

**STATE OF CALIFORNIA  
DEPARTMENT OF INSURANCE**

**In the Matter of:** Proposed adoption or amendment of the Insurance Commissioner's regulations pertaining to the Workers' Compensation Insurance Claims Cost Benchmark and pure premium rates, California Workers' Compensation Uniform Statistical Reporting Plan—1995, Miscellaneous Regulations for the Recording and Reporting of Data, and the California Workers' Compensation Experience Rating Plan—1995. These regulations shall be effective on **January 1, 2013**, unless another effective date is specified.

**FILE NUMBER REG-2012-00016**

**DECISION AND ORDER**

The passage of Senate Bill 863 has resulted in two major achievements for California's workers' compensation system: a needed increase of benefits to permanently injured workers and cost savings. I applaud the hard work of stakeholders, which included Labor and employers, in fashioning these reforms, and the Legislature in passing SB 863, and the Governor and his staff in supporting these reforms. I must now determine, with the assistance of my staff, the cost impact of this reform and how it may affect workers' compensation insurance for California's employers through the pure premium rate process.

The purpose of the pure premium rate process is to review the costs in the workers' compensation insurance system and to determine a set of advisory pure premium rates that are reasonably predictive of those costs over the next year. The Department of Insurance does not set workers' compensation insurance rates, but this review is intended to confirm that rates filed by insurance companies are adequate to cover benefits for injured workers and to provide for reasonable claims adjustment expenses. "Pure Premium" is often misunderstood by the general public and by employers who are required to have workers compensation insurance. The "pure premium rate" is the rate needed to cover the cost of benefits and loss adjustment expenses for future claims. The pure premium is expressed as the average cost per \$100 of employer payroll, also known as the Advisory Claims Cost Benchmark.

It needs to be emphasized once again that workers compensation insurers are free to set their rates wherever they choose, with one of only a few exceptions -- those rates have to be sufficient to make sure the companies remain solvent, and I am required to monitor the solvency of those insurers. It was not too long ago that over 30 workers compensation companies became insolvent with terrible consequences for businesses purchasing workers compensation insurance. Prices shot up. Insurers that were not insolvent exited the market. Employers had a hard time finding or affording workers compensation insurance. We must accurately evaluate pure premium rates based on the best actuarial information to avoid what happened before.

## **The Approved Advisory Claims Cost Benchmark and Pure Premium Rates**

The WCIRB is directed to adopt an Advisory Claims Cost Benchmark at \$2.56 per \$100 of employer payroll, and pure premium rates for individual classifications shall be adjusted in accordance with the adjustment of the Benchmark noted in the Proposed Decision in this matter. This reflects a 2.8% change from the average filed pure premium rate of \$2.49 as of November 9, 2012.

I find after reviewing all of the facts presented in the rate filing and at the advisory hearing held on November 16 that CDI actuaries and the WCIRB's actuarial analysis are closer to their mark than the overly optimistic recommendation of the WCIRB Governing Committee. This is a situation where the math does matter. The Department actuaries considered the facts carefully and concluded the WCIRB's Governing Committee decision to reject its own Actuarial Committee's recommendation was not sound and was based on unsupported speculation of savings that might eventually come from SB 863 reforms. Speculation is a dangerous game in the insurance business as demonstrated by the insolvencies that occurred in the 1990s.

The actuarial analysis of the WCIRB, which is similar to the Department's except for the use of State Compensation Insurance Funds unusually high loss adjustment expense numbers, calculates increased costs for the additional permanent disability benefits but greater savings for system reforms that result in a net decrease in system-wide costs of \$1.5 billion. The recommendation of the WCIRB Governing Committee assumes \$3.1 billion in savings without providing any evidence for the additional \$1.6 billion of savings. In addition, the use of the actuarial low range of loss development by the Public Members' actuary to support the Public Members' viewpoint of excessive cost savings and the failure to recommend an adequately supported pure premium rate level was unreasonable based upon the evidence.

Today, companies are paying out 116% more in claims than they are collecting in premium. It's a recipe for history to repeat itself—and we know better. The actuarial science is clear on this matter, and while I don't have the authority to set the rates, I will advise insurers to use pure premium rates that are sufficient to ensure they are able to pay claims.

The WCIRB Governing Committee recommended a pure premium rate of \$2.38 per \$100 of employer payroll based upon filings made by insurers as of July 1, 2012. However, by the time the hearing was conducted, the average filed pure premium rate was already \$2.49 per \$100 of employer payroll. This fact further highlights the fact that the WCIRB Governing Committee relied on significantly outdated information in reaching its recommendation, and, at the very least, should have updated its recommendation to reflect the current average filed pure premium rate level at the time of its decision.

