STATE OF CALIFORNIA

WORKERS' COMPENSATION RATE STUDY COMMISSION

COMMISSION REPORT

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DENNIS J. AIGNER, Ph.D., CHAIRMAN
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STEWART L. LONG, Ph.D.
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MELCHIOR D. POWELL, Ph.D.
SUSAN D. SCHAEFER, Ph.D.
JAMES C. VAN HORNE, Ph.D

EXECUTIVE DIRECTOR:

RICHARD H. SOPER, CMC

VOLUME III
COMMISSION STAFF REPORT
SOPER & ASSOCIATES

MARCH 1992

STATE OF CALIFORNIA

WORKERS' COMPENSATION RATE STUDY COMMISSION

COMMISSION REPORT

VOLUME III
COMMISSION STAFF REPORT
SOPER & ASSOCIATES

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STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEMBERS OF THE COMMISSION STAFF
SOPER & ASSOCIATES

Consulting Team:

RICHARD H. SOPER, CMC, Executive Director
Principal (Los Angeles area)
Project Manager

GLENN M. SHOR, Ph.D., M.P.P.
Senior Associate Consultant (San Francisco area)
Assistant Project Manager

SUSAN M. WRIGHT, J.D.
Senior Associate Consultant (Sacramento area)

LEROY A. LOSEKE, CPCU, ARM, AIC
Senior Associate Consultant (Los Angeles area)

LORI B. ARLEN, M.B.A., CFA
Statistical Analyst (Los Angeles area)

BENJAMIN K. DAVIS
Research Assistant (San Francisco area)

Administration/Report Production Team:

VIRGINIA R. SUNDT
Director of Administration (Los Angeles area)

LORI R. DANIELS
Assistant Director of Administration (Los Angeles area)

JOAN E. ALLINSON
Project Coordinator (Los Angeles area)

CAROL J. SAKANASHI
Project Coordinator (Los Angeles area)

SOPER & ASSOCIATES
P. O. Box 3727
Palos Verdes Peninsula, California 92074

Tel: (310) 544-4049
FAX: (310) 544-0498

STATE OF CALIFORNIA

WORKERS' COMPENSATION RATE STUDY COMMISSION

MEMBERS OF THE COMMISSION

COMMISSIONERS:

DENNIS J. AIGNER, Ph.D., DEAN (Commission Chairman)
University of California, Irvine
Graduate School of Management
Irvine, California

PATRICIA A. CHESHIER, Ph.D., PROFESSOR
California State University, Sacramento
Department of Insurance & Finance
School of Business & Economics
Sacramento, California

STEWART L. LONG, Ph.D., PROFESSOR
California State University, Fullerton
Department of Economics
Fullerton, California

WILLIAM E. NEELEY, Ph.D., PROFESSOR
California State University, Stanislaus
Department of Public Administration
Turlock, California

MELCHIOR D. POWELL, Ph.D., DEAN
California State University, Long Beach
Graduate Center for Public Policy and Administration
Long Beach, California

SUSAN D. SCHAEFER, Ph.D., PROFESSOR
California State University, Hayward
Department of Management & Finance
School of Business & Economics
Hayward, California

JAMES C. VAN HORNE, Ph.D., PROFESSOR
Stanford University
Graduate School of Business
Stanford, California

EXECUTIVE DIRECTOR

RICHARD H. SOPER, CMC
Soper & Associates
Palos Verdes Peninsula, California

TABLE OF CONTENTS

VOLUME III
COMMISSION STAFF REPORT
SOPER & ASSOCIATES

COMMISSION REPORT

VOLUME III
COMMISSION STAFF REPORT
SOPER & ASSOCIATES

TABLE OF CONTENTS
SUMMARY

14.0 COMMISSION TESTIMONY ANALYSIS III-14.0-1

15.0 COMPARATIVE STATE ANALYSIS
QUESTIONNAIRE PROCEDURES III-15.0-1

A. COMMISSION MEETING MINUTES III-APPENDIX-1

REPORT PAGE EXPLANATION

Every page of the Report is identified with the volume and section number, section name and page number. The only exceptions are the reports prepared by the economic and actuarial sub-contract resources. The following is a detailed explanation of the "Page Header", "Exhibit 2.10" and "Page Footer":

HEADER EXPLANATION:
Lines one and two identify the State and Commission.
Line three identifies the Report volume and individual section number.
Line four is the name of the specific section.

2.7 SELF-INSURANCE

Self-insurance is allowed in California for public agencies and approved private businesses meeting financial and claims processing standards. Self-insured employers must post bonds equal to 135% of their incurred liability, and are required to belong to a self-insurers' security fund that operates on an assessment basis to cover losses of bankrupt self-insurers. Generally between 15% and 25% of private sector payroll comes under self insurance coverage. See Exhibit 2.10, "Portion of Payroll Under WC Self-Insurance California, 1958-Present". Self-insurance coverage appears to rise during times when insurer profitability is high.

EXHIBIT 2.10
PORTION OF PAYROLL UNDER WC SELF-INSURANCE
CALIFORNIA, 1958-PRESENT

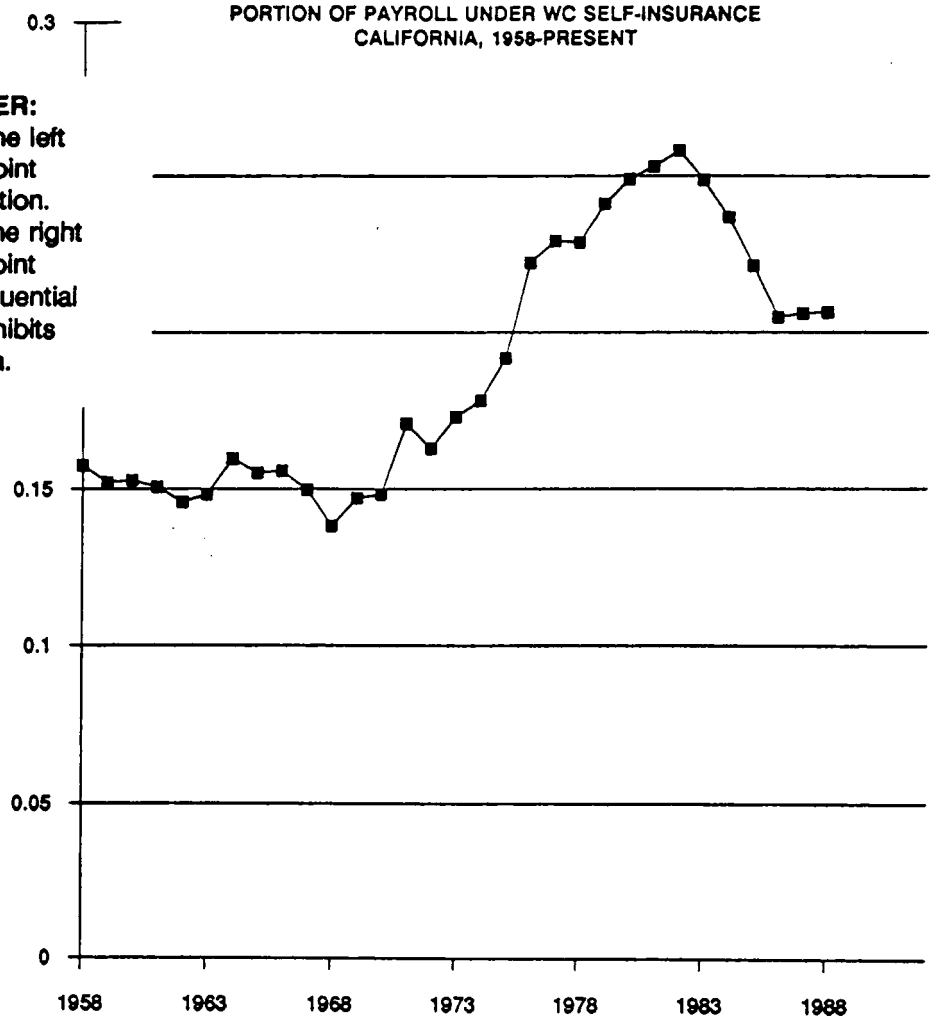

EXHIBIT NUMBER:
The number to the left of the decimal point indicates the section. The number to the right of the decimal point indicates the sequential numbering of exhibits within the section.

PAGE NUMBER EXPLANATION:
Each page is identified with a Roman numeral indicating the volume, the section number and an individual page number. The last number is the consecutive page numbering within the section.

