



POLICY BRIEF

Citizens' Guide to Initiative 1082 *To Reform Workers' Compensation in Washington*

by Carl Gipson
September 2010



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Citizen's Guide to Initiative 1082

To Reform Workers' Compensation in Washington

by Carl Gipson

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September 2010

Key Findings

1. Research shows that more competition in industrial insurance would help keep premiums in check, encourage innovation in rehabilitating injured workers and provide safer workplaces.
2. States that have recently introduced a competitive industrial insurance market have seen costs decline and customer satisfaction increase.
3. As written, I-1082 relieves employees from paying for industrial insurance premiums. As in the other 49 states, businesses would pay 100% of the cost.
4. I-1082 would not address every detail of the transition to a "hybrid" industrial insurance market, but would set mechanisms in place to do so.
5. As written, I-1082 does not alter the benefit levels of injured workers in any way.

Executive Summary

In November, Washington voters will vote on whether to allow private-sector competition to provide an alternative to the state-run industrial insurance system (workers' compensation). The state of Washington has had a government-run monopoly for industrial insurance since 1911, and today is one of only four states that do not allow private competition in this industry.

Washington Policy Center has long recommended the creation of a competitive marketplace for industrial insurance. Such a policy would serve both the business community and injured workers. Competition would help incent safer workplaces, thereby protecting employees, getting them back to work in a timely fashion and helping protect employers' bottom lines.¹

According to Initiative 1082's text, the goals of the measure are to:

1. Maintain existing benefit levels for injured workers while improving their opportunity to return to work;
2. Eliminate the requirement that workers pay one-half of their medical coverage for on-the-job injuries;
3. Open up the current state-run industrial insurance system to competition from private industrial insurance providers, with a July 1, 2012 start date for an open market;
4. Maintain a "best practices" approach to worker safety as developed by both private and public sectors.

For decades, Washington's industrial insurance system has been run solely by the state Department of Labor and Industries (L&I). Only a relatively small number of businesses, often large firms, self-insure. But the vast majority of Washington's businesses are forced to do business with the state, and over the years the business community has become jaded at the prospect of continuing this fractious relationship. The business community is pushing hard to open up the system to private sector competition in hopes of lowering premiums and getting injured workers back on the job more quickly. The number of workers' compensation claims has been falling for two decades, yet the cost of the system continues to grow at a high rate – affecting both businesses and employees.

Research shows that opening the state's industrial insurance system to private competition, if done correctly, would help keep premium increases in check, encourage innovation in rehabilitating injured workers, and most importantly, provide a safe workplace where employees can be productive and protected.

¹ "Policy Guide for Washington State: Third Edition," Washington Policy Center, 2008, page 217.

Introduction: Workers Compensation in Washington

Initiative 1082 seeks to open the state-run workers' compensation system to private sector competition. Washington is one of only four states where businesses must purchase industrial insurance from the state government.

Industrial insurance (referred to in this state as workers' compensation) is similar to other insurance in that a group of policy holders, in this case businesses, band together to mitigate the risk of incurring large costs caused by employees suing their employers over work-related injuries. The state program was established in 1911.

In Washington, the state is the sole provider of workers' compensation insurance. Businesses are required to pay a premium to insure their workers against the costs of on-the-job injuries and illnesses. The state uses the collected sums to cover the medical costs and lost wages of the small number of workers who sustain an injury in any given year. As a result, the cost of worker injuries is spread throughout the system, and no one company or worker should be financially devastated by a single accident.

The state system also provides some protections for employers. First, employees contribute towards the insurance premium (the only state where this is the case). Second, businesses are shielded from employee lawsuits, regardless of who is at fault. This is referred to as an "exclusive remedy" system – workers are guaranteed compensation, but they are unable to seek additional indemnity benefits through lawsuits.²

Each state has its own specific industrial insurance system, but they are largely based on one of three types of insurance models – a fully private model with no state-run system, a fully public model where the state is the sole provider, and a hybrid model where both private and public sector providers operate in the same state.

Initiative 1082 would convert Washington's industrial insurance model from a fully state-run system into the hybrid system, which most states currently have. As of mid-2010, 15 states have a public/private hybrid model; 31 have the private-only option. Washington, Ohio, North Dakota and Wyoming are the only states with a fully public model.

In 1971, Washington allowed companies to self-insure their workforce, but the qualifications to become eligible to self-insure are so strict that only large companies can afford this option. In Washington there are just under 400 companies, employing approximately 830,000 people, that self-insure. By comparison, the state-run L&I fund covers 168,000 employers that employ 2.4 million workers. This means only a small number of firms can reasonably expect to qualify for self-insurance.³

Most states allow small groups of similar businesses in a particular industry to self-insure. Washington does not allow this, except for a few governmental entities, such as school districts, educational districts, and hospital districts.⁴

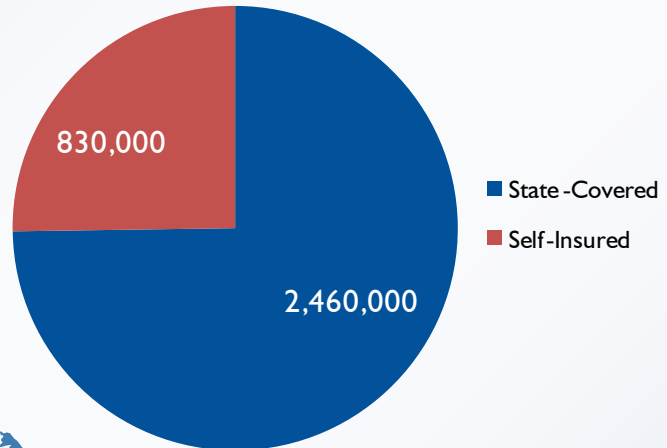
While the regulations that govern self-insurers are similar to those that regulate non-self-insurers, the system is set up for the benefit of larger employers, so smaller businesses are not able to seek private coverage.

² However, an employer who "had actual knowledge that an injury was certain to occur and willfully disregarded that knowledge," could be sued for additional benefits or damages. See RCW 51.24.020 or *Birklid v. Boeing*, 1995.

³ "2009 Year in Review," Department of Labor and Industries, available at <http://lni.wa.gov/IPUB/200-017-000.pdf>.

⁴ See Revised Code of Washington 51.14.150 (2)(a).

