WORKERS' COMPENSATION PREMIUM ASSESSMENTS

Report to the Utah Legislature by
The Utah Labor Commission & Workers' Compensation Advisory Council

November 4, 2009

INTRODUCTION

Parts of Utah's workers' compensation system are funded by assessments against workers' compensation insurance premiums and by similar assessments paid by self-insured employers. Section 34A-2-107 (5) (b) of the Utah Workers' Compensation Act, as enacted by the 2009 Utah Legislature in 1st Sub. Senate Bill 15, directs the Utah Labor Commission and its Workers' Compensation Advisory Council to study these premium assessments and make recommendations on two questions:

1. Whether the premium assessments should be changed; and
2. Whether changes should be made to how the premium assessments are used.

This report[1] summarizes the programs that are funded by premium assessments and sets out previous and (anticipated) future premium assessment rates. The report then presents the Labor Commission and Advisory Council's general comments regarding the efficacy of this system and concludes by responding to the two specific questions posed by the Legislature.

I. PROGRAMS FUNDED BY PREMIUM ASSESSMENTS

Premium assessments fund four separate programs, each established by statute and related to workers' compensation or workplace safety. The assessment rates for two of these programs—the Employers Reinsurance Fund and Uninsured Employers Fund—are set each year

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[1] Prepared by the following representatives of the Workers' Compensation Advisory Council and the Utah Labor Commission, and approved by the entire membership of the Council:

David R. Bird, Committee Chairman (Attorney, employer representative on Advisory Council);
K. Dawn Atkin (Attorney, employee representative on Advisory Council);
Dennis Lloyd (Vice President and General Counsel, Workers Compensation Fund, representing Ray Pickup, a WCF representative on Advisory Council);
Larry D. Bunkall (Director of the Labor Commission's Division of Industrial Accidents).

by the Labor Commission within a range that is set by statute. The assessment rates for the remaining two programs—the Workplace Safety Restricted Account and the Industrial Accidents Restricted Account—are set by statute. Each of the four programs is summarized below.

Employers' Reinsurance Fund ("ERF")—§ 34A-2-702. Of the four programs funded by premium assessments, the ERF is the oldest and most expensive, and has undergone the most significant statutory changes over the years.

The ERF was originally created to pay workers' compensation benefits related to injured workers' pre-existing impairments, thereby removing a disincentive that might otherwise discourage employers from hiring disabled workers. Historically, the ERF paid these benefits out of current assessment income and did not accumulate reserves to pay future benefits. By 1988, the ERF's unfunded liabilities were increasing rapidly and threatened Utah's credit rating and bonding ability. The Legislature addressed this problem in two steps.

- In 1988, the Legislature limited ERF liability for future claims and authorized an increase in premium assessments. (Laws of Utah, 1988 Session, Chapter 116, §§ 8 and11.)
- In 1994, the Legislature completely terminated ERF liability for injuries occurring after July 1, 1994. The Legislature directed the Commission to set assessment rates at a level that would allow ERF to fully fund its liabilities no later than June 30, 2025. (Laws of Utah, 1994 Session, Chapter 266, §9.)

Because the 1994 legislation terminated ERF liability for future injuries, ERF liabilities have gradually diminished as claims for pre-July 1994 injuries have been paid. At the same time, the Labor Commission has followed the recommendations of its independent actuaries and the Advisory Council to maintain ERF premium assessments at a relatively high level to build ERF reserves. This reserve-building process is almost complete, allowing the Labor Commission to begin reducing the level of ERF premium assessments. This trend is detailed in Part II of this report. Based on actuarial projections, the Labor Commission expects that ERF assessments will continue to decline for the next few years and end completely by 2013. At that time, the ERF will have sufficient reserves to pay all remaining pre-July 1994 claims. This is well in advance of 2025, the statutory deadline for achieving full funding.

For calendar year 2009, ERF's premium assessment is 5.0%; for 2010 the Labor Commission has proposed to reduce the assessment to 3.5%.

Uninsured Employers Fund ("UEF")--§34A-2-704. The 1984 Utah Legislature established the UEF to pay workers' compensation benefits to injured workers whose employers have failed to obtain workers' compensation coverage and are insolvent. (Laws of Utah, 1984 General Session, Chapter 77.) The UEF is funded from two sources: 1) Recoveries from uninsured employers of the amount of payments made to their employees, together with various penalties authorized by the Utah Workers' Compensation Act; and 2) premium assessments. Unlike the ERF, the UEF has always maintained reserves sufficient to meet its liabilities. The UEF is fully funded and actuarially sound.

During calendar year 2009, UEF's premium assessment is .25%; for 2010 the Labor Commission has proposed to reduce the assessment to .05%.