COMMISSION REPORT

VOLUME III
COMMISSION STAFF REPORT
SOPER & ASSOCIATES

TABLE OF CONTENTS
UNABRIDGED

14.0 COMMISSION TESTIMONY ANALYSIS III-14.0-1

14.1 TASK ACTIVITY OVERVIEW III-14.0-1
14.1.1 Testimony Matrix Development III-14.0-1
14.2 METHODOLOGY AND DEFINITIONS III-14.0-2
14.2.1 Testimony Matrix Design III-14.0-2
14.2.2 Testimony Matrix Definitions: Matrix-A III-14.0-2
14.2.3 Testimony Matrix Exhibit: Matrix-A III-14.0-4

EXHIBIT 14.1
TESTIMONY MATRIX-A SAMPLE III-14.0-4

14.2.4 Testimony Matrix Definitions: Matrix-B III-14.0-5
14.2.5 Testimony Matrix Exhibit: Matrix-B III-14.0-6

EXHIBIT 14.2
TESTIMONY MATRIX-B SAMPLE III-14.0-6

14.2.6 Summary of Witness Testimony III-14.0-6
14.2.7 Witness Review of Testimony Summary III-14.0-7
14.2.8 Testimony Received: Dates and Witnesses III-14.0-7

EXHIBIT 14.3
COMMISSION RECEIVED TESTIMONY . . . III-14.0-7

14.3 TESTIMONY MATRIX EXHIBITS III-14.0-9
14.3.1 Commission Mandated Testimony Matrix-A III-14.0-9
14.3.2 Witness Testimony Matrix-B III-14.0-9

EXHIBIT 14.4
COMMISSION MANDATED
TESTIMONY MATRIX III-14.0-10

EXHIBIT 14.5
WITNESS TESTIMONY MATRIX-B III-14.0-19

14.4 WORKERS' COMPENSATION INSURANCE RATING BUREAU TESTIMONY OF: ROBERT MIKE & DAVE BELLUSCI III-14.0-29
14.4.1 Summary Overview III-14.0-29
14.4.2 Requests Made to the Commission III-14.0-29
14.4.3 Matrix Items Discussed III-14.0-29
14.4.4 Summary of Testimony III-14.0.30
14.4.5 Issues Discussed Following Testimony III-14.0-34
14.4.6 Written Materials Submitted III-14.0-44
14.5 SUMMARY OF TESTIMONY CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION TESTIMONY OF: MARK GERLACH III-14.0-45
14.5.1 Summary Overview III-14.0-45
14.5.2 Requests Made to the Commission III-14.0-45
14.5.3 Matrix Items Discussed III-14.0-46
14.5.4 Summary of Testimony III-14.0-46
14.5.5 Issues Discussed Following Testimony III-14.0-48
14.5.6 Written Materials Submitted III-14.0-52
14.6 SUMMARY OF TESTIMONY CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION TESTIMONY OF: MERLE RABINE III-14.0-53
14.6.1 Summary Overview III-14.0-53
14.6.2 Requests Made to the Commission III-14.0-53
14.6.3 Matrix Items Discussed III-14.0-53
14.6.4 Summary of Testimony Presented III-14.0-54
14.6.5 Issues Discussed Following Testimony III-14.0-55
14.6.6 Written Materials Presented III-14.0-58

14.7 SUMMARY OF TESTIMONY ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES TESTIMONY OF: THOMAS F. CONNEELY, JOHN PASQUALETTO & DR. DAVID APPEL III-14.0-59
14.7.1 Summary Overview III-14.0-59
14.7.2 Requests to the Commission III-14.0-59
14.7.3 Matrix Items Discussed III-14.0-59
14.7.4 Summary of Testimony III-14.0-60
14.7.5 Issues Discussed Following Testimony III-14.0-65
14.7.6 Written Materials Presented III-14.0-74
14.8 SUMMARY OF TESTIMONY NATIONAL ASSOCIATION OF INDEPENDENT INSURERS TESTIMONY OF: NANCY SCHROEDER III-14.0-75
14.8.1 Summary Overview III-14.0-75
14.8.2 Requests Made to the Commission III-14.0-75
14.8.3 Matrix Items Discussed III-14.0-75
14.8.4 Summary of Testimony III-14.0-75
14.8.5 Issues Discussed Following Testimony III-14.0-78
14.8.6 Written Materials Presented III-14.0-80
14.9 SUMMARY OF TESTIMONY STATE COMPENSATION INSURANCE FUND . III-14.0-81
14.9.1 Summary Overview III-14.0-81
14.9.2 Requests Made to the Commission III-14.0-81
14.9.3 Matrix Items Discussed III-14.0-81
14.9.4 Summary of Testimony III-14.0-82
14.9.5 Issues Discussed Following Testimony III-14.0-85
14.9.6 Written Materials Submitted III-14.0-90
14.10 SUMMARY OF TESTIMONY CENTER FOR LABOR RESEARCH & EDUCATION TESTIMONY OF: BRUCE POYER III-14.0-91
14.10.1 Summary Overview III-14.0-91
14.10.2 Requests Made to the Commission III-14.0-91
14.10.3 Matrix Items Discussed III-14.0-91
14.10.4 Analysis of Testimony III-14.0-92
14.10.5 Issues Discussed Following Presentation III-14.0-95
14.10.6 Written Materials Presented III-14.0-97

14.11 SUMMARY OF TESTIMONY
TESTIMONY OF: KEVIN McCARTHY
ATTORNEY AT LAW III-14.0-99
14.11.1 Summary Overview III-14.0-99
14.11.2 Requests Made to the Commission III-14.0-99
14.11.3 Matrix Items Discussed III-14.0-100
14.11.4 Analysis of Testimony III-14.0-100
14.11.5 Issues Discussed Following
Testimony III-14.0-102
14.11.6 Summary III-14.0-104
14.12 SUMMARY OF TESTIMONY: TOM RANKIN
CALIFORNIA LABOR FEDERATION,
AFL-CIO III-14.0-105
14.12.1 Summary Overview III-14.0-105
14.12.2 Requests Made to the Commission III-14.0-105
14.12.3 Matrix Items Discussed III-14.0-105
14.12.4 Summary of Testimony III-14.0-106
14.12.5 Issues Discussed Following
Testimony III-14.0-108
14.12.6 Written Materials Presented III-14.0-111
14.13 SUMMARY OF TESTIMONY
ALLIANCE OF AMERICAN INSURERS III-14.0-113
14.13.1 Summary Overview III-14.0-113
14.13.2 Requests Made to the Commission III-14.0-113
14.13.3 Matrix Items Discussed III-14.0-114
14.13.4 Summary of Testimony Presented III-14.0-114
14.13.5 Issues Discussed Following
Testimony III-14.0-118
14.13.6 Written Materials Provided III-14.0-120
14.14 SUMMARY OF TESTIMONY
ASSOCIATION OF CALIFORNIA
INSURANCE COMPANIES
TESTIMONY OF: BARRY CARMODY III-14.0-121
DON YOUNG
KEN FUJINO
14.14.1 Summary Overview III-14.0-121
14.14.2 Requests Made to the Commission III-14.0-121
14.14.3 Matrix Items Discussed III-14.0-121
14.14.4 Summary of Testimony III-14.0-122
14.14.5 Issues Discussed Following
Testimony III-14.0-125
14.14.6 Written Materials Presented III-14.0-128

14.15 SUMMARY OF TESTIMONY
AMERICAN INSURANCE ASSOCIATION
TESTIMONY OF: MARK WEBB AND
TOM BROWN III-14.0-129
14.15.1 Summary Overview III-14.0-129
14.15.2 Requests Made to the Commission III-14.0-129
14.15.3 Matrix Items Discussed III-14.0-129
14.15.4 Summary of Testimony III-14.0-130
14.15.5 Issues Discussed Following
Testimony III-14.0-132
14.15.6 Written Materials Provided III-14.0-134
14.16 SUMMARY OF TESTIMONY
CALIFORNIA SELF-INSURER'S ASSOCIATION
TESTIMONY OF: JOE MARKEY AND
JOAN SPIEGEL III-14.0-135
14.16.1 Summary Overview III-14.0-135
14.16.2 Requests Made to the Commission III-14.0-135
14.16.3 Matrix Items Discussed III-14.0-135
14.16.4 Summary of Testimony III-14.0-135
14.16.5 Issues Discussed Following
Testimony III-14.0-137
14.16.6 Written Materials Provided III-14.0-143
14.17 SUMMARY OF TESTIMONY
INDEPENDENT INSURANCE AGENTS &
BROKERS OF CALIFORNIA
TESTIMONY OF: ROBERT LEVERING III-14.0-145
14.17.1 Summary Overview III-14.0-145
14.17.2 Requests Made to the Commission III-14.0-145
14.17.3 Matrix Items Discussed III-14.0-145
14.17.4 Summary of Testimony III-14.0-146
14.17.5 Issues Discussed Following
Testimony III-14.0-148
14.17.6 Written Materials Submitted III-14.0-151
14.18 SUMMARY OF TESTIMONY
TESTIMONY OF: DR. DAVID APPEL III-14.0-153
14.18.1 Summary Overview III-14.0-153
14.18.2 Requests Made to the Commission III-14.0-153
14.18.3 Matrix Items Discussed III-14.0-153
14.18.4 Summary of Testimony III-14.0-153
14.18.5 Issues Discussed Following
Presentation III-14.0-157
14.18.6 Written Materials Submitted III-14.0-161

14.19 SUMMARY OF TESTIMONY
CALIFORNIA APPLICANTS
ATTORNEYS' ASSOCIATION
TESTIMONY OF: PATTERSON FROZEN
FOODS, INC. III-14.0-163
14.19.1 Summary Overview III-14.0-163
14.19.2 Requests Made to the Commission III-14.0-163
14.19.3 Matrix Items Discussed III-14.0-163
14.19.4 Summary of Testimony Presented III-14.0-164
14.19.5 Issues Discussed Following
Presentation III-14.0-165
14.19.6 Written Materials Presented III-14.0-168
14.20 SUMMARY OF TESTIMONY
WASHINGTON STATE FUND
TESTIMONY OF: MR. WILLIAM WHITE III-14.0-169
14.20.1 Summary Overview III-14.0-169
14.20.2 Requests Made to the Commission III-14.0-169
14.20.3 Matrix Items Discussed III-14.0-169
14.20.4 Summary of Presentation III-14.0-169
14.20.5 Issues Discussed Following
Presentation III-14.0-170
14.20.6 Written Materials Provided III-14.0-171
14.21 SUMMARY OF TESTIMONY
XL MANUFACTURING COMPANY
TESTIMONY OF: JOHN RUSH III-14.0-183
14.21.1 Summary Overview III-14.0-183
14.21.2 Requests Made to the Commission III-14.0-183
14.21.3 Matrix Items Discussed III-14.0-183
14.21.4 Summary of Testimony III-14.0-183
14.21.5 Issues Discussed Following
Testimony III-14.0-185
14.21.6 Written Materials Submitted III-14.0-185
14.22 SUMMARY OF TESTIMONY
BURGER KING
TESTIMONY OF: MARK GERLACH AND
RICHARD BRENING III-14.0-187
14.22.1 Summary Overview III-14.0-187
14.22.2 Requests Made to the Commission III-14.0-187
14.22.3 Matrix Items Discussed III-14.0-187
14.22.4 Summary of Testimony III-14.0-188
14.22.5 Issues Discussed Following
Testimony III-14.0-190
14.22.6 Written Materials Submitted III-14.0-193

