Report on State Compensation Insurance Fund’s Experience
Under California Insurance Code Section 11780.5 (b)

February 26, 2015

Introduction

Assembly Bill (AB) 228 (Fuentes) was passed and signed into law on October 9, 2011. This legislation amended California Insurance Code Section (CICS) 11780.5 and expanded the ability of the State Compensation Insurance Fund (hereinafter “State Fund”) to provide workers’ compensation insurance to California employers with employees located outside of California. Included in the legislation was a requirement that the California Department of Insurance (hereinafter “CDI”) provide a report to the Secretary of the Senate and the Chief Clerk of the Assembly, assessing the experience of State Fund that is authorized pursuant to this subdivision and make recommendations concerning its continuation, limitation, or expansion. The CDI’s analysis of State Fund’s experience with regards to the authority granted under AB 228 is presented within this report.

Background

State Fund is a public enterprise fund whose organization and powers are defined by CICS 11770 through 11805. Concurrently with the enactment of the first compulsory workers’ compensation laws in California, State Fund was established by the California Legislature in 1914 to provide an available market for workers’ compensation insurance to employers located in California.

Prior to the adoption of AB 228, existing law permitted State Fund to insure a California employer against the employer's liability for workers’ compensation benefits, under the law of any other state, for California employees temporarily working outside of California on a specific assignment if State Fund insures the employer’s other employees who work within California. AB 228 expands State Fund’s authority to insure a California employer with employees located and working permanently outside of California against the employer’s liability for workers’ compensation benefits, under the law of any other state, provided that the majority of the employer’s operations and employees are located within California and State Fund also insures the employer’s employees who work within California.

AB 228 also added subdivision (d) to CICS 11780.5 which prohibits State Fund from initiating paid advertising or soliciting sponsorship of advertising campaigns to market or promote to prospective insureds the ability to insure qualified employers under the law of any other state.
A Benefit for California Employers

State Fund sponsored legislation through AB 228 to allow it to provide workers’ compensation coverage for its insureds with employees located outside of California. This legislation was designed to support California employers by reducing the time, effort and paperwork needed to purchase workers’ compensation insurance regardless of where their employees are located. Prior to the passage of AB 228, a California employer, who was insured with State Fund, had to obtain at least one or more separate policies with another insurance carrier to cover his or her employees working outside of California.

State Fund as a Reinsurer

Given that State Fund is licensed only in California, the insurance coverage for the non-California employees would need to be issued by an insurance carrier licensed in the out-of-state jurisdiction. CICS 11780.5, subdivision (b), paragraph (2), stipulates that State Fund is only authorized to contract as a reinsurer with a ceding insurer that has responded to a request for proposal from State Fund, and is admitted to transact workers’ compensation insurance in California and in the out-of-state jurisdiction where the non-California employees are located. State Fund may only contract for purposes of this subdivision if the ceding insurer meets all of the following criteria:

(A) The insurer has an A minus (A-) rating or better from A.M. Best Company;

(B) The insurer has substantial prior experience in transacting workers’ compensation business on another insurer’s behalf; and

(C) The insurer has a minimum surplus of one hundred million dollars ($100,000,000).

All policies reinsured by State Fund, pursuant to this subdivision, were issued by a single ceding insurer, and it is the sole ceding insurer reinsured by State Fund, pursuant to this subdivision, during the period from 2012 through 2014. The current reinsurance contract was effective on February 20, 2012. Under the terms of this contract, State Fund is liable for 100% of incurred losses and loss adjustment expenses arising out of each accident, occurrence or claim covered by the policies reinsured hereunder. Policies are written in accordance with the underwriting and rating guidelines filed by the ceding insurer in each of the non-California jurisdictions and all claims arising from policies subject to this contract are handled and adjusted by the ceding insurer.

The current contract expires on February 20, 2015 and State Fund has not made a decision yet on whether or not to renew the contract. State Fund also stated that it has no plans to enter into contracts with any other ceding insurers pursuant to this subdivision.
Effect on California Workers’ Compensation Marketplace

Based on the data reviewed by the CDI, the demand for insurance coverage under the authorization in AB 228 has been minimal. The number of out-of-state policies and the amount of premiums for each policy year since adoption of AB 228 comprised less than 0.1 percent of State Fund’s total policies and premiums for each such year. The following table illustrates the number of non-California policies and the related premiums reinsured by State Fund for each policy year:

<table>
<thead>
<tr>
<th>Policy Year</th>
<th>Number of Policies</th>
<th>Out-of-State Premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>4</td>
<td>$23,315</td>
</tr>
<tr>
<td>2013</td>
<td>42</td>
<td>$118,555</td>
</tr>
<tr>
<td>2014</td>
<td>53</td>
<td>$128,314</td>
</tr>
</tbody>
</table>

The impact on the California workers’ compensation marketplace has been insignificant given the low volume of non-California policies and premiums reinsured by State Fund. State Fund stated that it currently has no plans for growing the non-California business and did not provide the CDI with any projections. As such, the CDI does not make any assessment as to what impact this practice will have on the California workers’ compensation marketplace should the volume of non-California business change significantly.

Effect on State Fund

All underwriting, rating, claims adjustment and administration of the non-California policies are managed by the ceding insurer. As noted above, demand for insurance coverage under the authorization in AB 228 has been minimal and has not required a change in State Fund’s management and operations.

State Fund’s losses incurred on out-of-state business are very low based on data furnished to the CDI. State Fund’s loss experience on the non-California business is summarized below:

<table>
<thead>
<tr>
<th>Policy Year</th>
<th>Losses Incurred</th>
<th>Premiums Earned</th>
<th>Loss Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$0</td>
<td>$23,315</td>
<td>0%</td>
</tr>
<tr>
<td>2013</td>
<td>$300</td>
<td>$106,250</td>
<td>0.3%</td>
</tr>
<tr>
<td>2014</td>
<td>$0</td>
<td>$66,596</td>
<td>0%</td>
</tr>
</tbody>
</table>

Department of Insurance’s Recommendation

Based upon the information received from the State Fund and the review conducted, the CDI believes the additional authority granted to State Fund under AB 228 has not had a significant impact upon the California workers’ compensation marketplace or upon the State Fund. Given that AB 228 can have a positive effect on California employers, by reducing the need to obtain additional policies to cover their out of state employees, and the insignificant impact that the increased authority has had upon the workers’ compensation marketplace and on the operations of State Fund, the CDI recommends the extension of the authority granted by this legislation.