Workplace Safety Restricted Account ("WSRA")--§34A-2-701. The objective of the WSRA is to promote workplace safety, thereby preventing injuries and reducing workers' compensation claims. The Legislature had directed the Labor Commission to use these funds to provide safety consultation services for Utah employers, advertising to promote workplace safety, and other workplace safety programs and initiatives. At the end of each fiscal year, any balance in the WSRA over $500,000 is transferred into the ERF.

The WRSA is funded by a .25% premium assessment set by statute.

Industrial Accidents Restricted Account ("IARA")--§34A-2-705. The IARA, established in 2009 by 1st Sub. S.B. 15, funds two Labor Commission Divisions--Industrial Accidents and Adjudication. The Industrial Accidents Division is devoted entirely to workers' compensation issues; 90% of the Adjudication Division's work involves workers' compensation cases. Funds in the IARA are subject to legislative appropriation and, by statute, are used to pay the operating costs of these two divisions. By establishing the IARA, the Legislature also intended to end the practice of using UEF funds to pay part of the Labor Commission's general operating costs. At the end of each fiscal year, any balance in the IARA over $500,000 is transferred into the UEF. The IARA is subject to "sunset" review prior to July 1, 2013.

This account is funded with a statutory premium assessment of 0.5%.

PREMIUM ASSESSMENT RATES

Historical assessment rates and projected future assessment rates for the four special funds are shown below. This chart also shows the maximum combined premium assessment rate that is allowed by statute.

Calendar Year	**WC Premium Base** (millions)	**Premium Assessment Rates**					**Maximum Combined Assessment**
		ERF	**UEF**	**WSRA***	**IARA***	**TOTAL**	
2004	496.1	9.25%	0.25%	0.25%	-	9.75%	10.00%
2005	549.4	7.25%	0.25%	0.25%	--	7.75%	8.00%
2006	631.1	7.25%	0.25%	0.25%	---	7.75%	8.00%
2007	669.2	7.25%	0.25%	0.25%	---	7.75%	8.00%
2008	618.0	7.25%	0.25%	0.25%	- - -	7.75%	8.00%
2009	550.8	5.00%	0.25%	0.25%	- - -	5.50%	5.75%
2010	537.7	3.50%	0.05%	0.25%	0.50%	4.40%	5.75%

2011	570.0	2.00%	0.05%	0.25%	0.50%	2.80%	4.25%
2012	604.5	1.00%	0.05%	0.25%	0.50%	1.80%	2.25%
2013	638.1	0.00%	0.05%	0.25%	0.50%	0.80%	1.25%
2014	676.9	0.00%	0.05%	0.25%	0.50%	0.80%	1.25%

As demonstrated above, total premium assessment rates have been declining for several years and are projected to continue declining until 2013. In that year, the assessment rate is expected to level out at .8%, well below the maximum combined assessment rate permitted by statute. This reduction is primarily attributable to ERF achieving full funding and, to a lesser degree, the reduction in UEF assessment rates.

IV. GENERAL COMMENTS

Employees, employers and insurers support the Legislature's policy of using workers' compensation premium assessments to fund the ERF, UEF, WSRA and IARA.

Regarding the ERF, the Legislature has already acted to terminate this program in the future, but the fact remains that the ERF has already accrued liabilities that must be paid. It is reasonable and appropriate to fund this liability through declining premium assessments over the next few years. As to the UEF, the medical benefits and disability compensation paid to the injured employees of uninsured and insolvent employers are an appropriate and necessary component of Utah's workers' compensation system.

The overall injury rate at work has gone down the last successive years – a major goal of using funds from the WSRA to promote workplace safety.

Finally, workers' compensation stakeholders continue to support the Legislature's action during the 2009 legislative session of establishing the IARA to fund the Labor Commission's Industrial Accidents Division and Adjudication Division. This funding source is appropriate in view of these Divisions' essential roles in the orderly operation of the workers' compensation system. Creation of the IARA shows the Legislature's intent for use of premium assessments to support the administration of the workers' compensation system and establishes a system that promotes stability, transparency and accountability for the use of funds generated by premium assessments.

In summary, the Labor Commission and Advisory Council believe that workers' compensation premium assessments are an efficient and effective way of funding four important programs that benefit Utah employers and employees. However, the Labor Commission and Advisory Council do wish to identify the following area of concern.

Because premium assessments are computed, reported and paid by individual insurance carriers and self-insured employers, reasonable steps must be taken to insure that **each** carrier and self-insured employer properly reports and remits its assessment to the Utah State Tax Commission. Otherwise, entities that under-report their liability will enjoy an unfair advantage over competitors who correctly report and pay the assessment. Such underreporting would also reduce the funds available for the four programs discussed in this report.

