STATE AGENCY POLICY OPTIONS

A Report Prepared for the

Montana State Fund Subcommittee

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INTRODUCTION

The Montana State Fund/Workers' Compensation Insurance Subcommittee requested information on the policy implications and potential cost savings of changing the method used to select workers' compensation insurance policies for state agencies. The purpose of this report is to outline the various legislative options and their potential impacts. A number of terms specific to workers' compensation insurance premiums are used throughout this document. Appendix A provides definitions for a number of these terms.

Currently, statute allows businesses in Montana three plan options for obtaining workers' compensation insurance:

- Compensation Plan Number One – an employer is permitted to settle directly with employees as they become entitled to receive workers' compensation insurance benefits provided the self-insurance plan has been determined to be solvent and financially able to pay compensation and benefits by the Department of Labor and Industry and the Montana self-insurers guaranty fund.
- Compensation Plan Number Two – an employer can elect to insure employers' liability for workers' compensation and occupational disease with any insurance company authorized to transact business in Montana.
- Compensation Plan Number Three – an employer can elect to insure their liability for workers' compensation and occupational disease coverage with the Montana State Fund (MSF).

MSF Provides a Guaranteed Market for Workers' Compensation Insurance

MSF's role as the guaranteed market assures all Montana employers can provide workers' compensation insurance to their employees. While the 1989 Legislature decided to separate the workers' compensation function from the Department of Labor and Industry and created the State Compensation Insurance Fund, they left in place the requirement that state agencies must obtain workers' compensation insurance through the MSF. Part of the rational for this was that because MSF is required to accept those businesses with high risk of incurring workers' compensation claim costs they should also have a guaranteed market of businesses with a lower risk of incurring costs to somewhat balance the financial risks to MSF.

In FY 1991 MSF had 85 percent of the workers' compensation market which included the state agencies, and the Montana University System (MUS). In FY 2008, MSF had 69 percent of the workers' compensation market with state agencies comprising approximately 7.7 percent of earned premium revenues.

POLICY OPTIONS FOR LEGISLATIVE CONSIDERATION

The policy decisions for the legislature in relation to state agency workers' compensation insurance policies and the associated costs are:

- Should MSF continue to have a guaranteed market of the state agency workers' compensation insurance policies or should the State of Montana be allowed the ability to obtain its workers' compensation insurance through any of the three compensation plans?
- If the policy decision is for MSF to continue to have a guaranteed market of state agencies policies, should the state agencies continue to obtain policies from MSF separately or should the State of Montana be considered a single employer or some combination?

ELIMINATING THE REQUIREMENT STATE AGENCIES USE MSF

The 2003 Legislature passed Senate Bill 304, a bill directing a committee to study the role of the State Compensation Insurance Fund. Included within the recommendations of the study committee was the determination that MSF is not entitled to have state agencies as an exclusive book of business, and that state agency business be available for self-insurance or to private carriers in four years. This was not included as part of legislation considered by the 2005 Legislature.

Eliminating this requirement would allow state agencies to "shop" for lower premiums. Competition between the MSF and the private insurance companies may result in cost savings to Montana similar to cost savings which theoretically occur through the Request for Proposal process used to procure other services for state agencies. Areas where savings MAY be available include:

- Lower manual and standard rates associated with experience modification factors as private insurance companies do not use tier ratings to establish the manual premium rate. It should be noted that private insurance companies do have multiple companies with varying experience modification factors which somewhat mimic the tier rating used by MSF
- Different analysis of the percentage of the scheduled rate modifier factor that should be applied to the premiums as this determination is considered somewhat subjective on the part of the underwriter. Private insurers have the latitude to increase or decrease the premiums by plus or minus 40 percent through the scheduled rate modifier. Any amount beyond the 40 percent must be approved by the State Auditor's Office. MSF ranges for scheduled rate modifiers vary between -100 and 220 percent. According to MSF officials, they are allowed a greater flexibility with pricing using the scheduled rate modifier because they can not decline business
- Higher volume discounts for the high dollar premiums paid by the State of Montana may be available through private insurers

However, one major legislative consideration is that state agencies with lower experience modification factors and associated lower risks to the insurance company may be able to obtain workers' compensation insurance at a lower cost than that provided by MSF, while agencies with higher experience rating factors may not have the same options available to them. This allows private insurance companies to "cherry pick" state agency business while requiring MSF to insure those state agencies that have a higher risk of incurring claims costs as exhibited by their experience rating factors. This may result in cost increases to businesses insuring through MSF, including those state agencies with higher risks.