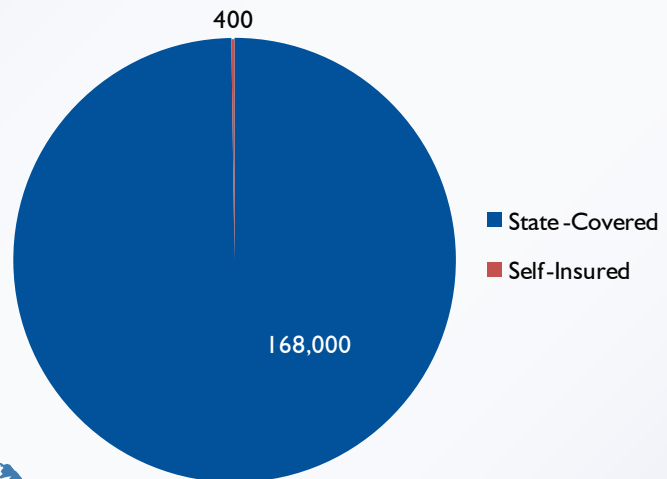
Employees Covered



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The battle over opening Washington's state-run system to private sector competition is not new. Legislation is introduced just about every session to allow private competition. Inevitably, these efforts fail.⁵

Employers Covered



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PART I – Text of Initiative 1082

Initiative 1082 would do several things to reform our state's workers' compensation system. The main reforms would:

1. Open the state system to private competition in industrial insurance.
2. Empower the Office of the Insurance Commissioner to oversee eligibility requirements for insurance firms that want to sell coverage.

⁵ Most recently, HB 2879, introduced during the 2010 Legislative Session, would have done largely what Initiative 1082 seeks to do.

3. Allow group insurance plans (still requiring some eligibility requirements for group members).
4. Create an Industrial Insurance Administrative Fund to fund the Board of Industrial Insurance Appeals.
5. Create a Joint Legislative Task Force on Private Competition for Industrial Insurance; and,
6. Relieve employees of the cost of insurance premiums; employers would pay 100 percent of premium costs.

The following section explains how each of these reforms would work.

I. Open the State System to Private Sector Competition in Industrial Insurance

The state industrial insurance system has been a monopoly since its inception in the early 20th century. As a result, Washington businesses have lost out on the benefits that competition brings when insurance companies vie for business. As previously mentioned, Washington is an outlier in this regard. Only three other states have a similar system to Washington. Other states have recently converted from a “public” model to a fully private model or hybrid model. Within the last decade, two states have successfully converted their systems into competitive environments, as detailed in Part II of this report.

The transition process would begin in 2011 with the deadline for full conversion to a “hybrid” model (public entity competing with private insurers) by July 1, 2012.

2. Empower the Office of the Insurance Commissioner to Oversee Eligibility Requirements for Insurance Firms that Want to Provide Coverage

Initiative 1082 gives the power to certify eligible industrial insurance providers to the Office of the Insurance Commissioner (OIC) – whose director is chosen by statewide election.

Currently, the Department of Labor and Industries (whose director is appointed by the governor) oversees the state-run monopoly system. The OIC regulates the state’s insurance industry, which includes auto, health, life, title insurance and more. The agency would have to expand in order to handle its increased responsibilities under Initiative 1082, which would be paid for through the new Industrial Insurance Administrative Fund (more about this in point 4).

Similar to how the OIC approves or disapproves of insurance companies to conduct business in Washington, it would extend this approval process to industrial insurance companies. Initiative 1082 directs the OIC to designate a license rating organization such as the National Council on Compensation Insurance, Inc., to design a set of rate plans, rules and policies in order to take advantage of industry standards.

Initiative 1082 also requires insurance providers to be a member of a license rating organization. This would help ensure credibility and accountability on the part of the insurance provider.

Another significant change brought about by Initiative 1082 would be the basis on which premiums are calculated. Currently, premiums are based on hours worked, while premiums in every other state are based on payroll. The initiative would change Washington's system and make workers' compensation premiums based on payroll.

3. Allow Group Insurance Plans

Initiative 1082 would allow group insurance plans. Currently, 35 states allow small employers in related businesses to self-insure as a group. This gives small businesses the same self-insurance option as their larger competitors, or they can choose to insure with public or private insurance providers. Such groups spur the sharing of best practices and improved safety, because each employer has an incentive to help lower the injury costs of other group members.

Insurers would be allowed to insure a group as long as the following requirements are met:

- a) "All the employers in the group are members of a statewide organization that has been in existence for at least four years." Examples of statewide organizations include trade associations, chambers of commerce, and co-ops.
- b) "The organization exists primarily for a purpose other than that of obtaining or offering industrial insurance coverage or insurance-related services."
- c) The group must be composed of similar employers who are "substantially similar." This is common among other industry groupings. From an actuarial standpoint, grouping businesses together in a similar industry, or rate class, helps mitigate exposure to risk.
- d) "The formation and operation of the group program in the organization will improve accident prevention and claims management for the employers in the group."

In keeping with current law, groups that self-insure would still be subject to rigorous state oversight. They would be subject to the same regulatory requirements as private insurers and the state fund. Injured workers would continue to be entitled to their statutory protections regardless of how their employers choose to insure. The Office of Insurance Commissioner would also oversee self-insured groups, along with the other private insurance providers. The groups would have to be run by statewide organizations (statewide trade associations, etc.) and local or regional organizations would not be allowed to run their own self-insurance program.

4. Create an Industrial Insurance Administrative Fund to Pay for a New Board of Industrial Insurance Appeals

The Office of the Insurance Commissioner would oversee a new fund to pay for the Board of Industrial Insurance Appeals (BIIA).⁶ The BIIA currently exists as a separate and independent state agency that hears appeals related to workers' compensation claims, WISHA claims and crime victim compensation. It is a relatively small agency; its total appropriation in the most recent budget was

⁶ More information on the Board of Industrial Insurance Appeals is available at www.biiia.wa.gov.

\$36 million.⁷ Any further funding from the legislation (coming from the general fund) must also be put into this new fund.