At this time, the Labor Commission and Advisory Council do not believe legislative action is necessary on this issue. The Commission is working with the Tax Commission to clarify and tighten procedures for assessing, collecting, and transmitting premium assessments. But the Commission and Advisory Council also believe there is a need for the Tax Commission to establish a vigorous auditing program to validate premium assessment returns for errors or omissions.

IV. RESPONSE TO LEGISLATIVE QUESTIONS--RECOMMENDATIONS

As noted at the beginning of this report, in enacting § 34A-2-107 (5) (b) of the Utah Workers' Compensation Act, the Legislature asked the Labor Commission and Advisory

Council to respond to two questions. Those questions, and the Commission and Council's answers, are set out below.

Question: Should the premium assessment be changed?

Answer: No. There is no need to make any legislative changes to the premium assessment system. Current independent actuarial studies conclude that assessment rates within existing statutory limits will be adequate to complete the process of funding ERF, and will be sufficient to fund UEF's requirements through the foreseeable future. The premium assessment for the WSRA provides a stable fund to promote workplace safety, and it is anticipated that the assessment for the IARA will likewise provide an adequate and stable funding source for the Commission's administration of the workers' compensation system.

Question: Should changes be made to how the premium assessment is used?

Answer: No. The Labor Commission and Advisory Council believe the premiums assessments are being applied to proper purposes related to the workers' compensation system and workplace safety, and are being used wisely.

SPECIAL NOTE: Copies of the Deloitte Consulting LLP's Statement of Actuarial Opinion for the ERF and UEF are a part of this report. Copies of the full actuarial report for both ERF and UEF are available through the office of the Division of Industrial Accidents at the Utah Labor Commission. Please contact Larry Bunkall, Director of the Industrial Accidents Division.

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September 3, 2009

Statement of Actuarial Opinion

Employers' Reinsurance Fund

Identification

I, Rod Morris, am a Specialist Leader with the firm of Deloitte Consulting LLP. I am a Member of the American Academy of Actuaries and meet its qualification standards for rendering this Statement of Actuarial Opinion, and I am a Fellow of the Casualty Actuarial Society.

Scope

We have estimated the unpaid claim liabilities listed below on which we are expressing an opinion.

In forming our opinion on the unpaid claim liabilities, we relied upon conversations, information, and data prepared by Mr. Larry Bunkall, Division Director; Mr. David Lamb, Director of Administrative Services; and Ms. Carol Hawkins all of the Industrial Accidents Division of the State of Utah. We evaluated that data for reasonableness and consistency with prior actuarial reports. A specific audit of the data and information is beyond the scope of this opinion. We have conducted such reasonableness tests of the data as we felt appropriate. In all other respects, we have relied without audit or verification on the data and background information provided and have assumed they are accurate and complete. If the information is inaccurate or incomplete, our findings and conclusions may need to be revised. In other respects, our examination included the use of such actuarial assumptions and methods and such tests of the calculations as we considered necessary.

Our review was limited to the items listed below, and did not include an analysis of any other balance sheet items. We have not examined the assets of the Employers' Reinsurance Fund and we have formed no opinion as to the validity or value of these assets. Our opinion on the unpaid claim liabilities is based upon the assumption that all such liabilities are backed by valid assets, which have suitably scheduled maturities and/or adequate liquidity to meet the cash flow requirements of the liabilities.

Opinion

We estimate the total unpaid claim liability for the Employers' Reinsurance Fund as of June 30, 2009 to be approximately $372.3 million on an undiscounted basis and $242.2 million on a discounted basis. The discounted unpaid claim liability was discounted using an annual interest rate of 2.5% for the next three years and 4.5% thereafter. Based on this analysis and the Employers' Reinsurance Fund assumptions and methods used to estimate the unpaid claim liability, it is our opinion that these estimates are a reasonable provision of the future payments to be made from the Employers' Reinsurance Fund as of June 30, 2009.

A summary of the results of our analysis by component is as follows:

	Undiscounted	Discounted
Permanent Disability (Active Claims)	$ 320,254,101	$ 205,755,335
Survivor Benefits (Active Claims)	3,492,902	2,182,078
Incurred But Not Reported Claims	16,249,047	10,550,247
Medical Reimbursements	29,100,136	20,933,723
Settlement Expenses	3,214,080	2,066,100
Total Unpaid Claim Liability Estimate	$ 372,310,266	$ 241,487,483

The estimates presented above are based on commonly accepted actuarial methods. In estimating the unpaid claim liability for the Employers' Reinsurance Fund, it is necessary to estimate the future indemnity, loss, and expense payments. It is certain that actual future payments will not develop exactly as estimated and may, in fact, vary significantly from our estimates. No warranty is expressed or implied that such variance will not occur. Further our estimates make no provision for the broadening of coverage by legislative action or judicial interpretation or for extraordinary future emergence of new classes of losses or types of losses not sufficiently presented in the Employers' Reinsurance Fund's historical experience or which are not yet quantifiable.