Insuring through a private insurer would require the State of Montana to issue an RFP for workers' compensation insurance coverage. Assurances related to the ability of the private insurer to provide the necessary coverage and customer service for claims would need to be included as part of the contract. Another consideration would be that the class codes used by MSF for state agencies were developed by MSF. A conversion from the MSF class codes to NCCI class codes would need to occur and could potential pose some challenges. Private insurers currently working with other states have expressed an interest in working with Montana should the legislature decide to change the policy options available to state agencies.

If the legislature wishes to consider eliminating the requirement that state agencies use MSF to obtain their workers' compensation insurance, they may wish to include one of the following requirements:

- If a single private insurance company is to provide workers' compensation insurance to state agencies it must insure all state agencies
- The State of Montana be considered as a single employer for purposes of obtaining workers' compensation insurance

SELF INSURING THE STATE OF MONTANA

Another option for consideration of the legislature may be for the state of Montana to self-insure for their workers' compensation insurance.

The 1999 Legislature eliminated the Montana University System (MUS) from the requirement that state agencies obtain workers' compensation insurance through MSF. From FY 2000 through FY 2003 MUS utilized both the Montana State Fund and a private insurance company to insure for workers' compensation insurance. In March 2003, the Board of Regents authorized MUS to proceed with the establishment of a self-funded workers' compensation program for the units of the MUS and agencies. The MUS used revenue bond financing to establish the initial reserves for the self-funded program.

An employer must be determined to be solvent and financially able to pay compensation and benefits by the Department of Labor and Industry and the Montana self-insurers guaranty fund before they can offer self-insurance for workers' compensation claims and benefits. Part of demonstrating financial solvency is the ability to set aside sufficient reserves to pay the costs of providing for workers' compensation benefits and claims.

The legislature should consider if it is either cost effective or efficient to have both the MSF and state agencies providing workers' compensation insurance. Under this scenario both entities would incur costs associated with providing services for injured workers, issuing benefits, managing and investing the funds for loss reserves and any equity and determining the actuarial soundness of the loss reserves and the strength of the surplus. Other factors in having the State of Montana self insure for workers' compensation insurance include:

- Increasing the state's management of its workers' compensation program
- Ensuring consistent application of state policies in relation to workers' compensation benefits and services to injured workers
- Adding additional responsibilities to the Department of Administration for management of another self-insurance program
- Future financial risk associated with self-insuring while developing loss reserves and equity for the program

Results for the MUS

The 1999 Legislature allowed MUS the ability to obtain its workers' compensation insurance through any of the three compensation plans, including developing a self-insurance program. It should be noted that MUS is structured differently from the state as a whole. A significant potion of the workforce operates for as instructors in the university system. However, non instructing staff outnumber the instructing staff at several institutions. Non instructional staff include those in various trades, county extension agents, police, radiation safety officers, livestock handling, and field researchers. State agencies have other varied occupations, which could influence final results if changes are made to workers' compensation plan coverage. Figure 1 shows a comparison of workers' compensation insurance between FY 2000 and FY 2007 between state agencies and MUS.

Figure 1
Comparision of % Increase from 2000 to 2007
Between State Agencies and OCHE/MUS

	FY 2000	FY 2007	% Increase
State Agencies	$5,885,936	$17,342,522	194.64%
OCHE/MUS	$1,813,046	$4,432,203	144.46%

As shown in Figure 1 increases have been less for MUS than for state agencies for the period since MUS was granted the flexibility to choose between compensation plans. It would appear there may be cost benefits to allowing state agencies flexibility in choosing compensation plans for workers' compensation insurance. However, the class codes used by state agencies are not the same as those used by OCHE/MUS and other factors may also be part of the difference such as wage growth.

OCHE staff completed a comparison between costs for standard premiums under its self-insurance plan as compared to Tier 3 published by MSF for the same class codes. These are presented in Figure 2 below.

Figure 2
Comparision between MUS and MSF
Standard Premium Costs
FY 2004 through FY 2009

Fiscal Year	MSF	MUS	Difference
2004	$3,600,604	$2,099,991	($1,500,613)
2005	4,142,361	3,011,257	(1,131,104)
2006	5,003,256	3,539,486	(1,463,770)
2007	5,408,310	4,042,140	(1,366,170)
2008	6,658,512	4,656,215	(2,002,297)
2009	$7,357,073	$5,075,243	($2,281,830)

Figure 2 shows significant savings between the standard premium for MUS under the self-insurance plan. However, while the amount of the standard premium is the final amount assessed the entities insured through the MUS plan, MSF has additional components to its premium assessment including scheduled rating factors and premium volume discounts which could lower or raise the final premium assessment charged for MUS workers' compensation insurance.