5. Create a Joint Legislative Task Force on Private Competition for Industrial Insurance

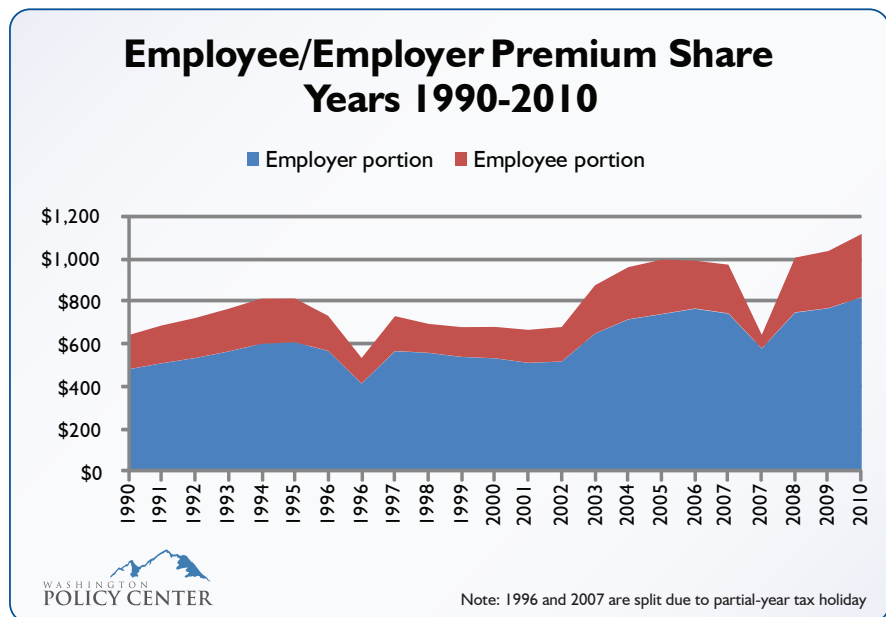
The new task force, the Joint Legislative Task Force on Private Competition for Industrial Insurance, would be tasked with proposing any follow-up legislation needed in order to make state statutes conform to the new hybrid system. Some of RCW chapter 51, and portions of other RCWs, would have to be re-written to accommodate the switch to a competitive system. There is no estimate on how many rulemakings the Department of Labor and Industries and the Office of the Insurance Commissioner would have to make as a result of future decisions by the Task Force or legislature.

The task force would consist of one member from the House and one from the Senate, four members from the employer community, two members representing the industrial insurance industry, and four employees. The task force's legislative recommendations would be due by December 31, 2011 and the legislature would have to adopt the implementation of policy directives by March 1, 2012.

6. Relieve Employees of the Cost of Insurance Premiums, Employers Would Carry 100 percent of Premium Costs

Washington is the only state that allows employers to pass a part of the industrial insurance premiums to their employees. Employers are allowed to deduct up to one-half of the amount that goes to the Medical Aid fund. This is a de facto payroll tax on the employee to help pay for the medical expense portion of the insurance plan. Employers currently pick up the full premiums that fund the Accident and the Supplemental Pension funds.

In 2010, employees are contributing about 28 percent of the premiums for industrial insurance (again, only going toward the Medical Aid fund), which



⁷ See Section 216, ESSB 6444, Enacted May 4, 2010, "2010 Operating Supplemental Budget," Office of Financial Management. Available at: <http://apps.leg.wa.gov/documents/billdocs/2009-10/Pdf/Bills/Session%20Law%202010/6444-S.SL.pdf>.

amounts to approximately \$435 million, compared to employer contributions estimated to be just over \$1.1 billion.⁸

Some opponents of Initiative 1082 point to this as a provision that would increase costs to the small business community. However, based on the data from other states that have opened up a state monopolistic system to private competition, the overall cost of the system would decrease enough to counteract any short term premium increases for employers that might come about because employees would no longer contribute to their own industrial insurance plans (more on how this would affect government workers in Part II).

PART II – Assessing Washington’s State-Run Workers’ Compensation System

Case Studies of Other States Introducing Competition

West Virginia

Beginning with legislation in 2005, the state of West Virginia opened its workers’ compensation system to any insurer that met certain state requirements. The West Virginia legislature passed Senate Bill 1004 in January of 2005, which privatized their workers’ compensation system by creating a new employers’ mutual insurance company, Brickstreet Mutual, which went into operation January 1, 2006. Almost 150 insurance companies filed with the West Virginia Office of the Insurance Commissioner upon privatization of the system, almost two-dozen companies were completely new to the state.⁹ As of 2010, over 200 companies are on the Insurance Commissioner’s list of approved workers’ compensation carriers.¹⁰ So, while West Virginia converted from a monopolistic system to a private one (whereas Initiative 1082 would implement a hybrid system), the results can be used to give a snapshot of what would likely happen in Washington state.

Initial reports assessing the privatization of West Virginia’s workers’ compensation program are positive. The transition period took place between January 1, 2006 and July 1, 2008, when private sector competitors were allowed to provide insurance services. After one year of competition, *Insurance Journal* reported that West Virginia’s market is performing well:

- Overall premiums have dropped 30.3 percent, or more than \$150 million;
- 198 different workers’ compensation insurance companies had filed rates and forms;
- Of those 198 companies, 154 have active workers’ compensation policies in the voluntary market;
- There are 120 policies in the residual market representing premiums of about \$1.9 million; and,
- More than 90 percent of all claims are ruled upon within the first 30 days.

⁸ PowerPoint Slide, “2010 Proposed Rate Discussion” at the Workers’ Compensation Advisory Committee Meeting (September 21, 2009) at 72, available at <http://washingtonpolicy.org/sites/default/files/wcac-presentation-9-15-09---final%20%282%29.pdf>.

⁹ Insurance Information Institute, at: http://www.iii.org/issues_updates/workers-compensation.html

¹⁰ West Virginia’s WC carrier list is available at <http://www.wvinsurance.gov/LinkClick.aspx?fileticket=eiYwSDOITbQ%3d&tabid=73&mid=752>.

But the article also reported that it was not just businesses' bottom lines that improved, workers benefited as well. According to the Insurance Commissioner,

- Claim protests fell 68 percent;
- The overall appeals process was streamlined, resulting in claim disputes being resolved in a shorter time period;
- Claimants received better claim management because adjusters have fewer claims to manage; and,
- The unfunded liability on "old fund" claims dropped from \$3.1 billion to \$1.5 billion.¹¹

Since then, premiums have continued to drop and are now down an average of 43.7 percent since the state system was privatized. The number of insurance providers authorized in the state is up to 207 – more than the number of insurance companies authorized to provide car insurance.¹²

Nevada

In 1995 the Nevada legislature voted to allow private companies to provide workers' compensation insurance in a competitive market. The three-way plan (state fund, private carriers and self-insurance) was implemented in 1999.

Immediately after the law was implemented 64 insurance carriers filed applications with the state's Division of Insurance to sell workers' compensation policies. Less than one year later, 238 carriers were authorized to sell workers' compensation policies.¹³

In the time since private insurers were allowed into the state, and the state fund turned into a mutual holding company (which has since been demutualized into a stockholder-owned company) and rates have decreased most years – including 2010 when rates declined on average 7.6 percent.¹⁴ One story from 2007 describes a 64 percent reduction in premiums for the construction industry in the seven years since private insurers were allowed.¹⁵

Arizona

The state of Arizona also recently began privatizing its State Compensation Fund, which previously competed on the open market with private insurers. According to the Arizona Department of Insurance, the state fund had a market share of almost 32 percent, but will become a private mutual insurance company. The transition is scheduled to conclude by January 2013.¹⁶

¹¹ "West Virginia Touts Switch to Private Workers' Compensation System," *Insurance Journal*, July 7, 2009. Available at: <http://www.insurancejournal.com/news/southeast/2009/07/07/102008.htm>.