Finally, the WCIRB Governing Committee should base its recommendation on actuarially supported numbers and careful consideration of the evidence before it, rather than speculating. The WCIRB Actuarial Committee provided a detailed evaluation and analysis of loss data and potential SB 863 reform savings. Nevertheless, in less than an hour of discussion, the Governing Committee ignored its own actuary's analysis. Obviously, some judgment needs to be exercised when dealing with major changes to this insurance system, particularly when those changes are untested. It is also understood that some portions of that analysis maybe subject to a range of

outcomes. However, in this case the Governing Committee seemingly arrived at its pure premium recommendation after discarding the primary analysis. The Committee backed into its conclusion without sufficient evaluation. In my view this is not an appropriate way to handle this process. In the future, I will expect the WCIRB Governing Committee to provide a sufficient and reasonable basis for its recommendation with proper actuarial support.

### **The Workers' Compensation Reforms of SB 863**

Much of the SB 863 reforms will depend upon regulations implemented by the Division of Workers' Compensation and the outcome of challenges to the reforms. Our focus should be upon improving the system to promptly deliver adequate benefits to injured workers at the lowest cost possible to employers and their insurers.

The first major component of SB 863 provides for an increase in permanent disability benefits to injured workers, benefits that previously were inadequate. Utilizing objective criteria to determine impairment and providing limits on what can be compensated, the permanent disability reforms also help to address areas of potential abuse.

The second major component of SB 863 provides for system reforms, particularly associated with the delivery of and payment for medical treatment, resulting in projected cost savings to cover the permanent disability increases and bring additional savings and stability to the system. These reforms include independent review of medical treatment requests and billing disputes. Additionally, problems that we have seen with the filing of medical liens are also addressed, providing for more potential savings.

The workers compensation system has struggled to stabilize rising costs over the last few years, particularly in medical care. The tools that employers and insurers use to control medical care appeared not to be effective or were under-utilized. This resulted in double-digit annual increases in medical costs. The SB 863 reforms put in place an opportunity for additional decreases in medical cost inflation and system stability and, in turn, will assist with making the costs in the system more predictable.

### **Additional Monitoring of the SB 863 Reforms and Future Improvements to the System**

Prior to the enactment of SB 863, I testified before a joint committee of the Legislature that costs were increasing in the workers' compensation system, combined ratios exceeded premiums by a significant amount, and that insurers paying out more than they were collecting in premiums was not sustainable in the long run. Action was needed to address those increases.

SB 863 provides overall savings that also allowed for an increase of benefits to injured workers. However, there continues to be a need for additional reform and more work needs to be done to accrue more cost savings.

In order to make sure that the savings associated with SB 863 are realized it is essential that SB 863 is implemented as soon as possible. To that end the Department of Industrial Relations (DIR) is working on the regulations to implement SB 863, including those that will control the various types of independent review, fee schedules, and other procedures. Additionally, a study is underway regarding the effect of independent review on costs in the system. I have offered the assistance of the Department of Insurance to the Director of DIR and her staff as they take on the enormous challenge associated with issuing a large number of SB 863 related regulations quickly. We also must be prepared to adjust the SB 863 reforms for any changes or challenges that may occur in the system.

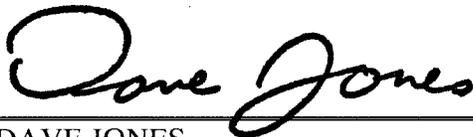
There are additional reforms to be explored that were not part of SB 863 to achieve additional savings. These include addressing through legislation and regulations ongoing problems with the overuse of powerful and addicting pain medications and reviewing reasons for increasing cumulative trauma claims and post-termination claims. We need to also standardize as many processes and procedures as possible. I encourage all stakeholders to refrain from thinking their work is done with regard to workers compensation system reforms and encourage the Legislature and Governor to use this upcoming legislative session to advance more reforms to reduce systemic costs and to make sure that resources are going where they should be going – to assist injured workers – as opposed to transactional and frictional costs.

And all of this will need to be monitored by the WCIRB and evaluated as to cost impact. I expect to hear from the WCIRB as further changes occur.

## ORDER

I hereby adopt the Proposed Decision and Order of Hearing Officer Christopher A. Citko dated November 30, 2012 in the above entitled matter and the directions to the WCIRB noted above as my Decision.

IT IS SO ORDERED THIS 30<sup>th</sup> DAY OF NOVEMBER, 2012.



DAVE JONES  
Insurance Commissioner