When asked if MUS sees other benefits to the self-insurance program staff listed the following:

1. The bonds used to pay for loss reserves in the first few years of the program have been paid in as scheduled. Paying off the bonds eliminated a fixed $436,000 annual expense which should result in a positive impact on premium needs.
2. Loss control policies implemented by the Board of Regents when the self-insurance program was put into place have reduced policy costs due to return-to-work requirements, workplace safety requirements, and vehicle operation safety requirements
3. The change resulted in decreased frequency rate. MUS frequency rate has decreased in the past 3 years and is lower in FY 2006, FY 2007, and FY 2008 than it was prior to self funding.
4. A recent audit of 3 years of claim files managed by the current TPA measured over 40 specific objective and subjective performance components and resulted in a performance satisfaction level of 98 percent.
5. MUS partnered with the same claims TPA and worked with the same claim adjustor and claims assistant for the past 5 years. While some cost development is expected to occur over time, the claim adjustor has been very consistent in establishing pro-active handling of claims, setting accurate reserves, and managing claim costs.
    a. MUS has 30 open claims for FY2004-2007; 28 claims remain open with MSF for FY 1999-2000, FY2002-2003. The time taken to resolve and move claims towards appropriate closure has decreased significantly since self-funding
    b. Loss runs provided to MUS by MSF show claim reserves of approximately $1.8 million on the 28 claims that remain open with MSF (FY2003, 2002, 2000, 1999). Claim reserves are approximately $190,053 on the 30 open MUS claims in the self insured years. (FY2007, 2006, 2005, 2004). A review of claims management practices, re-open rates, and reserve histories indicate consistently accurate claim reserving for MUS
    c. The average cost of an MUS claim for FY2004 through FY2007 is $2,583. The average cost of a claim with MSF (FY2003, 2002, 2000, 1999) is $4,324. The average cost of a claim with ICW (FY2001) is $4,228. The comparison must be reviewed with the understanding that both the MSF and ICW claims have had more time to develop, some further development in MUS claim costs is expected. However, with the improved claim closure rate and claim reserves highlighted above, the average claim cost should remain well controlled.
6. Anecdotal feedback from injured workers regarding customer service provided by the claims adjustor for MUS has been primarily positive with employees reporting that calls are returned promptly, communications are clear and timely, treatment is fair and timely, and access to medical is fair and timely.

While MUS program staff credit a part of their success to the claims administrator, they believe other systematic improvements are fundamental to the short and long term success of the self-funded program. Other improvements include:

- Unifying loss control efforts across all campuses using system-wide policies and sharing safety and risk management expertise and resources
- Capitalizing on shared goals of safe and health employees and better dissemination of workplace safety and injury prevention information to employees and supervisors
- Increased understanding of the importance of injury prevention and cost control
- Consistent and transparent premium rate setting process
- Determination of when and how to allocate any excess equity generated through interest on invested premiums

The above information is based on the work of MUS program managers. MSF has reviewed the information contained in the report. However, it would require additional time for them to review the methodologies used and compare the information they maintain on their system with the information developed by MUS before they are able to comment.

STATE OF MONTANA AS A SINGLE EMPLOYER

If the policy option is to continue to provide MSF a guaranteed market of the state agency workers' compensation insurance policies, one potential for cost savings to Montana taxpayers could include changing the methodology for the number of policies currently used to provide workers' compensation insurance to the State of Montana. 39-71-403, MCA requires state agencies to use MSF as their insurer for workers' compensation insurance. As the statute refers to state agencies and not the state of Montana, each state agency obtains workers' compensation insurance and is separately rated as to their experience and management of workers' compensation risks.

Changes to the Experience Modification Factor Using a Single Policy

MSF assesses premium costs for policies based on the experience modification factor of each state agency and the related premium rating tier. In FY 2008, the range for state agencies experience modification factor was between .82 and 1.56. According to MSF, by definition, the states experience modification factor as a single entity would be 1.0 due to the fact that state agencies use their own class codes as provided by MSF. If insured by a private insurer and using class codes used by other employers a single entity state agency experience modification factor could vary from 1.0. NCCI has calculated the experience modification factor for the State of Montana as a single employer and determined that in FY 2008 the experience rate modifier would have been 0.97. This places the policy into rating tier 3 for purposes of determining the manual premium for the policy. The experience modification factors for tier 3 range from 0.95 to 1.24.