¹² George Hohman, "Workers' comp progress gets a thorough review," *Daily Mail*, September 6, 2010, available at <http://www.dailymail.com/Business/201009050410>.

¹³ Sky Barnhart, "Workers' Comp Market Overview," *Insurance Journal*, April 3, 2000, available at: <http://www.insurancejournal.com/magazines/west/2000/04/03/coverstory/21701.htm>.

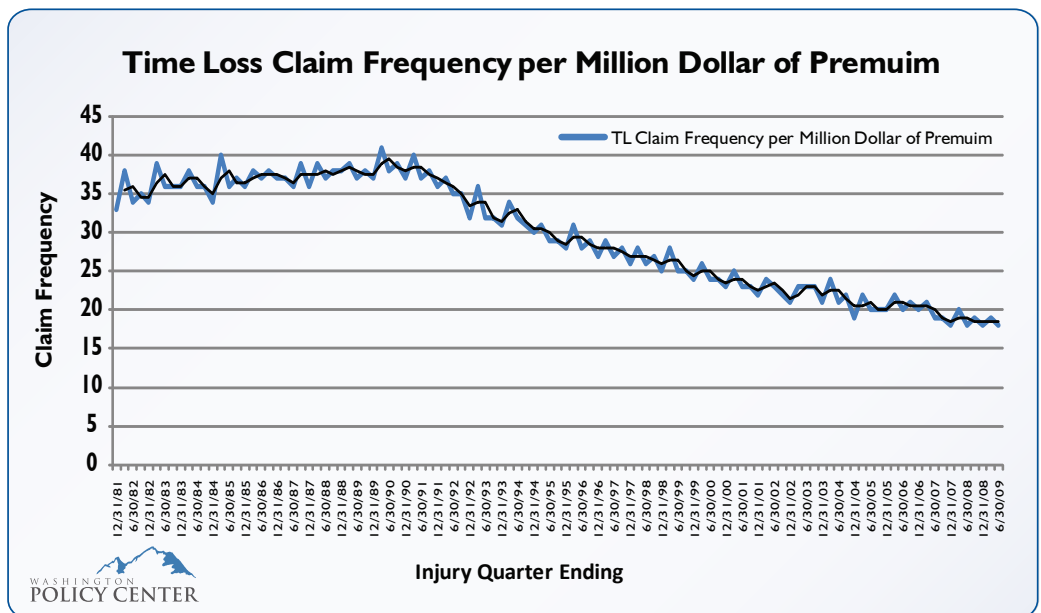
¹⁴ "Nevada—Voluntary Loss Costs and Ratings Values and Assigned Risk Rates and Ratings Values to Be Effective March 1, 2010," National Council on Compensation Insurance, December 22, 2009, available at: <http://doi.nv.gov/spc/docwc/NV2010VoluntaryLossCost.pdf>.

¹⁵ Ian Mylchreest, "Ten years on, Builders is still growing in Nevada," *Las Vegas Business Press*, February 12, 2007, available at http://www.lvbusinesspress.com/articles/2007/02/12/news/iq_12290807.txt.

¹⁶ "Arizona Privatizes Workers' Compensation Insurer," *Insurance Journal*, May 13, 2010, available at: <http://www.insurancejournal.com/news/west/2010/05/13/109822.htm>.

Washington Premiums Increase While Claims Decrease

A major concern of the business community is that premiums continue to rise while the number of claims filed decreases. On a national basis, claim frequency dropped 4.0 percent in 2009, 3.4 percent in 2008 and 3.0 percent in 2007, extending a downward trend that started in the 1990s.¹⁷ On the state level, claim frequency has also fallen over the last two decades. According to L&I, the Department has seen a 52 percent decrease since 1990.¹⁸



Nationally, workplace injuries are now at their lowest level since reporting began. According to the latest national data, incidence rates of nonfatal occupational injuries fell 11 percent between 2006 and 2008.¹⁹

Lack of Rate Stability in Washington Harms Businesses

While injury rates declined, businesses have been required to pay more for insurance throughout this decade. Since 2000, average premiums in Washington have risen more than 65 percent, from \$0.35 cents per hour to \$0.58 cents per hour²⁰ – which includes the \$315 million medical aid rate holiday in the second half of 2007.²¹

This is not the case in Oregon, where rates have not increased since 1990. Oregon businesses have also seen a steady decrease in workers' compensation premiums, declining in 2006 through 2011. The average decrease in 2010 was 1.3 percent, whereas Washington's average increase for the same year was 7.6 percent.²²

¹⁷ Dennis C. Mealy, "2010 State of the Line: Analysis of Workers Compensation Results," NCCI Holdings, Inc., pages 7-8, available at: <http://www.ncci.com/Documents/AIS-2010-SOL-Article.pdf>.

¹⁸ PowerPoint Slide, "2010 Proposed Rate Discussion" at the Workers' Compensation Advisory Committee Meeting (September 21, 2009) at 51, 52, available at <http://washingtonpolicy.org/sites/default/files/wcac-presentation-9-15-09---final%20%282%29.pdf>.

¹⁹ "Table 7: Incidence rates of nonfatal occupational injuries and illnesses by major private industry sector and selected case types, 2006-2008," Bureau of Labor Statistics, October 29, 2009, available at: <http://www.bls.gov/news.release/osh.t07.htm>.

²⁰ Labor and Industries, "Average Standard Premium Rates (per hour worked)," available at <http://lni.wa.gov/claimsins/files/rates/avgstdpremrates.pdf>.

²¹ Labor and Industries, "Six-month workers' compensation rate holiday begins July 1," press release, available at: <http://lni.wa.gov/news/2007/pr070621a.asp>.