14.23 SUMMARY OF TESTIMONY
ROUND TABLE PIZZA
TESTIMONY OF: ALLEN TOY III-14.0-195
14.23.1 Summary Overview III-14.0-195
14.23.2 Requests Made to the Commission III-14.0-195
14.23.3 Matrix Items Discussed III-14.0-195
14.23.4 Summary of Testimony Presented III-14.0-195
14.23.5 Issues Discussed Following Testimony III-14.0-196
14.23.6 Written Materials Submitted III-14.0-196
14.24 SUMMARY OF TESTIMONY
J. C. PENNEY COMPANY
TESTIMONY OF: DONNA MOSLEY III-14.0-197
14.24.1 Summary Overview III-14.0-197
14.24.2 Requests Made to the Commission III-14.0-197
14.24.3 Matrix Items Discussed III-14.0-197
14.24.4 Summary of Testimony III-14.0-197
14.24.5 Issues Discussed Following Testimony III-14.0-198
14.24.6 Written Materials Submitted III-14.0-200
14.25 SUMMARY OF TESTIMONY
LANDRY PERSONNEL GROUP
TESTIMONY OF: LEE LANDRY III-14.0-201
14.25.1 Summary Overview III-14.0-201
14.25.2 Requests Made to the Commission III-14.0-201
14.25.3 Matrix Items Discussed III-14.0-201
14.25.4 Summary of Testimony III-14.0-201
14.25.5 Issues Discussed Following Testimony III-14.0-202
14.25.6 Written Materials Provided III-14.0-203
14.26 SUMMARY OF TESTIMONY
ASSOCIATION OF CALIFORNIA WATER AGENCIES JOINT POWERS INSURANCE AUTHORITY
TESTIMONY OF: JERRY STOCKETT III-14.0-205
14.26.1 Summary Overview III-14.0-205
14.26.2 Requests Made to the Commission III-14.0-205
14.26.3 Matrix Items Discussed III-14.0-205
14.26.4 Summary of Testimony III-14.0-205
14.26.5 Issues Discussed Following Testimony III-14.0-206
14.26.6 Written Materials Submitted III-14.0-208

14.27 SUMMARY OF TESTIMONY
CALIFORNIA WEBBING INDUSTRIES
TESTIMONY OF: STEVEN KELEN III-14.0-209
14.27.1 Summary Overview III-14.0-209
14.27.2 Requests Made to the Commission III-14.0-209
14.27.3 Matrix Items Discussed III-14.0-209
14.27.4 Summary of Testimony III-14.0-209
14.27.5 Issues Discussed Following Testimony III-14.0-211
14.27.6 Written Materials Submitted III-14.0-212
14.28 SUMMARY OF TESTIMONY
STATE OF CALIFORNIA
OFFICE OF SELF-INSURANCE PLANS
TESTIMONY OF: MARK ASHCRAFT III-14.0-213
14.28.1 Summary Overview III-14.0-213
14.28.2 Requests Made to the Commission III-14.0-213
14.28.3 Matrix Items Discussed III-14.0-213
14.28.4 Summary of Testimony III-14.0-213
14.28.5 Issues Discussed Following Testimony III-14.0-216
14.28.6 Written Materials Submitted III-14.0-222
14.29 SUMMARY OF TESTIMONY
ZERO CORPORATION
TESTIMONY OF:
WILFORD GODBOLD, JR. III-14.0-223
14.29.1 Summary Overview III-14.0-223
14.29.2 Requests Made to the Commission III-14.0-223
14.29.3 Matrix Items Discussed III-14.0-223
14.29.4 Summary of Testimony III-14.0-223
14.29.5 Issues Discussed Following Testimony III-14.0-224
14.29.6 Written Materials Presented III-14.0-226
14.30 SUMMARY OF TESTIMONY
SCHOOLS EXCESS LIABILITY FUND
TESTIMONY OF: JOHN WILSON III-14.0-227
14.30.1 Summary Overview III-14.0-227
14.30.2 Requests Made to the Commission III-14.0-227
14.30.3 Matrix Items Discussed III-14.0-227
14.30.4 Summary of Testimony III-14.0-227
14.30.5 Issues Discussed Following Testimony III-14.0-228
14.30.6 Written Materials Presented III-14.0-229

14.31 SUMMARY OF TESTIMONY
STATE OF CALIFORNIA
OFFICE OF BENEFIT ASSISTANCE &
ENFORCEMENT
TESTIMONY OF: CHRISTINE BAKER III-14.0-231
14.31.1 Summary Overview III-14.0-231
14.31.2 Requests Made to the Commission III-14.0-231
14.31.3 Matrix Items Discussed III-14.0-231
14.31.4 Summary of Testimony III-14.0-231
14.31.5 Issues Discussed Following
Testimony III-14.0-232
14.31.6 Written Materials Submitted III-14.0-233
14.32 SUMMARY OF TESTIMONY
STATE COMPENSATION INSURANCE FUND
TESTIMONY OF: BRAD RICHMOND
SAFETY & HEALTH MANAGER
NORM HANSEN, VICE PRESIDENT III-14.0-235
14.32.1 Summary Overview III-14.0-235
14.32.2 Requests Made to the Commission III-14.0-235
14.32.3 Matrix Items Discussed III-14.0-235
14.32.4 Summary of Testimony III-14.0-235
14.32.5 Issues Discussed Following
Testimony III-14.0-237
14.32.6 Written Materials Submitted III-14.0-240
14.33 SUMMARY OF TESTIMONY
STATE OF CALIFORNIA DIVISION
OF WORKERS' COMPENSATION
TESTIMONY OF: CASEY YOUNG
ADMINISTRATIVE DIRECTOR III-14.0-241
14.33.1 Summary Overview III-14.0-241
14.33.2 Requests Made to the Commission III-14.0-241
14.33.3 Matrix Items Discussed III-14.0-241
14.33.4 Summary of Testimony III-14.0-241
14.33.5 Issues Discussed Following
Testimony III-14.0-242
14.33.6 Written Materials Submitted III-14.0-242
14.34 SUMMARY OF TESTIMONY
UNICARE INSURANCE
TESTIMONY OF: RUSSELL LEATHERBY . . . III-14.0-243
14.34.1 Summary Overview III-14.0-243
14.34.2 Requests Made to the Commission III-14.0-243
14.34.3 Matrix Items Discussed III-14.0-243
14.34.4 Summary of Testimony III-14.0-243

14.34.5 Issues Discussed Following Testimony III-14.0-245
14.34.6 Written Material Submitted III-14.0-248
14.35 SUMMARY OF TESTIMONY PACIFIC ACTUARIAL CONSULTANTS TESTIMONY OF: WENDY JOHNSON III-14.0-249
14.35.1 Summary Overview III-14.0-249
14.35.2 Requests Made to the Commission III-14.0-249
14.35.3 Matrix Items Discussed III-14.0-249
14.35.4 Summary of Testimony III-14.0-249
14.35.5 Issues Discussed Following Testimony III-14.0-250
14.35.6 Written Materials Submitted III-14.0-251
14.36 SUMMARY OF TESTIMONY THE INDUSTRIAL MEDICAL COUNCIL TESTIMONY OF: DR. IRA MONOSSON ... III-14.0-253
14.36.1 Summary Overview III-14.0-253
14.36.2 Requests Made to the Commission III-14.0-253
14.36.3 Matrix Items Discussed III-14.0-253
14.36.4 Summary of Testimony III-14.0-253
14.36.5 Issues Discussed Following Testimony III-14.0-254
14.36.6 Written Materials Submitted III-14.0-256

15.0 COMPARATIVE STATE ANALYSIS QUESTIONNAIRE PROCEDURES III-15.0-1

15.1 QUESTIONNAIRE STRATEGY III-15.0-1
15.1.1 Questionnaire Distribution III-15.0-1
15.1.2 Questionnaire Format Types III-15.0-1
15.2 QUESTIONNAIRE TRANSMITTAL III-15.0-1

EXHIBIT 15.1
QUESTIONNAIRE TRANSMITTAL LETTER SAMPLE III-15.0-2

15.2.1 State Insurance Commissioner Packet III-15.0-5
15.2.2 State Administrative Workers' Compensation Administrator Packet III-15.0-5
15.2.3 Workers' Compensation Rating Bureau Packet III-15.0-5
15.3 QUESTIONNAIRE DOCUMENTS III-15.0-6
15.3.1 Workers' Compensation Analysis Staff Memorandum III-15.0-6

