increased state revenues these taxes could generate would total \$51 million to \$65 million for 2013–2015. The Department of Revenue would incur costs in administering the B&O taxes totaling \$150,000 through 2015.
- Costs borne by L&I would include information technology changes, rulemaking, actuarial analysis, policy issuance, accounting systems, and fraud detection. L&I would also incur costs for the Employment Standards Program and Apprenticeship Program and for collection of fees for the state's occupational safety and health program and the University of Washington's environmental research facility. OFM estimates these costs would total \$38 million over five years.
- The Joint Legislative Task Force, created by I-1082 to conform current statutes to the initiative, would increase costs for L&I, if L&I provides "actuarial, policy and technical assistance to the task force." State costs from L&I's assistance would be \$1.2 million total.
- The Board of Industrial Insurance Appeals Administration would hear appeals of employees and employers covered by private industrial insurers. The increased case load would increase costs by \$28.4 million through 2015.

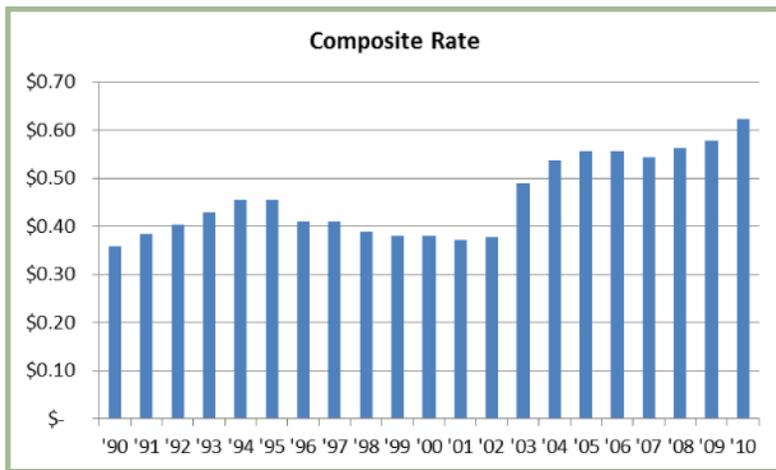
### Contingency Reserves and Rates

In December 2009, the state auditor released an audit of the state workers' compensation program, which includes the Medical Aid Fund, the Accident Fund, and the Pension Reserve Fund. The Auditor found that during fiscal year 2009, "the contingency reserves for both the Accident Fund and Medical Aid Fund declined substantially." The declines were due to a drop in market value, loss and loss adjustment expense liabilities, and the fact that in 2008 and 2009 "premium rates were insufficient to fund the system." In fact, the state fund's contingency reserves declined by \$1.1 billion in fiscal year 2009.

As of September 23, 2010, there is an extremely low balance in the overall contingency reserve of \$182 million (by comparison, at the end of June 2009, the balance was \$550 million, which was still unsustainably low). Worse, the Accident Fund contingency reserve is *negative* \$360 million.

L&I raised rates for the Accident Fund by 4.5 percent in 2010 and for the Medical Aid Fund by 8.4 percent. Given those rates, an independent actuarial firm estimated that the Accident Fund faces a 74.4 percent chance of insolven-

cy within two years, an 81.4 percent chance within three years, and an 89.5 percent chance within five years. For the Medical Aid Fund, the firm estimated a 3.9 percent chance of insolvency in two years, a 12.9 percent chance within three years, and a 26.5 percent chance within five years. Additionally, the firm estimated that in order for the Accident Fund to break even, it would need a 33 percent rate increase (L&I's estimate was 23.3 percent). In order for the Medical Aid Fund to break even, the firm estimated it would need a 24.5 percent rate increase (L&I's estimate was 21.5 percent).



Still, workers' compensation premium rates are rising. (The chart on the left shows the composite rates over the years, in dollars per hour, which is Washington's unique convention. Other states quote rates as a percent of payroll, which is how the rate changes in the chart on page 1 are calculated, in order to compare to Oregon.) In 2010, the 7.6 percent average rate increase will bring in an additional \$117 million. L&I has decided not to propose 2011 rates until after November's election—an announcement they normally make in September. L&I argues that it makes more sense to start the process after seeing whether I-1082 passes, since the initiative would change the rate calculation. The agency's

unfortunate decision to delay deprives voters of information relevant to their assessment of I-1082.

**Discussion**

As we discussed in January, one aspect of Washington's workers' compensation system that is particularly expensive is the practice of providing pensions to workers with permanent disabilities. L&I awarded 1542 pensions in fiscal year 2009, compared with 13 pensions awarded by Oregon in calendar year 2009. Numbers like these provide additional reasons to give L&I competition.

Other states have opened their industrial insurance markets to private companies in recent years, with promising results. For example, as noted above, West Virginia enacted legislation in 2005 that allowed private insurers to sell industrial insurance and also privatized the state workers' compensation system (a transition period ended in 2008). So far, premiums have gone down 30.3 percent (that figure will be 43.7 percent as of November 1, 2010), and the unfunded liability on the old state fund claims has been reduced from \$3.1 billion to \$1.5 billion.

I-1082 would give employers a choice of industrial insurance providers who would necessarily compete amongst themselves and with the state to provide the best rates, in the most efficient way. Most other states allow this competition and employers are well-served by it. It's time for Washington to join the mainstream.

---

## References

- Department of Labor and Industries. 2009. Ten Year Summary of Financial Information. <http://www.lni.wa.gov/ClaimsIns/Files/StateFundFinancial/TenYearSummaryFinInfo.pdf>
- Gipson, Carl. 2010. Citizen's Guide to Initiative 1082, Washington Policy Center. <http://www.washingtonpolicy.org/sites/default/files/Initiative-1082.pdf>
- National Academy of Social Insurance. 2010. Workers' Compensation: Benefits, Coverage, and Costs, 2008. September.
- Office of Financial Management. Fiscal Impact for Initiative 1082. <http://www.ofm.wa.gov/initiatives/2010/1082.pdf>
- Schurke, Judy. 2010. Joint Work Session: Senate Labor, Commerce, and Consumer Protection Committee and House Commerce and Labor Committee. September 23.
- Washington Research Council. 2010. Mainstreaming Workers' Compensation: Reforms for 2010. PB09-03. <http://www.researchcouncil.org/docs/PDF/WRCBusinessClimate/MainstreamingWorkersComp2010.pdf>
- Washington State Auditor's Office. 2009. Workers' Compensation Program Audit. Report No. 1002832. <http://www.sao.wa.gov/auditreports/auditreportfiles/ar1002832.pdf>
-