We have not examined the assets of the Employers' Reinsurance Fund and have formed no opinion as to the validity or value of these assets. Our opinion on the reserves is based upon the assumption that all reserves are backed by valid assets, which have suitably scheduled maturities and/or adequate liquidity to meet the cash flow requirements of the liabilities.

This opinion and accompany report is prepared for the internal use of the State of Utah – Labor Commission exclusively for the administration of the Employers' Reinsurance Fund and is intended to assist the Labor Commission in accruing an appropriate reserve. It is not intended for other purposes, such as a debt offering or reinsurance negotiations.

Actuarial Report

An actuarial report and underlying actuarial workpapers supporting the findings expressed in this Statement of Actuarial Opinion will be provided to the State of Utah – Labor Commission.

Rod Morris

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September 3, 2009

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September 3, 2009

Statement of Actuarial Opinion

Uninsured Employers' Fund

Identification

I, Rod Morris, am a Specialist Leader with the firm of Deloitte Consulting LLP. I am a Member of the American Academy of Actuaries and meet its qualification standards for rendering this Statement of Actuarial Opinion, and I am a Fellow of the Casualty Actuarial Society.

Scope

We have estimated the unpaid claim liabilities listed below on which we are expressing an opinion.

In forming our opinion on the unpaid claim liabilities, we relied upon conversations, information, and data prepared by Mr. Larry Bunkall, Division Director; Mr. David Lamb, Director of Administrative Services; and Ms. Carol Hawkins all of the Industrial Accidents Division of the State of Utah. We evaluated that data for reasonableness and consistency with prior actuarial reports. A specific audit of the data and information is beyond the scope of this opinion. We have conducted such reasonableness tests of the data as we felt appropriate. In all other respects, we have relied without audit or verification on the data and background information provided and have assumed they are accurate and complete. If the information is inaccurate or incomplete, our findings and conclusions may need to be revised. In other respects, our examination included the use of such actuarial assumptions and methods and such tests of the calculations as we considered necessary.

Our review was limited to the items listed below, and did not include an analysis of any other balance sheet items. We have not examined the assets of the Uninsured Employers' Fund and we have formed no opinion as to the validity or value of these assets. Our opinion on the unpaid claim liabilities is based upon the assumption that all such liabilities are backed by valid assets, which have suitably scheduled maturities and/or adequate liquidity to meet the cash flow requirements of the liabilities.

Opinion

We estimate the total unpaid claim liability for the Uninsured Employers' Fund as of June 30, 2009 to be approximately $12.7 million on an undiscounted basis and $9.7 million on a discounted basis. The discounted unpaid claim liability was discounted using an annual interest rate of 2.5% for the next three years and 4.5% thereafter. Based on this analysis and the assumptions and methods used to estimate the unpaid claim liability, it is our opinion that these estimates are a reasonable provision of the future payments to be made from the Uninsured Employers' Fund as of June 30, 2009.

A summary of the results of our analysis by component is as follows:

	Undiscounted	Discounted
Estimated Outstanding Claims	$ 11,587,233	$ 8,797,002
Settlement Expenses	1,158,723	879,700
Total Unpaid Claim Liability Estimate	$ 12,745,956	$ 9,676,702

The estimates presented above are based on commonly accepted actuarial methods. In estimating the unpaid claim liability for the Uninsured Employers' Fund, it is necessary to estimate the future indemnity, loss, and expense payments. It is certain that actual future payments will not develop exactly as estimated and may, in fact, vary significantly from our estimates. No warranty is expressed or implied that such variance will not occur. Further our estimates make no provision for the broadening of coverage by legislative action or judicial interpretation or for extraordinary future emergence of new classes of losses or types of losses not sufficiently presented in the Uninsured Employers' Fund's historical experience or which are not yet quantifiable.

We have not examined the assets of the Employers' Reinsurance Fund and have formed no opinion as to the validity or value of these assets. Our opinion on the reserves is based upon the assumption that all reserves are backed by valid assets, which have suitably scheduled maturities and/or adequate liquidity to meet the cash flow requirements of the liabilities.

This opinion and accompany report is prepared for the internal use of the State of Utah – Labor Commission exclusively for the administration of the Uninsured Employers' Fund and is intended to assist the Labor Commission in accruing an appropriate reserve. It is not intended for other purposes, such as a debt offering or reinsurance negotiations.

Actuarial Report

An actuarial report and underlying actuarial workpapers supporting the findings expressed in this Statement of Actuarial Opinion will be provided to the State of Utah – Labor Commission.

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