EXHIBIT 15.2
STAFF QUESTIONNAIRE
EXPLANATION MEMORANDUM -
STATE INSURANCE
COMMISSIONER PACKET III-15.0-6

15.3.2 Workers' Compensation Rate Study Commission - Objectives and Responsibilities III-15.0-9

EXHIBIT 15.3
STATE OF CALIFORNIA
WORKERS' COMPENSATION
RATE STUDY COMMISSION -
OBJECTIVES AND RESPONSIBILITIES . . . III-15.0-9

15.3.3 Questionnaire I - Basic III-15.0-15

EXHIBIT 15.4
QUESTIONNAIRE I - BASIC III-15.0-15

15.3.4 Questionnaire II - Technical III-15.0-34

EXHIBIT 15.5
QUESTIONNAIRE II - TECHNICAL III-15.0-34

15.3.5 Questionnaire III - Bureau III-15.0-45

EXHIBIT 15.6
QUESTIONNAIRE III - BUREAU III-15.0-45

APPENDICES

A. COMMISSION MEETING MINUTES III-APPENDIX-1

EXHIBIT A-III-1
COMMISSION MEETING MINUTES
DIRECTORY III-APPENDIX-1

EXHIBIT A-III-2
SAMPLE COMMISSION MEETING AGENDA . . . III-APPENDIX-3

A.1 December 17, 1990 Minutes III-APPENDIX-5

A.2 January 15, 1991 Minutes III-APPENDIX-9

A.3 February 15, 1991 Minutes III-APPENDIX-15

A.4 April 8, 1991 Minutes III-APPENDIX-17

A.5 May 29, 1991 Minutes III-APPENDIX-23

A.6 June 12, 1991 Minutes III-APPENDIX-25

A.7 July 16, 1991 Minutes III-APPENDIX-27

A.8 August 21, 1991 Minutes III-APPENDIX-31

A.9 September 20, 1991 Minutes III-APPENDIX-39

A.10 October 25, 1991 Minutes III-APPENDIX-45

A.11 November 15, 1991 Minutes III-APPENDIX-51

A.12 December 13, 1991 Minutes III-APPENDIX-59

A.13 January 10, 1992 Minutes III-APPENDIX-63

A.14 January 24, 1992 Minutes III-APPENDIX-67

A.15 February 7, 1992 Minutes III-APPENDIX-71

A.16 February 20 - 21, 1992 Minutes III-APPENDIX-75

A.17 March 6, 1992 Minutes III-APPENDIX-83

A.18 March 20, 1992 Minutes III-APPENDIX-89

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SECTION 14.0

COMMISSION TESTIMONY ANALYSIS

14.1 TASK ACTIVITY OVERVIEW III-14.0-1

14.2 METHODOLOGY AND DEFINITIONS III-14.0-2

14.3 TESTIMONY MATRIX EXHIBITS III-14.0-9

14.4 - 14.36 INDIVIDUAL TESTIMONY III-14.0-29

SECTION 14.0

COMMISSION TESTIMONY ANALYSIS

14.1 TASK ACTIVITY OVERVIEW

This section of the Commission Staff Report is concerned with testimony and other materials presented to the Workers' Compensation Rate Study Commission during the course of its public meetings. These meetings spanned, 1991, and concluded with the December 13, 1991 hearing, at which time the Commission issued a deadline for any additional materials to be submitted on or before January 2, 1992.

During the period of commission testimony, thirty three (33) witnesses came forward representing the insurance industry, organized labor, the self-insurance community, the legal and medical profession, economists, insurance consultants, small and large employers, joint powers agencies, insurance trade associations, and several state departments, including the Division of Workers' Compensation and the Office of Self-Insurance Plans. In summary virtually every witness was considered a workers' compensation stakeholder.

The Workers' Compensation stakeholder testimony covered a broad range of issues, some of which extended beyond the ratemaking issues. The Commission was receptive to this testimony to the extent that it clarified the nature of the workers' compensation problem in the State of California, noting that it was often difficult to segregate one aspect of the problem from another when focusing on the ratemaking issue.

14.1.1 TESTIMONY MATRIX DEVELOPMENT

After the receipt of testimony which took place in March and April, 1991, the Commission required an index to provide:

A summary of issues that were discussed to determine if any of the subject areas of the legislative "charge" had been omitted

A reference to tie the testimony to these specific issues

The Commission Staff developed the "Testimony Matrix" which is explained in detail in Subsection 14.2 and is utilized to provide an overview of findings in Subsection 14.3. In order to develop the matrices, each witnesses' testimony was summarized. Section 14.2 explains the methodology used as well as the general definitions of the categories used on the matrices.

Upon reviewing the matrices, a Commission Subcommittee consisting of Commissioners Susan Schaefer, Ph.D. and William Neeley, Ph.D. assisted by Staff Senior Consultant Susan Wright, J.D., identified additional areas which required further information including:

Equity for small business employers
Aggregate excess insurance
Cost of actual operation (as affects small businesses)
Safety incentives

(Continued)

Self-insurance/pools
Profitability
Medical Considerations

The identification of these areas led to further public hearings in October, November and December of 1991, during which additional testimony was received related to the above items.

14.2 METHODOLOGY AND DEFINITIONS

The sections that follow represent the matrices that were developed and the summarized testimony of the 33 presenting witnesses. It should be kept in mind that the matrices serve as an index. From this index, it can readily be determined which issues were of importance or discussed by the witness. The summarized testimony can then be reviewed to obtain a synopsis of the major points made by the witness. Lastly, the transcript of the hearings were provided to the Commission to be used as an additional resource to review the witness' verbatim testimony as needed.

As this task was initially conceptualized, a table or chart was needed to enable the Commission to refer to issues discussed by witnesses, identifying what was said, especially in key areas of the "charge" facing the Commission. A matrix was developed which purported to identify parties, issues and to assign a weight to the witnesses' testimony. The subsection explains the methodology used:

To design the matrix
To summarize the testimony
To weight the focus of the witnesses' testimony
To define the terms used on the matrix

14.2.1 TESTIMONY MATRIX DESIGN

In summary, the testimony matrix design criteria objective involved a concise method of analyzing testimony and providing a single page summary overview of the findings. The matrices are an index to the testimony.

There are two pages to the matrix, an "A" page (hereinafter "Matrix-A") which represents the categories specified by the Legislature to be examined by the Commission, and a "B" page (hereinafter "Matrix-B") which identifies issues which surfaced repeatedly throughout the course of the testimony.

Across the top of Matrix-A and Matrix-B are the names of the witnesses identified first by the group or organization they represent, and secondly by the individual's last name. In some situations, an organization had more than one representative, or appeared more than once before the Commission. The names appear in the order in which testimony was received throughout the public hearings (March 12 through December 13, 1991). Those witnesses are specifically listed in Exhibit 14.3 located in Subsection 14.2.6 which follows.

Matrix-A and Matrix-B utilize the same point system. Points range from one (1) to three (3), with 3 being the "highest" focus or level of importance, 2 being "important", and 1 being mentioned in the testimony, but not a major focal point. Additionally, if one of these issues was discussed by the Commission during its question and answer period, then the letter "X" was used to indicate that a discussion took place.

14.2.2 TESTIMONY MATRIX DEFINITIONS: MATRIX-A

There are 13 Legislation-identified issues which appear on the Matrix-A pages. They are as follows:

AGGREGATE EXCESS INSURANCE: discussion concerning the Commission's charge to evaluate whether Insurance Code Section 703.5's prohibition against the sale by admitted California insurers (or discussion between employer and broker) of aggregate excess insurance should be repealed as it pertains to public self-insured employers.

APPROPRIATE/EXPEDITIOUS CLAIMS SERVICE: discussion concerning the Commission's "charge" to evaluate the extent to which the present California workers' compensations ratemaking system and proposed alternatives meet the goal of providing appropriate and expeditious claim services to injured employees (includes discussion concerning the provision of benefits to injured workers, recourse available to injured workers, quality of claim services offered by insurance companies, self-insured employers and a review/audit of those claim services by state agencies).

AVAILABILITY OF INSURANCE (MARKET AVAILABILITY): discussion concerning the Commission's "charge" to evaluate the extent to which the present California workers' compensation ratemaking system and proposed alternatives meet the goal of encouraging availability of insurance to all sizes and classifications of employers to assure a stable, predictable, and competitive insurance market, with a focus on availability.

COMPETITION BETWEEN INSURERS: discussion concerning the Commission's "charge" to analyze the extent to which the present ratemaking system fosters or discourages competition between insurers.

COST OF ACTUAL OPERATION (LOWEST NET COST TO INSUREDS): discussion concerning the Commission's "charge" to evaluate the extent to which the present California workers' compensation ratemaking system and proposed alternatives meet the goal of providing the lowest net cost to insured employers consistent with the protection and services provided and the losses and expenses incurred.

EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM: discussion concerning the Commission's "charge" to evaluate the extent to which the present California workers' compensation ratemaking system and proposed alternatives meet the goal of providing a fair and equitable distribution of the costs of the system to insured employers reflecting, to the extent consonant with sound principles of insurance, the actual losses and expenses of individual employers.

EXCLUSIVE STATE FUND: ADVANTAGES/DISADVANTAGES: discussion concerning the Commission's "charge" to analyze those states which use an exclusive state fund to provide workers' compensation insurance to employers, and the advantages and disadvantages of establishing an exclusive state fund in California. (Please note that the term exclusive state fund has been accepted by the insurance industry and replaces the previously used term "monopolistic state fund".)

MINIMUM RATE LAW: discussion concerning the effect of maintaining/abolishing the minimum rate law; an analysis of all aspects of the current system by which minimum rates are established in California, including an analysis the extent to which this system fosters or discourages competition between insurers;

PROFITABILITY (REASONABLE RATE OF RETURN): discussion concerning the Commission's "charge" to evaluate the extent to which the present California workers' compensation ratemaking system and proposed alternative meet the goal of providing a reasonable rate of return to insurers.