State agency standard premium was $17.7 million. Using the FY 2008 payroll, the standard premium would be $17.4 million under the single policy, a reduction of $305,273.

Single Policy Requires New Scheduled Rate Modifier

Scheduled rate modifiers are applied to the standard premium as part of the assessment process. According to MSF officials, they are used to take into account factors which may not show up in the experience modifier. The factors used to establish the percentage include management cooperation, safety organization, and other factors. In FY 2008 premium assessment calculation the scheduled rate modifiers for state agencies ranged from 0.90 to 1.52 percent.

The 2007 Legislature approved $0.7 million for workers' compensation cost containment, providing a centralized oversight function for safety, loss-prevention, return-to-work programs, financial accountability, and oversight of expenditures within the Health Care Benefits Division of the Department of Administration. As the State of Montana as a single employer would be a new entity with centralized management related to workers' compensation insurance up and running an argument could be made for the scheduled rate modifier to be established at 1.00, which would not increase or decrease the standard premium for the State of Montana as a single employer. MSF used 1.00 as a scheduled rate modifier for the Office of the Public Defender, a new state agency. Using this methodology the premium assessment for FY 2008 would be the same as the calculated standard premium discussed above.

However, this would need to be determined by MSF after reviewing the various factors as a single policy. MSF officials state they would need to examine the various factors which go into the scheduled rate modifier before they could determine what the modifier would be under a single policy. As state above, MSF scheduled rate modifier can vary from -100 percent to 220 percent. It is possible that any savings resulting from using one experience modification factor for all state agencies would be eliminated by a higher scheduled rate modifier employed by MSF.

Volume Discounts Increase Cost Savings Under a Single Policy

Volume discounts are then applied to determine the final premium assessment amount. Using a single policy for the State of Montana would potentially maximize these volume discounts. Using the FY 2008 premium assessments calculation, the state would have saved an additional $230,000 in premium costs as a single employer. The actual amount would vary based on the actual experience modification factor and scheduled rating modification factor used for the policy.

The MSF also offers various programs which could further reduce the premium costs for State of Montana. They include but are not limited to:

- Retrospective rating
- Premium retention

Potential Drawbacks

According to MSF officials, one potential drawback to having all state employees covered under a single policy would be the potential loss of the price signal which reflects how a single agency is doing. Under MSF current pricing practices for state agencies, all state agency experience modification factors balance to 1.0. Those state agencies with higher injury rates and less focus on safety have higher experience modification factors compared to other state agencies. Under a single policy the experience the largest state agencies, Department of Transportation and Departments of Public Health and Human Services, would drive the experience modification factor for the state.

Also, according to MSF officials, payment of dividends would be reduced under a single policy. Under MSF rules, general dividends are allowed on each policy covered under a group retention policy. Under a single policy the retention program premium is returned but the policy is not eligible for a general dividend. MSF determined that from FY 1999 to FY 2007 the state received $2.9 million in dividends. If a single policy had been used the state would have received $2.0 million in dividends, a reduction of $0.9 million.

MSF officials did state, however, that if state agencies have high performance with improved safety and decreased losses due to accidents the state would be better under a single policy.

FUNDING WORKERS' COMPENSATION INSURANCE PREMIUMS FOR THE STATE AS A SINGLE EMPLOYER

Currently each state agency is funded for workers' compensation insurance premiums as a part of personal services. Changing to a single workers' compensation policy creates some budgetary considerations for the legislature as the change to a single policy would result in increases in costs to some agencies and decreases to others, with likely statewide cost reductions overall. One consideration may be to centralize state agency premium payments within the Health Care Benefits Division of the Department of Administration (D of A), which is responsible for financial accountability and oversight of the state's expenditures for workers' compensation insurance.

Figure 3 presents the funding sources used in FY 2008 by the various state agencies for premium costs.

