

**Department of Industrial Relations
Self Insurance Plans
Alternative Composite Deposit
Title 8, Chapter 8, Subchapter 2**

Statement of Emergency

The Department of Industrial Relations hereby finds that the promulgation of these regulations is necessary for the immediate preservation of the general welfare of California and its citizens. The following facts provide the basis for the finding of emergency.

Labor Code Section 3740 et.seq. established the Self-Insurers' Security Fund (Fund) to provide for the continuation of worker compensation benefits to employees of private self insured companies that are unable to meet their compensation liabilities for any reason, the most common reasons being insolvency and default (refusal or inability to pay existing liabilities). In such situations the Director of Industrial Relations orders the Fund to assume the workers compensation obligations of the defaulting or insolvent self insured employers in California pursuant to Labor Code Section 3701.5.

The Director also orders the private self insured company's security deposit (which may be any combination of surety bonds, letters of credit, securities, or cash held by the Department) to be converted to cash. The security deposit proceeds are transferred to the Security Fund to cover the cost of benefits to the self insurer's injured employees and to cover the administrative costs associated with payment of the claims. There is no guarantee, however, that the security deposits posted will always fully secure the ultimate costs of the claims. Any inadequacy in the amounts of the posted security deposits causes the Security Fund to assess all the remaining private self insurers to fund the shortfall so that the full measure of benefits may be paid to injured workers of insolvent self insured employers.

Due to many factors, including variable market conditions and the long "tail" of liability for workers' compensation claims, many self insured employers are finding it difficult (sometimes virtually impossible) to secure their workers' compensation liabilities in California with a surety bond or, to a lesser extent, with a letter of credit.

Since 1984, the Fund has assumed the claims of 54 insolvent private self insured employers (estates). As of December 31, 2001, the Fund has booked approximately \$76 million in future

Statement of Emergency

Page 2

claim liabilities and claim handling expenses, as documented in its 2001 Financial Statement. The Fund has approximately \$30 million in assets to offset this liability, leaving approximately \$46 million in unfunded liabilities. As indicated on page ten of the 2001 Financial Report, the Fund has assumed five additional estates, plus one estate has been assumed that is not listed on page ten. The addition of these estates brings the totals as of May, 2003 to approximately \$96 million in claims liabilities, \$40 million in assets, and \$56 million in unfunded liabilities.

The maximum assessment capability of the Security Fund under Labor Code Section 3745 is approximately \$4.5 million per year. Current cash flow needs of the Fund for payment of benefits in 2003, 2004, and 2005 are estimated at approximately \$10 million per year, without including the liabilities of any additional estates. The Security Fund itself is looking at imminent insolvency. If the Security Fund were unable to fund these payments of benefits, workers' compensation benefits due to the affected injured employees of insolvent or defaulting self insured employers would be reduced or terminated.

Since January 1, 2003, the Director has turned over three new estates to the Fund (Dillingham Construction, Bethlehem Steel, and Fleming Foods, successor to United Grocers). The extent of unfunded liabilities in these relatively small new estates has not yet been determined. The Fund's problems would be especially acute in the event of the insolvency of a large self insured employer resulting in potentially thousands of claims being turned over to the Fund.

To remedy the Fund's financial situation and prevent an impending crisis, the private self insured employers sponsored legislation (Chapter 866, s.2002) to provide a new method to collectively secure the workers' compensation liabilities of private self insured employers and to resolve the pending insolvency of the Security Fund. Labor Code Section 3701.8 authorizes a new collective posting of a broader array of security deposit instruments by the Fund as an "alternative deposit program" to the existing system under Labor Code Section 3701. At the same time, the alternative security deposit program provides an immediate means to build the financial strength and integrity of the Security Fund to pay both past and future insolvencies and defaults of workers' compensation liabilities of private self insured employers.

In order to implement the alternative security deposit system, the Director of Industrial Relations is required to adopt regulations. Pursuant to Labor Code Section 3701.8(a), "...(t)he regulations shall provide for the director to set a total security deposit requirement for these participating self-insured

employers based on a review of their annual reports and any other self-insurer information as may be specified by the director..." Pursuant to Labor Code Section 3701.8(g), "(n)otwithstanding any other provision of this section, the director shall, by regulation, set minimum credit, financial, or other conditions that a private self-insured must meet in order to be a fully participating self-insurer in the alternative security system..."

These regulations implement and make specific Labor Code Section 3701.8 and specify the manner in which the new assessment will function and how the funds will be collected and handled.

The adoption of these regulations will allow the Fund and the self insurers to enter into the alternative security deposit program agreements immediately, increase the net assets of the Fund to pay benefits already due, and insure future payment of workers compensation benefits for injured employees of private self insured employers that are unable to pay benefits due for any reason.

Without the immediate promulgation of these regulations, the Fund will not be able to implement Labor Code Section 3701.8 to collect the new deposit assessment that will enable it to move down the road to financial recovery. Failure to immediately promulgate the regulations would put the Fund into the position of further financial hardship and would place injured workers at the risk of not receiving workers' compensation benefits owed by the Fund.

Authority and Reference

This regulation was adopted pursuant to the authority granted in Labor Code section 3702.10. This regulation will clarify and make specific Labor Code section 3701.8.