RATE STABILITY/PREDICTABILITY: discussion concerning the Commission's "charge" to evaluate the extent to which the present California workers' compensation ratemaking system and proposed alternatives meet the goal of encouraging predictable, and competitive insurance market, with a focus on rate stability and predictability.

RATING BUREAU FUNCTIONS: discussion concerning the Commission's "charge" to analyze the functions of the Workers' Compensation Insurance Rating Bureau and whether those functions should instead be performed by the Department of Insurance.

SAFETY INCENTIVES: discussion concerning the Commission's "charge" to evaluate the extent to which California's present workers' compensation ratemaking system and proposed alternatives meet the goal of providing financial incentives to insured employers to maintain safe operations.

SOLVENCY (SECURITY OF PAYMENT OF BENEFITS): discussion concerning the Commission's "charge" to evaluate the extent to which California's present workers' compensation ratemaking system and proposed alternatives meet the goal of assuring security of the payment of benefits from the insurer to injured workers.

Additionally, a category titled "WRITTEN MATERIALS PRESENTED" was included with these legislation-identified issues, to enable the Commission to more easily identify those witnesses who had provided written or other materials.

14.2.3 TESTIMONY MATRIX EXHIBIT: MATRIX-A

A sample Exhibit 14.1 of an actual testimony matrix has been provided in order to clarify the definition explanation. Testifying witnesses are identified in the horizontal description section. The thirteen (13) legislation-identified issues appear in the vertical description section. Following is Exhibit 14.1:

EXHIBIT 14.1
TESTIMONY MATRIX-A SAMPLE

DESCRIPTION*	WORKERS' COMPENSATION INSURANCE RATING BUREAU	CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION (Gerlach)	CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION (Rabine)	ASSOCIATION OF CALIFORNIA INSURANCE CO. (Conneely / Appel / Pasqualetto)
AGGREGATE EXCESS INSURANCE				
APPROPRIATE / EXPEDITIOUS CLAIMS SERVICE			3 X	
AVAILABILITY OF INSURANCE (MARKET AVAILABILITY)		1		
COMPETITION BETWEEN INSURERS	1 X	3	3 X	2 X
COST OF ACTUAL OPERATION (LOWEST NET COST TO INSURED)			1 X	
EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM	3	1		1
EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES			3	
MINIMUM RATE LAW		3 X	3	3
PROFITABILITY (REASONABLE RATE OF RETURN)	3 X	1		3 X
RATE STABILITY / PREDICTABILITY	3		3	1
RATING BUREAU FUNCTIONS	3 X	X		
SAFETY INCENTIVES	3 X	3	3	3
SOLVENCY (SECURITY OF PAYMENT OF BENEFITS)		1 X		3
WRITTEN MATERIALS	YES	YES	YES	YES

14.2.4 TESTIMONY MATRIX DEFINITIONS: MATRIX-B

The Matrix-B pages contain a category of issues specifically identified by the witnesses. These additional categories include the following:

ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS): discussion concerning analysis of the present workers' compensation insurance ratemaking system and the effectiveness of workers' compensation insurance ratemaking system in other states.

BROKER'S ROLE (COMMISSIONS/MARKETING): discussion concerning the role of the broker in the workers' compensation insurance process, renewing insurance, etc.

COST FACTORS/DRIVER OF SYSTEM: discussion concerning costs that drive the workers' compensation system including medical, legal, and rehabilitation costs, as well as costs related to stress claims.

DATA (AVAILABILITY/IMPARTIALITY): discussion concerning caveats to the Commission to scrutinize the source of data being made available to it, as well as discussions concerning the manner in which data was being prepared for the Commission by various groups.

DIVIDENDS: discussion concerning the extent to which California's present workers' compensation ratemaking system provides financial incentives to insured employers through its use of dividends, etc.

EQUITY/SMALL BUSINESS EMPLOYERS: discussion concerning availability of insurance services, claim services, dividends, safety groups, etc. to the small business employer.

INJURED WORKERS' BILL OF RIGHTS: discussion concerning the need for an amendment to assure prompt and expeditious provision of benefits to injured workers.

JOB CLASSIFICATIONS/CLASSIFICATION RATING: discussion concerning the effect on small employers of reclassification of jobs, recourse concerning the Insurance Rating Bureau's classification process, the number of classifications, etc.

LOSS CONTROL: discussion concerning insurer loss control services, the impact on workplace injuries, etc.

NEED FOR WORKERS COMPENSATION REFORM/BENEFIT INCREASES: discussion concerning the ongoing need for reform in the area of workers' compensation law, coupled with increased benefits for the injured worker.

POLITICAL MANIPULATION OF RATES: discussion concerning the role of the Insurance Commissioner, the Legislature and Governor, and their ability to influence the ratemaking process; impact on other states' ratemaking system when subject to political manipulation of rates, etc.

RATE ADEQUACY: discussion concerning the Commission's charge to evaluate the present ratemaking system to the end that rates are adequate. (Discussion often overlaps into area of "solvency", rate stability/predictability".)

PROSPECTIVE VERSUS RETROSPECTIVE RATING: discussion concerning front-end pricing versus retrospective pricing, including effect of dividends, etc.

SELF-INSURANCE/POOLS: discussion related to the self-insurance workers' compensation marketplace including criteria for self-insurance, solvency, claims administration, joint powers agencies and other pooling mechanisms, need to purchase aggregate excess insurance, etc.

VOLUNTARY/INVOLUNTARY MARKET (RESIDUAL MARKET ANALYSIS): discussion concerning the State Commission Insurance Fund's share of the Insurance market, both voluntary and involuntary, and how the involuntary market is managed and handled in other states.

14.2.5 TESTIMONY MATRIX EXHIBIT: MATRIX-B

A sample Exhibit 14.2 of an actual testimony matrix has been provided in order to clarify the definition explanation. Testimony witnesses are identified horizontally in the description section. Vertically the description contains categories of issues specifically identified by witnesses. Following is Exhibit 14.2:

EXHIBIT 14.2
TESTIMONY MATRIX-B SAMPLE

DESCRIPTION	CALIFORNIA FEDERATION OF LABOR (Rankin)	ALLIANCE OF AMERICAN INSURERS (Lawson / Bateman / Hoschek)	ASSOCIATION OF CALIFORNIA INSURANCE CO. (Carmody / Young / Fujino)	AMERICAN INSURANCE ASSOCIATION (Webb / Brown)
ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS)	3	2		1
BROKER'S ROLE (COMMISSIONS / MARKETING)				
COST FACTORS / DRIVERS OF SYSTEM		3	3	3 X
DATA (AVAILABILITY / IMPARTIALITY)	3			
DIVIDENDS	X			3 X
EQUITY / SMALL BUSINESS EMPLOYERS				X
INJURED WORKERS' BILL OF RIGHTS				
JOB CLASSIFICATION / CLASSIFICATION RATING				
LOSS CONTROL	3	3 X	2	3
NEED FOR WORK COMP REFORM / BENEFIT INCREASES	3	3	1	3
POLITICAL MANIPULATION OF RATES	3	3	1	
PROSPECTIVE VERSUS RETROSPECTIVE RATING	X			1
RATE ADEQUACY		2		3
SELF-INSURANCE / POOLS				
VOLUNTARY / INVOLUNTARY MKT. (RESIDUAL MKT. ANALYSIS)		X		3

14.2.6 SUMMARY OF WITNESS TESTIMONY

In addition to the matrix, a transcript of the proceedings was reviewed and the testimony of each witness summarized. Each summary is divided into six (6) key parts:

1 Summary Overview
2 Requests Made to the Commission
3 Matrix Items Discussed
4 Summary of Testimony

5 Issues Discussed Following Testimony
6 Written Materials Presented

SUMMARY OVERVIEW: The first section is a brief summary of the main points of the witness' testimony.

REQUESTS MADE TO THE COMMISSION: This section concerned specific requests made to the commission by the witness.

MATRIX ITEMS DISCUSSED: The third section ties back directly to the matrix itself and serves as a reference. [*For example, if a Commissioner wanted to review all testimony which pertained to "Aggregate Excess Insurance", it would be a simple job to ascertain which witnesses had addressed the issue, and, using the matrix as an index, move directly to that testimony.*]

SUMMARY OF TESTIMONY: This section summarizes the actual testimony of the witness.

ISSUES DISCUSSED FOLLOWING TESTIMONY: This section is almost a verbatim summary of the questions and answers raised by the Commission following the witnesses' presentation.

WRITTEN MATERIALS SUBMITTED: This section indicates whether the witness provided written reports or other materials to the Commission.

14.2.7 WITNESS REVIEW OF TESTIMONY SUMMARY

The individual witnesses were provided with a copy of the matrix and summary of their testimony. They were encouraged to review and make changes to the testimony summary if they did not agree with the reviewer's statements. The majority of the witnesses sought to clarify certain aspects of the summary, and these changes were incorporated into the final product.

14.2.8 TESTIMONY RECEIVED: DATES AND WITNESSES

The Commission received testimony on six specific dates: March 12, April 8 and 9, October 25, November 15 and December 13, 1991. The following Exhibit 14.3 identifies the witnesses that provided testimony on those dates, listed in sequential order of appearance.