Figure 3
Workers' Compensation Insurance Costs
By Fund

FY 2008	
General Fund	$7,937,208
State Special Revenue	6,909,706
Federal Special Revenue	1,669,545
Debt Service	6,555
Enterprise Revenue	571,250
Internal Service Revenue	872,100
State Special Revenues - Nonbudgeted	31,729
Pension Trust Funds	$24,567
Total Workers' Compensation Insurance	$18,022,660

Appropriating funding for workers' compensation insurance premiums in the D of A budget allows for greater oversight of the expenditures and should increase financial accountability. In order to assess these costs to the various funding sources in a cost effective manner, an indirect cost recovery model for workers' compensation would need to be developed.

Given the costs savings realized by MUS since the legislature granted them flexibility to determine which compensation plan they would use for workers' compensation insurance and the additional benefits which may be realized since the legislature authorized oversight of the workers' compensation insurance to the Healthcare Benefits Division of the Department of Administration, the legislature may wish to consider legislation to:

- Allow the Healthcare Benefits Division the flexibility to determine the policy structure for the State of Montana
- Allow the State of Montana the ability to obtain its workers' compensation insurance through any of the three compensation plans

D of A has requested a bill for consideration by the legislature allowing flexibility to determine the policy structure for the State of Montana.

APPENDIX A

TERMS SPECIFIC TO WORKERS' COMPENSATION INSURANCE PREMIUMS

Loss Costs - the cost of providing indemnity and medical benefits to the injured worker and the costs to administer their claims. Loss costs do not include administrative costs, production costs, taxes, licenses, fee or profit and contingency factors. Those are included in the individual carriers' loss costs multiplier.

Class Codes – job classifications for specific businesses based on the same or similar exposure to risks, used to determine loss costs.

Experience Modification Factors - a factor used as a predictor of future losses, based on the individual employers' loss history in comparison to the same types of employers in the state. The experience modification factor is expressed in relation to 1.00. 1.00 represents the state average losses for that type of employer. More accidents and claims result in a higher experience modification factor, little or no accidents are reflected in a lower experience modification factor which results in lower premiums. The National Counsel on Consumer Insurance (NCCI) determines the experience modification factors for Montana businesses with annual premiums in excess of $2,500.

Loss cost Multiplier – an insurance carrier calculation of how much, as a percentage of loss costs they need, to provide coverage in the state, including their costs of doing business, providing customer service and profit. The loss cost multiplier (LCM) modifies the loss cost for each class code, to develop manual rates, the starting point for premium calculation of individual employers. For example, an LCM of 1.21 , means the rates for that insurance carrier is 121 percent of loss costs.

Rating Tiers – MSF uses tiers to determine the loss cost multipliers for rates. Overall MSF uses 5 different rating tiers to determine the manual rate it will assess Montana employers. Tier 1 is used for the lowest risk employers and tier 5 is for the highest risk employers. MSF uses NCCI experience modifiers to place employers into various rating tiers. In contract, private carriers license individual subsidiaries with different rate levels.

Manual Premium – MSF's manual premium is determined for employers based on NCCI loss costs per $100 of payroll for each specific classification code and the loss cost multiplier for the carrier selected (MSF uses one of the five rating tiers). As discussed above, the tier rating or individual company selection, determines the loss cost multiplier applied to the loss costs. While the loss costs per $100 of payroll are the same for each rating tier or licensed company; the loss cost multiplier increases or decreases the loss costs to reach the manual premium

Standard Premium - Once the manual premium has been established, the carrier applies the experience modification factor to the manual premium. The manual premium with the experience modification factor applied is referred to as the standard premium. The experience modifier increases or decreases the premium costs depending on the workers' compensation experience of the employer over the last 3 years, not including the most recent policy period

Scheduled Rate Modifier - The scheduled rate modifier is used to take into account factors which may not show up in the experience modifier. According to MSF, the following general criteria are used to determine the amount of the scheduled rate modifier. The total percentage variation to the loss cost multiplier is also shown.

- Premises – 20 percent
- Medical Facilities – 15 percent
- Safety Devices – 30 percent
- Employee Selection/Training – 30 percent
- Management Cooperation – 20 percent
- Safety Organization – 30 percent
- Other Categories – 75 percent

If MSF applied all of the criteria outlined above, the premium amount could increase 220 percent or decrease 100 percent. Part of the reason the MSF schedule rating factors are as large as they are is because MSF is required to provide coverage to any employer, including those with the worst safety records.

Volume Discounts - MSF provides for a 5 percent volume discount for premiums between $12,000 to $150,000, a 7 percent discount for premiums of $150,001 to $750,000, and 90 percent for premiums above $750,000. Private carrier premium discount programs are similar, and filed with the State Auditor’s Office. .

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