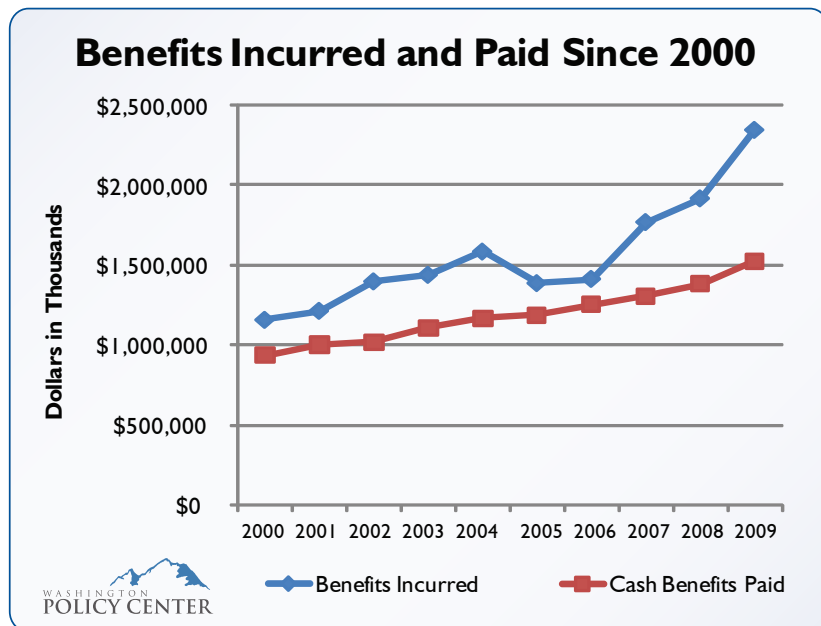
²² "Workers' compensation rate to decline for fourth straight year," Oregon Department of Consumer and Business Services, September 10, 2009, available at: http://www.oregon.gov/DCBS/docs/news_releases/2009/nr_wc_rate_2010.pdf.

Oregon also announced that in 2011, workers' compensation rates will decrease by 1.8 percent, which represents a 13 percent decrease since 2006.²³

In the ten years since Nevada opened up its industrial insurance system to private competition – and proceeded to privatize its state fund – rates have also steadily declined or remained stable. And as previously noted, in the short time since West Virginia followed Nevada's example, its premiums have dropped by 43 percent since the conversion process began in 2006.

High Benefit, High Cost State System

Washington gives out generous benefits to injured workers. According to the National Academy of Social Insurance, Washington has the second-highest benefits per covered worker, at \$692.79, whereas the national average is just under \$420.²⁴ Washington ranks third highest in workers' compensation benefits per \$100 of covered wages at 1.56 percent, down from 1.63 percent the year previous.²⁵



One of the more controversial data points is the measurement of time-loss claims. Time-loss claims refer to benefits paid to workers injured severely enough to miss more than three days of work.

The average time-loss claim in Washington is 274 days.²⁶ This number fluctuates during economic recessions but the trend is clear – in the early 1970s the average time-loss claim was only 96 days. And time-loss claims are up 38 percent over the last decade.²⁷

²³ "Workers' compensation premium rate will decrease again in 2011," Oregon Department of Consumer and Business Services, September 8, 2010, available at: http://egov.oregon.gov/DCBS/docs/2011_rates/nr_wc_rate_for_2011.pdf.

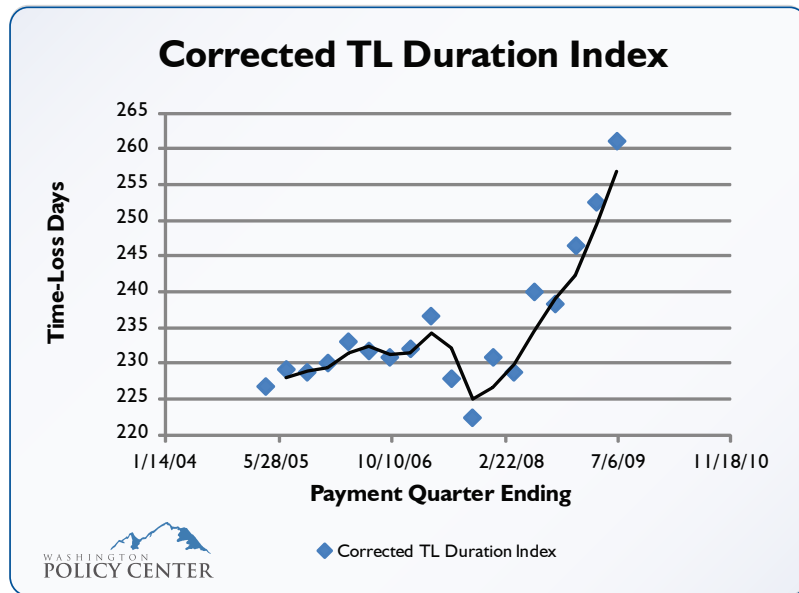
²⁴ "Workers' Compensation-Benefits Paid," 2010 Competitiveness Redbook, Table 25, WashACE.

²⁵ "Workers' Compensation: Benefits, Coverage, and Costs, 2007," National Academy of Social Insurance, August 2009, table 10. Available at: http://www.nasi.org/sites/default/files/research/Workers_Comp_Report_2007.pdf.

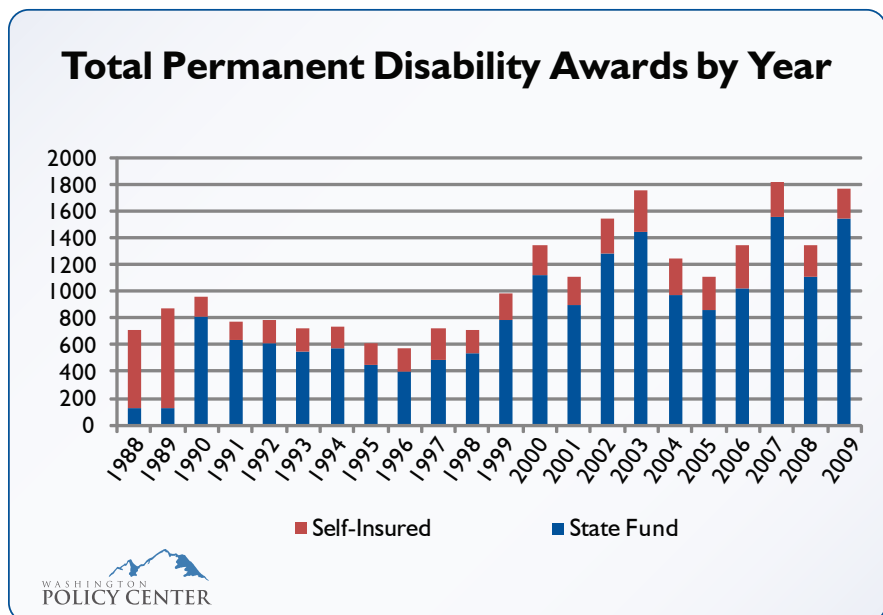
²⁶ Workers' Compensation Advisory Committee (WCAC) – Meeting Minutes, page 11. Available at <http://wpc.cust.lexi.net/sites/default/files/4-30-10%20Draft%20Minutes.pdf>.