EXHIBIT 14.3
COMMISSION RECEIVED TESTIMONY

March 12, 1991

Workers' Compensation Insurance Rating Bureau:
Robert Mike and David Bellusci
California Applicant's Attorneys' Association:
Mark Gerlach and Merle Rabine
Association of California Insurance Companies:
Tom Conneely, David Appel and John Pasqualetto
National Association of Independent Insurers:
Nancy Schroeder

April 8, 1991

State Compensation Insurance Fund:
Jack Webb, Geri Madden and James Neary

EXHIBIT 14.3 - Continued

Center for Labor Research and Education:
Bruce Poyer
Attorney-at-Law:
Kevin McCarthy
Alliance of American Insurers:
Rodger Lawson, Keith Bateman and Barry Hoschek (Liberty Mutual)
California Federal of Labor, AFL-CIO:
Tom Rankin

April 9, 1991

Association of California Insurance Companies:
Barry Carmody, Ken Fujino (Transamerica Workers' Compensation Insurance) and Don Young (Citation Insurance Group)
American Insurance Association:
Mark Webb and Tom Brown (Fireman's Fund Insurance Company)
California Self-Insurance Association:
Joe Markey and Joan Spiegel (Lucky Stores)
Independent Insurance Agents and Brokers of California:
Robert Levering
Dr. David Appel
Patterson Frozen Foods:
Paul Fanelli

October 25, 1991

XL Manufacturing:
John Rush
Burger King:
Mark Gerlach and Richard Brening
Round Table Pizza:
Allen Toy
J.C. Penny:
Donna Moseley
Landry Personnel Services:
Lee Landry
Association of California Water Agencies:
Jerry Stockett

November 15, 1991

California Webbing Industries:
Steve Kelen
State of California, Office of Self-Insurance Plans:
Mark Ashcraft, Manager
Zero Corporation:
Wilford Godbold, Jr.

EXHIBIT 14.3 - Continued

December 13, 1991

Schools Excess Liability Fund:
John Wilson
Office of Benefit Assistance and Enforcement (OBAE):
Christine Baker
State Compensation Insurance Fund:
Brad Richmond and Norm Hansen
Division of Workers' Compensation:
Casey Young, Administrative Director
Unicare:
Russell Leatherby
Pacific Actuarial Consultants:
Wendy Johnson
Industrial Medical Council:
Dr. Ira Monosson

The Commission was provided with copies of the matrix and summaries of testimony, as well as the complete hearing transcripts. Sections 14.3 through 14.36, which follow, contain the matrices and the summarized testimony, respectively.

14.3 TESTIMONY MATRIX EXHIBITS

14.3.1 COMMISSION MANDATED TESTIMONY MATRIX-A

Exhibit 14.4 represents Commission Mandated Testimony identified as Matrix-A. The specific witness and corresponding organization is identified in the description of the matrix. In addition, the subject witness testimony is cross-referenced to the narrative analysis identified subsection. The legislation-identified issues appear in the vertical description section.

The Testimony Matrix-A commences on the following page.

14.3.2 WITNESS TESTIMONY MATRIX-B

The Witness Testimony Matrix-B is similar to the preceding Matrix-A.

Exhibit 14.5 concerning Witness Testimony Matrix-B follows the Exhibit 14.4 concerning Commission Mandated Testimony.

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EXHIBIT 14.4
COMMISSION MANDATED TESTIMONY MATRIX

The following Testimony Matrix-A Exhibit concerns:

WORKERS' COMPENSATION INSURANCE RATING BUREAU
Corresponding Narrative Analysis located in Subsection 14.4

CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION (Gerlach)
Corresponding Narrative Analysis located in Subsection 14.5

CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION (Rabine)
Corresponding Narrative Analysis located in Subsection 14.6

ASSOCIATION OF CALIFORNIA INSURANCE CO. (Conneely / Appel / Pasqualetto)
Corresponding Narrative Analysis located in Subsection 14.7

COMMISSION MANDATED ISSUES: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION*	WORKERS' COMPENSATION INSURANCE RATING BUREAU	CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION (Gerlach)	CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION (Rabine)	ASSOCIATION OF CALIFORNIA INSURANCE CO. (Conneely / Appel / Pasqualetto)
AGGREGATE EXCESS INSURANCE				
APPROPRIATE / EXPEDITIOUS CLAIMS SERVICE			3 X	
AVAILABILITY OF INSURANCE (MARKET AVAILABILITY)		1		
COMPETITION BETWEEN INSURERS	1 X	3	3 X	2 X
COST OF ACTUAL OPERATION (LOWEST NET COST TO INSURED)			1 X	
EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM	3	1		1
EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES			3	
MINIMUM RATE LAW		3 X	3	3
PROFITABILITY (REASONABLE RATE OF RETURN)	3 X	1		3 X
RATE STABILITY / PREDICTABILITY	3		3	1
RATING BUREAU FUNCTIONS	3 X	X		
SAFETY INCENTIVES	3 X	3	3	3
SOLVENCY (SECURITY OF PAYMENT OF BENEFITS)		1 X		3
WRITTEN MATERIALS	YES	YES	YES	YES

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY

1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.4 - Continued

The following Testimony Matrix-A Exhibit concerns:

NATIONAL ASSOCIATION OF INDEPENDENT INSURERS (Schroeder)
Corresponding Narrative Analysis located in Subsection 14.8

STATE COMPENSATION INSURANCE FUND (Madden / Neary / Webb)
Corresponding Narrative Analysis located in Subsection 14.9

CENTER FOR LABOR RESEARCH AND EDUCATION (Poyer)
Corresponding Narrative Analysis located in Subsection 14.10

KEVIN MCCARTHY, ATTORNEY AT LAW
Corresponding Narrative Analysis located in Subsection 14.11

COMMISSION MANDATED ISSUES: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION*	NATIONAL ASSOCIATION OF INDEPENDENT INSURERS (Schroeder)	STATE COMPENSATION INSURANCE FUND (Madden / Neary / Webb)	CENTER FOR LABOR RESEARCH (Poyer)	KEVIN MCCARTHY ATTORNEY AT LAW
AGGREGATE EXCESS INSURANCE				
APPROPRIATE / EXPEDITIOUS CLAIMS SERVICE		1 X	3 X	2
AVAILABILITY OF INSURANCE (MARKET AVAILABILITY)		1		2
COMPETITION BETWEEN INSURERS	3	2	X	
COST OF ACTUAL OPERATION (LOWEST NET COST TO INSURED)	X			
EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM	X	2		
EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES	X	3 X	3 X	3 X
MINIMUM RATE LAW	1 X	3	X	2
PROFITABILITY (REASONABLE RATE OF RETURN)	X			
RATE STABILITY / PREDICTABILITY	3	2		
RATING BUREAU FUNCTIONS				
SAFETY INCENTIVES	3	2 X		2
SOLVENCY (SECURITY OF PAYMENT OF BENEFITS)		1		3
WRITTEN MATERIALS	YES	YES	YES	NO

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY
1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.4 - Continued

The following Testimony Matrix-A Exhibit concerns:

CALIFORNIA FEDERATION OF LABOR (Rankin)
Corresponding Narrative Analysis located in Subsection 14.12

ALLIANCE OF AMERICAN INSURERS (Lawson / Bateman / Hoschek)
Corresponding Narrative Analysis located in Subsection 14.13

ASSOCIATION OF CALIFORNIA INSURANCE CO. (Carmody / Young / Fujino)
Corresponding Narrative Analysis located in Subsection 14.14

AMERICAN INSURANCE ASSOCIATION (Webb / Brown)
Corresponding Narrative Analysis located in Subsection 14.15

COMMISSION MANDATED ISSUES: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION*	CALIFORNIA FEDERATION OF LABOR (Rankin)	ALLIANCE OF AMERICAN INSURERS (Lawson / Bateman / Hoschek)	ASSOCIATION OF CALIFORNIA INSURANCE CO. (Carmody / Young / Fujino)	AMERICAN INSURANCE ASSOCIATION (Webb / Brown)
AGGREGATE EXCESS INSURANCE				
APPROPRIATE / EXPEDITIOUS CLAIMS SERVICE	3		3	
AVAILABILITY OF INSURANCE (MARKET AVAILABILITY)	1			
COMPETITION BETWEEN INSURERS	1	3 X	3 X	1
COST OF ACTUAL OPERATION (LOWEST NET COST TO INSURED)	3			
EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM	3			
EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES	3	3		
MINIMUM RATE LAW	3 X	2 X	3 X	3 X
PROFITABILITY (REASONABLE RATE OF RETURN)			3	1
RATE STABILITY / PREDICTABILITY			3 X	3
RATING BUREAU FUNCTIONS	3 X			
SAFETY INCENTIVES	3 X	3	2	3
SOLVENCY (SECURITY OF PAYMENT OF BENEFITS)	1	3 X	3	2
WRITTEN MATERIALS	NO	YES	YES	YES

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY
1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.4 - Continued

The following Testimony Matrix-A Exhibit concerns:

CALIFORNIA SELF-INSURERS' ASSOCIATION (Markey / Spiegel)
Corresponding Narrative Analysis located in Subsection 14.16

INDEPENDENT INSURANCE AGENTS & BROKERS OF CALIFORNIA (Levering)
Corresponding Narrative Analysis located in Subsection 14.17

DR. DAVID APPEL
Corresponding Narrative Analysis located in Subsection 14.18

PATTERSON FROZEN FOODS (Fanelli)
Corresponding Narrative Analysis located in Subsection 14.19