Informative Digest/Policy Statement Overview

Labor Code section 3701.8 provides for an alternative security deposit program for private self insured employers with the Self Insurer's Security Fund (Fund). The proposal will require specific self insurers, as identified by the Office of Self Insurance Plans, to participate in the program. The program will require the eligible self insurer to secure its worker's compensation liabilities with the Self Insurers Security Fund (Fund). The self insurer will secure its liabilities through the payment of a deposit assessment to the Fund. The self insurer participating in the program will no longer be required to post an individual security deposit for the portion of its liabilities covered by the Fund.

Existing Section 15201 provides definitions for commonly used terminology related to workers' compensation self insurance. This section will be amended to include definitions of "alternative security deposit" and "Security Fund."

Existing Sections 15210, 15210.1 and 15210.2 require all private self insured employers to post and maintain a security deposit in accordance with the provisions of Labor Code Section 3701. These sections will be amended to add references to the new alternative composite deposit program requirements and to provide authority for summary revocation of a certificate to self insure for failure to secure workers' compensation liabilities for 60 days.

Existing Section 15216 provides for administration of insolvent self insurers claims. This proposal will provide for calling the security deposit for a defaulting self insurer's liabilities secured by an alternative composite deposit with the Fund.

A new Section 15220 will establish participation criteria in the alternative composite deposit program. The proposal provides that the Manager of Self Insurance Plan will identify all private self insured employers as either a fully participating member, a partially participating member or excluded from any participation. All self insurers identified as eligible for the program are required to participate in the alternative composite deposit.

A new section 15220.1 will identify a method for evaluating self insurer's financial status for companies without annual independently prepared financial statements or published credit ratings. The section will establish a new form, A4-7, Financial Summary, for rating the financial stability of that self insurer. This section will require the private self insurer to provide the financial information needed to evaluate the company.

A new section 15220.2 will specify that Self Insurance Plans will annually develop a list of the security deposit amounts required for each self insurer qualified for the alternative composite deposit program. This section will provide that a private self insurer that fails to file their Annual Report by April 1 of each year, shall be deemed to have twice the liabilities indicated on their prior year's Annual Report for the purpose of preparing the listing of required security deposits.

A new section 15220.3 will establish the Security Fund provisions for securing the liabilities covered by the Alternative Composite Deposit. This section requires the Security Fund to make a proposal in writing to the Manager of Self Insurance Plans and specifies the contents in the proposal.

A new section 15220.4 will establish three deposit assessments to be paid by the self insurer participating in the alternative composite deposit program. The assessment will be the Default Loss Fund Fee, Excess Liability Protection Fee, and the Pre-Existing Deposit Shortfall Fee.

A new Section 15220.5 will establish that the Security Fund is responsible for the collection of the assessments provided for in section 15220.4 and will also provide for penalties for failure to pay the assessments.

A new section 15220.6 will provide for an assessment made by the Security Fund for new self insurers. The assessment will be the New Self Insurers' Fair Share Contribution Fee and will be a pro rata contribution based on the first ten years of the Default Loss Fund.

A new Section 15220.7 will establish appeal procedures on alternative composite deposit assessments and penalties.

A new Section 15220.8 will require the Security Fund to provide detailed accounting reports to the Director on all the assessments and to post all cash collected with the Director. This section will also provide the Security Fund with an option to invest the cash outside the State Treasury. This section also provides for the release of cash to pay workers compensation benefits.

Existing Section 15430 provides for hearing procedures by the Director. This proposal will add the alternative composite deposit assessment as a provision for investigating or holding a hearing by the Director.

Disclosures Regarding the Proposed Action

The Department of Industrial Relations has made the following determinations:

Costs or Savings to State Agencies

No costs or savings to state agencies will result as a consequence of the proposed action.

Determination of Mandate

The Director of Industrial Relations has determined that the proposed regulations do not impose a mandate on local agencies or school districts or a mandate requiring reimbursement by the State pursuant to Part 7 (commencing with Section 17500) of

Division 4 of the Government Code because the proposed amendment will not require local agencies or school districts to incur additional costs in complying with the proposal. Furthermore, these regulations do not constitute a "new program or higher level of service of an existing program within the meaning of Section 6 of Article XIII B of the California constitution."

Cost or Savings to Local Agencies or School Districts Required to be Reimbursed

No costs to local agencies or school are required to be reimbursed in accordance with Government Code Sections 175000 through 17630.

Other Non-discretionary Costs or Savings Imposed on Local Agencies or School Districts

This proposal does not impose non-discretionary cost or savings imposed on local agencies or school districts.

Costs or Savings in Federal Funding to the State

This proposal will not result in costs or savings in federal funding to the state.

Impact on Housing Costs

The Department of Industrial Relations has made an initial determination that the amendment of this regulation will not have a significant effect on housing costs.

Cost Impact on Representative Private Persons or Businesses

The department is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

Impact on Business

The Department of Industrial Relations has made an initial determination that the amendment of this regulation will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California business to compete with businesses in other states.

Assessment of Job/Business Creation or Elimination

The Department has made an assessment that the proposed amendment to the regulation would not (1) create nor eliminate jobs within California, (2) create new business or eliminate existing businesses within California, and (3) affect the expansion of businesses currently doing business within California.

SMALL BUSINESS IMPACT

This regulation will have no adverse impact on small business because it does not impose any new requirements on employers nor does it amend any existing requirements impacting small business. Small businesses generally are not affected by workers' compensation self insurance regulations, since small businesses cannot qualify for self insurance and businesses affected by these regulations are not defined as small businesses.