²⁷ PowerPoint Slide, "2010 Proposed Rate Discussion" at the Workers' Compensation Advisory Committee Meeting (September 21, 2009) at 45, available at <http://washingtonpolicy.org/sites/default/files/wcac-presentation-9-15-09---final%20%282%29.pdf>.

According to NCCI, the median time-loss duration is 45 days, whereas the mean is about 125 days.²⁸ This data comes from the states participating in NCCI, which Washington state does not (but could if Initiative 1082 were to pass). Washington, with its average of 274 days of time-loss claims, is 219 percent higher than the national mean. This is an obvious concern for premium payers – both employers and employees.



This data also suggests that L&I adequately handles shorter-term claims, as our median time-loss claims are better than national norms (45 days nationally versus 26 days state²⁹). However, long-term claims account for a majority of costs. The Department’s internal analysis shows that eight percent of claims account for almost 88 percent of the cost to the system.³⁰



²⁸ PowerPoint Slides, “Workers Compensation Temporary Total Disability Indemnity Benefit Duration,” National Council on Compensation Insurance, May 8, 2009 at 2, 6, available at <http://www.ncci.com/documents/AIS-2009-WC-TempTotal-Disability.pdf>.

²⁹ PowerPoint Slide, “2010 Proposed Rate Discussion” at the Workers’ Compensation Advisory Committee Meeting (September 21, 2009) at 49, available at <http://washingtonpolicy.org/sites/default/files/wcac-presentation-9-15-09---final%20%282%29.pdf>.

³⁰ Ibid, at 57.

Total Permanent Disability (TPD) pension claims are also of concern, since Washington grants far more pensions than the average state, and continues to increase at a rapid pace. According to the Upjohn Institute for Employment Research, the number of these pensions awarded tripled from 1996 to 2003. In 2009, the state awarded over 1,500 TPD pensions from employers covered by the state fund and 229 pensions from self-insured employers. If Washington were issuing TPD pensions in accordance with national averages, the number of pensions issued per year should be around 200.

The U.S. average of TPD pensions is about seven a year per 100,000 workers. But an in-depth analysis of Washington's pension award system puts our state's number at 65, almost twice that of California's, which is second-highest in the nation at 37.³¹

Initiative 1082 does not have provisions that directly address long-term pension reform. In fact, Initiative 1082 does not increase or decrease benefits for injured workers. Benefits are set by statute and there is no language in the ballot measure that would alter current benefits. The Joint Legislative Task Force on Competition for Industrial Insurance could approach the unsustainable benefit issue and suggest legislation that would help curtail Washington's out-of-control pension and time-loss problems.

Legislation aimed at addressing this problem was rebuffed during the 2010 Legislative Session. House Bill 2950 would have allowed voluntary medical provider networks, among other things, but it failed to receive a hearing during the 2010 Legislative Session. Other research shows that medical provider networks are generally associated with lower medical costs.³²

Financial Troubles of the Workers' Compensation Funds

Another major concern with the state fund is that the premiums necessary to keep the funds solvent will place an unsustainable burden on ratepayers, who are both employers and employees. In 2009, the Department decided to raise workers' compensation rates an average of 7.6 percent. A state auditor report issued in December 2009 shed light on the shaky financial footing of the state fund.

State law requires the Office of the State Auditor to annually audit the financial statements of the Department of Labor & Industry's workers' compensation funds. While the reserves were found to be within normal industry levels, there was marked concern for the dramatic decline in the contingency reserve funds for both the Accident and Medical Aid funds.

The report listed three reasons for this outcome:

1. The market value of investments declined dramatically during the evaluation period;
2. Loss and loss adjustment expenses, especially in the Accident Fund, increased significantly;
3. Premium rates during 2008 and 2009 were not sufficient to fund the system.

³¹ Information derived from "Washington Pension System Review," W.E. Upjohn Institute for Employment Research and "2010 Proposed Rate Discussion," Department of Labor and Industries, slide 43.

³² "Mainstreaming Workers' Compensation: Reforms for 2010," Washington Research Council, January 8, 2010, available at <http://www.researchcouncil.org/docs/PDF/WRCBusinessClimate/MainstreamingWorkersComp2010.pdf>.

The Department operated its normal programs while undercharging for its services. The Audit report said that, because of these three factors, there is,

“A 74.4 percent chance of insolvency in the Accident Fund within two years, 81.4 percent within three years and 89.5 percent within five years. A 3.9 percent probability of insolvency in the Medical Aid Fund in two years, 12.9 percent within three years and 26.5 percent within five years.”³³

The report also points out something troubling. If the Department wanted to keep premium levels at the “break-even rate,” the rate at which the Accident Fund merely breaks even but does not have a contingency reserve, the amount paid by businesses and employees would need to increase by 33 percent. But the Department only raised rates by 4.5 percent, even though the Department’s own estimate put the break-even rate increase at 23.3 percent.

Likewise, the Auditor’s office estimated that the Department should have raised the Medical Aid Fund premiums by 24.5 percent. The Department raised the Medical Aid Fund premiums by 8.4 percent in 2010, even though the Department’s estimate put the break-even rate increase at 21.5 percent.

This means the Department recognized that the rates needed to reach the “break-even” point would have put an even heavier burden on businesses and employees. While it is unlikely that any business would complain that workers’ compensation rates are too low, the tepid economic recovery could result in catastrophic rate increases in the near future if there is no systemic reform.

Appropriations For Non-Workers’ Compensation Projects

Over the past decade businesses have expressed their concern with policymakers’ penchant for dipping into one of the workers’ compensation accounts to pay for projects that are at best ancillary to the industrial insurance industry.

One of the reasons policymakers looked to the workers’ comp funds for loans to start a new program or expanding an existing program was that for several years the contingency levels were fairly high. In 2008, the combined contingency reserve stood at \$1.6 billion. However, due to many factors but primarily because of the economic recession, that contingency fund stood at just \$647 million on March 31, 2010.³⁴

Using premiums collected from businesses or employees to spend on programs or benefits that have little to do with industrial insurance overextends the funding source and can lead to sharp increases in premiums.

A recent example occurred when the legislature passed Senate Bill 5659 in 2008, which set up a paid family leave program for parents of newborn or adopted children. The program relied heavily on loans from the Supplemental Pension Fund. A year later, the Pension fund lost much of its value,³⁵ and the legislature was forced to delay implementation of the Family Leave Insurance Program for three years.