COMMISSION MANDATED ISSUES: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION*	CALIFORNIA SELF-INSURERS' ASSOCIATION (Markey / Spiegel)	INDEPENDENT INSURANCE AGENTS & BROKERS OF CALIFORNIA (Levering)	DR. DAVID APPEL	PATTERSON FROZEN FOODS (Fanelli)
AGGREGATE EXCESS INSURANCE	3 X			X
APPROPRIATE / EXPEDITIOUS CLAIMS SERVICE	X	2		
AVAILABILITY OF INSURANCE (MARKET AVAILABILITY)		3		
COMPETITION BETWEEN INSURERS		3 X		X
COST OF ACTUAL OPERATION (LOWEST NET COST TO INSURED)				3
EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM				
EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES		3 X		
MINIMUM RATE LAW		2 X		X
PROFITABILITY (REASONABLE RATE OF RETURN)			3 X	
RATE STABILITY / PREDICTABILITY				
RATING BUREAU FUNCTIONS		3		
SAFETY INCENTIVES		2 X		X
SOLVENCY (SECURITY OF PAYMENT OF BENEFITS)	X			
WRITTEN MATERIALS	NO	YES	YES	YES

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY
1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.4 - Continued

The following Testimony Matrix-A Exhibit concerns:

WASHINGTON STATE FUND (White)
Corresponding Narrative Analysis located in Subsection 14.20

XL MANUFACTURING COMPANY (Rush)
Corresponding Narrative Analysis located in Subsection 14.21

BURGER KING (Brening / Gerlach)
Corresponding Narrative Analysis located in Subsection 14.22

ROUND TABLE PIZZA (Toy)
Corresponding Narrative Analysis located in Subsection 14.23

COMMISSION MANDATED ISSUES: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION*	WASHINGTON STATE FUND (White)	XL MANUFACTURING COMPANY (Rush)	BURGER KING (Brening / Gerlach)	ROUND TABLE PIZZA (Toy)
AGGREGATE EXCESS INSURANCE				
APPROPRIATE / EXPEDITIOUS CLAIMS SERVICE			2 X	
AVAILABILITY OF INSURANCE (MARKET AVAILABILITY)				
COMPETITION BETWEEN INSURERS			3	
COST OF ACTUAL OPERATION (LOWEST NET COST TO INSURED)		3	2	3 X
EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM				
EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES	3 X			
MINIMUM RATE LAW			1	
PROFITABILITY (REASONABLE RATE OF RETURN)				
RATE STABILITY / PREDICTABILITY			3 X	
RATING BUREAU FUNCTIONS				
SAFETY INCENTIVES			2 X	
SOLVENCY (SECURITY OF PAYMENT OF BENEFITS)				
WRITTEN MATERIALS		NO	NO	YES

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY
1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.4 - Continued

The following Testimony Matrix-A Exhibit concerns:

JC PENNEY (Mosley)
Corresponding Narrative Analysis located in Subsection 14.24

LANDRY PERSONNEL GROUP
Corresponding Narrative Analysis located in Subsection 14.25

ASSOCIATION OF CALIFORNIA WATER AGENCIES JPIA (Stockett)
Corresponding Narrative Analysis located in Subsection 14.26

CALIFORNIA WEBBING INDUSTRIES (Kelen)
Corresponding Narrative Analysis located in Subsection 14.27

COMMISSION MANDATED ISSUES: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION*	JC PENNEY (Mosley)	LANDRY PERSONNEL GROUP	ASSOCIATION OF CALIFORNIA WATER AGENCIES JPIA (Stockett)	CALIFORNIA WEBBING INDUSTRIES (Kelen)
AGGREGATE EXCESS INSURANCE			3 X	
APPROPRIATE / EXPEDITIOUS CLAIMS SERVICE	3 X	1		
AVAILABILITY OF INSURANCE (MARKET AVAILABILITY)				
COMPETITION BETWEEN INSURERS		2		1
COST OF ACTUAL OPERATION (LOWEST NET COST TO INSURED)	3 X	3	X	3 X
EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM				
EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES				
MINIMUM RATE LAW		3		3 X
PROFITABILITY (REASONABLE RATE OF RETURN)	X	2		1
RATE STABILITY / PREDICTABILITY				
RATING BUREAU FUNCTIONS				
SAFETY INCENTIVES	3		3 X	
SOLVENCY (SECURITY OF PAYMENT OF BENEFITS)				
WRITTEN MATERIALS	NO	YES	YES	YES

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY
1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.4 - Continued

The following Testimony Matrix-A Exhibit concerns:

STATE OF CALIFORNIA OFFICE OF SELF-INSURANCE PLANS (Ashcraft)
Corresponding Narrative Analysis located in Subsection 14.28

ZERO CORPORATION (Godbold)
Corresponding Narrative Analysis located in Subsection 14.29

SCHOOLS EXCESS LIABILITY FUND (Wilson)
Corresponding Narrative Analysis located in Subsection 14.30

STATE OF CALIFORNIA OFFICE OF BENEFIT ASSISTANCE AND ENFORCEMENT (Baker)
Corresponding Narrative Analysis located in Subsection 14.31

COMMISSION MANDATED ISSUES: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION*	STATE OF CALIFORNIA OFFICE OF SELF-INSURANCE PLANS (Ashcraft)	ZERO CORPORATION (Godbold)	SCHOOLS EXCESS LIABILITY FUND (Wilson)	STATE OF CALIFORNIA OFFICE OF BENEFIT ASSISTANCE AND ENFORCEMENT (Baker)
AGGREGATE EXCESS INSURANCE	3 X		3 X	
APPROPRIATE / EXPEDITIOUS CLAIMS SERVICE	1 X			3 X
AVAILABILITY OF INSURANCE (MARKET AVAILABILITY)				
COMPETITION BETWEEN INSURERS		X		
COST OF ACTUAL OPERATION (LOWEST NET COST TO INSURED)		3 X		
EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM				
EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES				
MINIMUM RATE LAW	1 X	X	X	
PROFITABILITY (REASONABLE RATE OF RETURN)				
RATE STABILITY / PREDICTABILITY				
RATING BUREAU FUNCTIONS				
SAFETY INCENTIVES	X		2	
SOLVENCY (SECURITY OF PAYMENT OF BENEFITS)	3			
WRITTEN MATERIALS	YES	YES	NO	YES

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY
1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.4 - Continued

The following Testimony Matrix-A Exhibit concerns:

STATE COMPENSATION INSURANCE FUND (Richmond / Hansen)
Corresponding Narrative Analysis located in Subsection 14.32

STATE OF CALIFORNIA DIVISION OF WORKERS' COMPENSATION (Young)
Corresponding Narrative Analysis located in Subsection 14.33

UNICARE (Leatherby)
Corresponding Narrative Analysis located in Subsection 14.34

PACIFIC ACTUARIAL CONSULTANTS / CSAC (Johnson)
Corresponding Narrative Analysis located in Subsection 14.35

COMMISSION MANDATED ISSUES: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION*	STATE COMPENSATION INSURANCE FUND (Richmond / Hansen)	STATE OF CALIFORNIA DIVISION OF WORKERS' COMPENSATION (Young)	UNICARE (Leatherby)	PACIFIC ACTUARIAL CONSULTANTS / CSAC (Johnson)
AGGREGATE EXCESS INSURANCE				3 X
APPROPRIATE / EXPEDITIOUS CLAIMS SERVICE		3		
AVAILABILITY OF INSURANCE (MARKET AVAILABILITY)				
COMPETITION BETWEEN INSURERS			3 X	
COST OF ACTUAL OPERATION (LOWEST NET COST TO INSURED)				
EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM			3	
EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES				
MINIMUM RATE LAW	1 X		3	
PROFITABILITY (REASONABLE RATE OF RETURN)			3 X	
RATE STABILITY / PREDICTABILITY				
RATING BUREAU FUNCTIONS			3	
SAFETY INCENTIVES	3 X	1	3	
SOLVENCY (SECURITY OF PAYMENT OF BENEFITS)			2	
WRITTEN MATERIALS	YES	NO	NO	YES

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY
1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.4 - Continued

The following Testimony Matrix-A Exhibit concerns:

INDUSTRIAL MEDICAL COUNCIL (Monosson)
Corresponding Narrative Analysis located in Subsection 14.36

COMMISSION MANDATED ISSUES: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION*	INDUSTRIAL MEDICAL COUNCIL (Monosson)
AGGREGATE EXCESS INSURANCE	
APPROPRIATE / EXPEDITIOUS CLAIMS SERVICE	X
AVAILABILITY OF INSURANCE (MARKET AVAILABILITY)	
COMPETITION BETWEEN INSURERS	
COST OF ACTUAL OPERATION (LOWEST NET COST TO INSURED)	
EQUITABLE DISTRIBUTION OF COSTS OF SYSTEM	
EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES	
MINIMUM RATE LAW	
PROFITABILITY (REASONABLE RATE OF RETURN)	
RATE STABILITY / PREDICTABILITY	
RATING BUREAU FUNCTIONS	
SAFETY INCENTIVES	
SOLVENCY (SECURITY OF PAYMENT OF BENEFITS)	
WRITTEN MATERIALS	NO

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY

1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.5
WITNESS TESTIMONY MATRIX - B

The following Testimony Matrix-B Exhibit concerns:

WORKERS' COMPENSATION INSURANCE RATING BUREAU
Corresponding Narrative Analysis located in Subsection 14.4

CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION (Gerlach)
Corresponding Narrative Analysis located in Subsection 14.5

CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION (Rabine)
Corresponding Narrative Analysis located in Subsection 14.6

ASSOCIATION OF CALIFORNIA INSURANCE CO. (Conneely / Appel / Pasqualetto)
Corresponding Narrative Analysis located in Subsection 14.7