³³ “Workers’ Compensation Program: Audit Period July 1, 2008 through June 30, 2009,” Washington State Auditor’s Office, Report No. 1002832, December 31, 2009, pages 5-6.

³⁴ PowerPoint Presentation, “Industrial Insurance (State) Fund Interim Statutory Financial Information; Fiscal Year 2010 – Third Quarter As of March 31, 2010,” Department of Labor and Industries, available at <http://washingtonpolicy.org/sites/default/files/B.%20Economic%20update%20--%20Kirsta%20Glenn2.pdf> at 9.

³⁵ Ibid, at 10.

Other examples exist of the legislature funding non-insurance activities with insurance premiums. In 2002, funding for the Department of Labor & Industries' Employment Standards Program moved from the state's general fund to the Accident/Medical Aid accounts. This program administers the wage and hour laws of the state and provides education and outreach to businesses and labor regarding labor law and teen worker protections. The reason for the move was attributed to the state's general fund being too volatile to economic conditions thereby potentially harming this program's funding.³⁶

Also in 2002, the legislature moved funding for the Department's Apprenticeship program from the state's general fund to the Accident/Medical Aid fund. According to the Department, the program acts as the administrative arm of the Washington State Apprenticeship and Training Council, which ensures apprenticeship programs are following state and federal standards. Justification for this had to do with the safety training aspect to apprenticeship programs.³⁷

How Does Washington's System Stack up to Other States?

It should be noted that ascertaining true costs is very difficult. First, observers often disagree about what constitutes an "acceptable cost." Second, each state has a unique industrial composition that drives underlying costs in a unique way, making state-by-state comparisons difficult. Lastly, costs are often averaged across industries – but industry classifications and the corresponding premiums vary drastically.

Regardless of the complexity of comparing systems, there still exist many studies that look at a number of different categories and rate the states accordingly.

For instance, the National Academy of Social Insurance ranks Washington state as having the second most generous benefit payouts per covered worker, and third highest costs per percentage of covered wages.³⁸

The Oregon Department of Consumer and Business Services issues a study of workers' compensation premiums by state every other year.³⁹ Opponents of Initiative 1082 point to the report's ranking of Washington as having the 38th highest premium costs in the nation to mean that the state's workers' comp costs are well below average – and that when the employee contribution portion is factored into account, Washington has the 5th lowest cost for employers.

However, it is difficult to truly assess the usefulness of this comparison. As the report itself points out, because Washington's premiums are based on hours worked instead of payroll, study authors had to use their best guess to convert hours worked into payroll – and hours worked may result in an overstatement of payroll due to miscalculation of overtime. Therefore, the effective average payroll rate is most likely understated. In addition, the Oregon study does not take into

³⁶ "Use of Workers' Compensation Funds Report to the Legislature," Department of Labor and Industries, December 2006, page 9, available at <http://www.lni.wa.gov/Main/AboutLNI/Legislature/Implementation/PDFs/WkersCompFundUseRpt.pdf>.

³⁷ *Ibid* at 10.

³⁸ "Workers' Compensation Benefits Paid," *2010 Competitiveness Redbook*, WashACE, table 25.

³⁹ "Oregon Workers' Compensation Premium Rate Ranking: Calendar Year 2008," Oregon Department of Consumer & Business Services, March 2009, available at http://www.cbs.state.or.us/imd/rasums/2083/08web/08_2083.pdf.

account Washington's self-insured employees, which make up about one-third of the state's workforce (but only about 400 of the state's employers).

Office of Financial Management Analysis⁴⁰

The Office of Financial Management (OFM) predicts the impact of Initiative 1082 will be substantial on businesses as well as state and local government.

Naturally, the size of the state fund will shrink as employers move to private sector industrial insurance providers. OFM estimates the state fund will shrink by \$1.1 billion to \$1.43 billion by 2014. Revenue and costs are both expected to increase, as insurance providers pay license fees, and tax revenue to the state will rise \$61-75 million.

Costs could rise by up to \$22 million for the state per year and \$10.5 million to local governments because the state, which employs over 100,00 people, would no longer take one-half of the Medical Aid premium out of its workers' paychecks (the same would be true for private businesses). Local governments, which include K-12 education personnel, are in the same position. So, while the cost to the state could rise, payroll taxes to government workers would be reduced in the same manner that private-sector employees will see a bump in pay.

Other cost increases would come from the increased role the Office of Insurance Commissioner will play in regulating the industrial insurance market, estimated to be \$12 million over the next five fiscal years (2011-2015). OFM also forecasts approximately \$25 million in costs associated with administrative needs due to rulemaking changes and other systems needed for L&I to comply with the new law.

The Board of Industrial Appeals is also expected to see an increase in activity, which OFM assumes will cost the state \$28.4 million over the 2012-2015 time period.

Total cost increases to the state are expected in the \$202 million range for five fiscal years, and \$47.25 million in increases to local governments over the same time period. The Office of Financial Management did not attempt to estimate cost savings to state or local governments as a result of increased competition in the industrial insurance market.

The state would also see new revenues come in. OFM is assuming 320 new insurers would enter the market in Washington and 500 agents or brokers would be licensed to sell industrial insurance. These companies, agents and brokers would have to pay taxes and fees to the state. While the fees amount to a modest \$27,500 over the same five-year fiscal period, the tax estimates are in the \$51 million to \$65 million range over the 2013-2015 period (the market would not be open until July 1, 2012). Local government revenues are indeterminate; no one knows where new insurance companies and agents would locate within the state.

Task Force Must Address Technical Aspects Needed to Complete Reform

One of the concerns with Initiative 1082 is that it relies on the Joint Legislative Task Force to address some of the more complex parts of transitioning to a hybrid industrial insurance system. In doing so, the Task Force would have

⁴⁰ "Initiative 1082 Fiscal Impact," Office of Financial Management, available at <http://ofm.wa.gov/initiatives/2010/1082.pdf>.

to deal with the unfunded liabilities created by the Initiative. OFM estimates that 38 percent of employers would sign up with private sector industrial insurance providers by 2013, and over half of employers are expected to go this route by 2014.⁴¹

One aspect of industrial insurance, like most insurance systems, is that sometimes beneficiaries are entitled to long-term benefits if an injury is severe enough. Washington's state-run system uses a "pay-as-you-go" approach for cost-of-living increases (COLA) for long-term pensioners. Due to state law there is no contingency reserve set aside to pay for these COLA increases, as there are contingency reserves for the medical aid and accident funds.

According to the Office of the State Auditor, this situation results in approximately \$11 billion in future anticipated COLA expenditures for existing claims.⁴² The initiative does not specifically address this issue. The Joint Legislative Task Force would formulate the relevant policies needed to fix this long-term liability. As an example, it could emulate Nevada's experience when that state privatized its system. Officials were able to offload \$2 billion in unfunded liabilities to the private sector.⁴³ Washington would most likely attempt to do the same.

Another area of concern expressed by opponents of Initiative 1082 is extending the Insurance Fair Conduct Act and the state Consumer Protection Act to cover industrial insurance providers. As written, the initiative does not place industrial insurance companies under these provisions. However, the initiative process is not suited to make these types of regulatory revisions – initiatives are also unable to revise laws that do not exist.

Industrial insurance providers do not fall under the Insurance Fair Conduct Act or the Consumer Protection Act because, since the inception of industrial insurance one hundred years ago, no workers' compensation company has been allowed to operate in this state. This means there has been no need to include industrial insurance companies under either act until now. It also means L&I is not subject to these provisions. Therefore, should Initiative 1082 pass, the Task Force could recommend the regulatory or statutory changes needed to include industrial insurance providers under both acts by the time the market opens for competition in 2012.

Conclusion

Workers' compensation in Washington state is a complex monopoly system of government mandates and policies crossed with actuarial realities, all the while focusing on providing safe places for employees to work and caring for those who have experienced on-the-job injuries.

However, the "exclusive remedy" system – one where state government controls the industry, save for the one-half of one percent of businesses that can self-ensure, is on a shaky financial footing. The current system punishes a business community that has produced safer workplaces over the last two decades, and has been rewarded with steadily increasing insurance rates.

Initiative 1082 would introduce choice in industrial insurance – something that businesses have not had since the inception of industrial insurance in 1911. Businesses would be able to choose one of the several hundred of new insurance

⁴¹ Ibid.

⁴² Email to author from State Auditor Brian Sonntag's Office, August 12, 2010, copy available on request.

⁴³ "Workers' Compensation Gives Nevada Business Incentives," *Insurance Journal*, September 6, 2005, available at <http://www.insurancejournal.com/news/west/2005/09/06/59166.htm>.

companies expected to move into Washington, or the business could stay with the Department of Labor and Industries' fund.

A steady stream of research, backed by the empirical data from the experiences of West Virginia, Nevada and other states, shows that businesses and employees would benefit from introducing competition to Washington's industrial insurance market. Several other states have moved, or are exploring moves, toward privatizing their state industrial insurance funds. This recent trend was brought on mostly due to the current economic conditions, as policymakers in other states recognized that the private sector is better equipped to handle these insurance funds.

Initiative 1082 would not address every detail of the transition to a "hybrid" industrial insurance market, but it would set up a mechanism to address some of the concerns of both the business community and labor. The language in the initiative would not increase or reduce benefits for injured workers.

Initiative 1082 would help focus the industrial insurance industry on what it was originally intended to be: a true insurance plan which mitigates risk for employers, provides fair and reliable benefits for injured workers, and contributes to a stable business environment for all Washington citizens.

State	State Fund	Private Insurers	Self-Insurance	Type of Law
Alabama	No	Yes	i,g	Compulsory
Alaska	No	Yes	i	Compulsory
Arizona	Yes*	Yes	i,g	Compulsory
Arkansas	No	Yes	i,g	Compulsory
California	Yes	Yes	i	Compulsory
Colorado	Yes	Yes	i,g	Compulsory
Connecticut	No	Yes	i,g	Compulsory
Delaware	No	Yes	i,g	Compulsory
Dist. of Columbia	No	Yes	i	Compulsory
Florida	No	Yes	i,g	Compulsory
Georgia	No	Yes	i,g	Compulsory
Hawaii	No	Yes	i,g	Compulsory
Idaho	Yes	Yes	i	Compulsory
Illinois	No	Yes	i,g	Compulsory
Indiana	No	Yes	i	Compulsory
Iowa	No	Yes	i,g	Compulsory
Kansas	No	Yes	i,g	Compulsory
Kentucky	Yes	Yes	i,g	Compulsory
Louisiana	No	Yes	i,g	Compulsory
Maine	No	Yes	i,g	Compulsory
Maryland	Yes	Yes	i,g	Compulsory
Massachusetts	No	Yes	i,g	Compulsory
Michigan	No	Yes	i.g.	Compulsory
Minnesota	Yes	Yes	i,g	Compulsory
Mississippi	No	Yes	i,g	Compulsory

State	State Fund	Private Insurers	Self-Insurers	Type of Law
Missouri	No	Yes	i,g	Compulsory
Montana	Yes	Yes	i,g	Compulsory
Nebraska	No	Yes	i	Compulsory
Nevada	No	Yes	i,g	Compulsory
N. Hampshire	No	Yes	i,g	Compulsory
New Jersey	No	Yes	i	Elective
New Mexico	No	Yes	i,g	Compulsory
New York	Yes	Yes	i,g	Compulsory
N. Carolina	No	Yes	i,g	Compulsory
N. Dakota	Yes (monopoly)	No	None	Compulsory
Ohio	Yes (monopoly)	No	i	Compulsory
Oklahoma	Yes	Yes	i,g	Compulsory
Oregon	Yes	Yes	i,g	Compulsory
Pennsylvania	Yes	Yes	i,g	Compulsory
Rhode Island	No	Yes	i,g	Compulsory
S. Carolina	No	Yes	i,g	Compulsory
S. Dakota	No	Yes	i	Elective
Tennessee	No	Yes	i,g	Compulsory
Texas	Yes	Yes	i	Elective
Utah	Yes	Yes	i	Compulsory
Vermont	No	Yes	i	Compulsory
Virginia	No	Yes	i,g	Compulsory
Washington	Yes (monopoly)	No	i	Compulsory
West Virginia	No	Yes	i	Compulsory
Wisconsin	No	Yes	i	Compulsory
Wyoming	Yes (monopoly)	No	None	Compulsory for hazardous industries

Source: U.S. Chamber of Commerce

i – individual business

g – group of businesses can self-insure

* Arizona's fund is scheduled to be privatized in 2013

About the Author

Carl Gipson is Director of the Center for Small Business at Washington Policy Center. He also directs WPC's technology and telecommunications policy research. He regularly writes opinion pieces, legislative memos and policy notes, and is the author of *Reviving Washington's Small Business Climate*, *24 Ways to Improve Washington's Small Business Climate*, *A Citizen's Guide to Initiative 920: The Estate Tax*, and other publications. Carl appears regularly in print and broadcast media across the state and addresses chambers of commerce and other civic groups. He was a columnist for *The Olympian* in 2003 and received his bachelor's degree in political science from Western Washington University in 2001.



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