ADDITIONAL ISSUES RAISED BY WITNESS: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION	WORKERS' COMPENSATION INSURANCE RATING BUREAU	CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION (Gerlach)	CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION (Rabine)	ASSOCIATION OF CALIFORNIA INSURANCE CO. (Conneely / Appel / Pasqualetto)
ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS)	X	3	1	3
BROKER'S ROLE (COMMISSIONS / MARKETING)			1	
COST FACTORS / DRIVERS OF SYSTEM	1			
DATA (AVAILABILITY / IMPARTIALITY)	2			3 X
DIVIDENDS	3 X	2	X	3
EQUITY / SMALL BUSINESS EMPLOYERS	X		3	3
INJURED WORKERS' BILL OF RIGHTS				
JOB CLASSIFICATION / CLASSIFICATION RATING	2 X			
LOSS CONTROL				
NEED FOR WORK COMP REFORM / BENEFIT INCREASES			3 X	
POLITICAL MANIPULATION OF RATES		1		
PROSPECTIVE VERSUS RETROSPECTIVE RATING	3 X	3 X		3
RATE ADEQUACY	3	1		
SELF-INSURANCE / POOLS				
VOLUNTARY / INVOLUNTARY MKT. (RESIDUAL MKT. ANALYSIS)				

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY

1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.5 - Continued

The following Testimony Matrix-B Exhibit concerns:

NATIONAL ASSOCIATION OF INDEPENDENT INSURERS (Schroeder)
Corresponding Narrative Analysis located in Subsection 14.8

STATE COMPENSATION INSURANCE FUND (Madden / Neary / Webb)
Corresponding Narrative Analysis located in Subsection 14.9

CENTER FOR LABOR RESEARCH AND EDUCATION (Poyer)
Corresponding Narrative Analysis located in Subsection 14.10

KEVIN MCCARTHY, ATTORNEY AT LAW
Corresponding Narrative Analysis located in Subsection 14.11

ADDITIONAL ISSUES RAISED BY WITNESS: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION	NATIONAL ASSOCIATION OF INDEPENDENT INSURERS (Schroeder)	STATE COMPENSATION INSURANCE FUND (Madden / Neary / Webb)	CENTER FOR LABOR RESEARCH (Poyer)	KEVIN MCCARTHY ATTORNEY AT LAW
ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS)	3	3	2	
BROKER'S ROLE (COMMISSIONS / MARKETING)		1		3
COST FACTORS / DRIVERS OF SYSTEM		3 X		1
DATA (AVAILABILITY / IMPARTIALITY)			2	
DIVIDENDS	3	3 X	2	3
EQUITY / SMALL BUSINESS EMPLOYERS	3	3		2
INJURED WORKERS' BILL OF RIGHTS			3	3
JOB CLASSIFICATION / CLASSIFICATION RATING			3	
LOSS CONTROL		2		1 X
NEED FOR WORK COMP REFORM / BENEFIT INCREASES				3
POLITICAL MANIPULATION OF RATES	3		3	2
PROSPECTIVE VERSUS RETROSPECTIVE RATING		3		
RATE ADEQUACY	3 X			
SELF-INSURANCE / POOLS				
VOLUNTARY / INVOLUNTARY MKT. (RESIDUAL MKT. ANALYSIS)	X	3 X		

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY

1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.5 - Continued

The following Testimony Matrix-B Exhibit concerns:

CALIFORNIA FEDERATION OF LABOR (Rankin)
Corresponding Narrative Analysis located in Subsection 14.12

ALLIANCE OF AMERICAN INSURERS (Lawson / Bateman / Hoschek)
Corresponding Narrative Analysis located in Subsection 14.13

ASSOCIATION OF CALIFORNIA INSURANCE CO. (Carmody / Young / Fujino)
Corresponding Narrative Analysis located in Subsection 14.14

AMERICAN INSURANCE ASSOCIATION (Webb / Brown)
Corresponding Narrative Analysis located in Subsection 14.15

ADDITIONAL ISSUES RAISED BY WITNESS: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION	CALIFORNIA FEDERATION OF LABOR (Rankin)	ALLIANCE OF AMERICAN INSURERS (Lawson / Bateman / Hoschek)	ASSOCIATION OF CALIFORNIA INSURANCE CO. (Carmody / Young / Fujino)	AMERICAN INSURANCE ASSOCIATION (Webb / Brown)
ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS)	3	2		1
BROKER'S ROLE (COMMISSIONS / MARKETING)				
COST FACTORS / DRIVERS OF SYSTEM		3	3	3 X
DATA (AVAILABILITY / IMPARTIALITY)	3			
DIVIDENDS	X			3 X
EQUITY / SMALL BUSINESS EMPLOYERS				X
INJURED WORKERS' BILL OF RIGHTS				
JOB CLASSIFICATION / CLASSIFICATION RATING				
LOSS CONTROL	3	3 X	2	3
NEED FOR WORK COMP REFORM / BENEFIT INCREASES	3	3	1	3
POLITICAL MANIPULATION OF RATES	3	3	1	
PROSPECTIVE VERSUS RETROSPECTIVE RATING	X			1
RATE ADEQUACY		2		3
SELF-INSURANCE / POOLS				
VOLUNTARY / INVOLUNTARY MKT. (RESIDUAL MKT. ANALYSIS)		X		3

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY

1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.5 - Continued

The following Testimony Matrix-B Exhibit concerns:

CALIFORNIA SELF-INSURERS' ASSOCIATION (Markey / Spiegel)
Corresponding Narrative Analysis located in Subsection 14.16

INDEPENDENT INSURANCE AGENTS & BROKERS OF CALIFORNIA (Levering)
Corresponding Narrative Analysis located in Subsection 14.17

DR. DAVID APPEL
Corresponding Narrative Analysis located in Subsection 14.18

PATTERSON FROZEN FOODS (Fanelli)
Corresponding Narrative Analysis located in Subsection 14.19

ADDITIONAL ISSUES RAISED BY WITNESS: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION	CALIFORNIA SELF-INSURERS' ASSOCIATION (Markey / Spiegel)	INDEPENDENT INSURANCE AGENTS & BROKERS OF CALIFORNIA (Levering)	DR. DAVID APPEL	PATTERSON FROZEN FOODS (Fanelli)
ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS)				
BROKER'S ROLE (COMMISSIONS / MARKETING)		3 X		
COST FACTORS / DRIVERS OF SYSTEM	3			3
DATA (AVAILABILITY / IMPARTIALITY)				
DIVIDENDS		3 X	3 X	3 X
EQUITY / SMALL BUSINESS EMPLOYERS				
INJURED WORKERS' BILL OF RIGHTS				
JOB CLASSIFICATION / CLASSIFICATION RATING		2		3 X
LOSS CONTROL		2		
NEED FOR WORK COMP REFORM / BENEFIT INCREASES				3
POLITICAL MANIPULATION OF RATES		1		
PROSPECTIVE VERSUS RETROSPECTIVE RATING				
RATE ADEQUACY				
SELF-INSURANCE / POOLS	3 X			
VOLUNTARY / INVOLUNTARY MKT. (RESIDUAL MKT. ANALYSIS)				

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY

1 LOW	3 HIGH
2 MEDIUM	X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.5 - Continued

The following Testimony Matrix-B Exhibit concerns:

WASHINGTON STATE FUND (White)
Corresponding Narrative Analysis located in Subsection 14.20

XL MANUFACTURING COMPANY (Rush)
Corresponding Narrative Analysis located in Subsection 14.21

BURGER KING (Brening / Gerlach)
Corresponding Narrative Analysis located in Subsection 14.22

ROUND TABLE PIZZA (Toy)
Corresponding Narrative Analysis located in Subsection 14.23

ADDITIONAL ISSUES RAISED BY WITNESS: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION	WASHINGTON STATE FUND (White)	XL MANUFACTURING COMPANY (Rush)	BURGER KING (Brening / Gerlach)	ROUND TABLE PIZZA (Toy)
ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS)				
BROKER'S ROLE (COMMISSIONS / MARKETING)			2	
COST FACTORS / DRIVERS OF SYSTEM		3		
DATA (AVAILABILITY / IMPARTIALITY)				
DIVIDENDS			2 X	
EQUITY / SMALL BUSINESS EMPLOYERS		3	2	3
INJURED WORKERS' BILL OF RIGHTS				
JOB CLASSIFICATION / CLASSIFICATION RATING		3 X		
LOSS CONTROL		2	1 X	2
NEED FOR WORK COMP REFORM / BENEFIT INCREASES		2		3
POLITICAL MANIPULATION OF RATES				
PROSPECTIVE VERSUS RETROSPECTIVE RATING			3 X	
RATE ADEQUACY				
SELF-INSURANCE / POOLS				
VOLUNTARY / INVOLUNTARY MKT. (RESIDUAL MKT. ANALYSIS)				

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY

1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.5 - Continued

The following Testimony Matrix-B Exhibit concerns:

JC PENNEY (Mosley)
Corresponding Narrative Analysis located in Subsection 14.24

LANDRY PERSONNEL GROUP
Corresponding Narrative Analysis located in Subsection 14.25

ASSOCIATION OF CALIFORNIA WATER AGENCIES JPIA (Stockett)
Corresponding Narrative Analysis located in Subsection 14.26

CALIFORNIA WEBBING INDUSTRIES (Kelen)
Corresponding Narrative Analysis located in Subsection 14.27

ADDITIONAL ISSUES RAISED BY WITNESS: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION	JC PENNEY (Mosley)	LANDRY PERSONNEL GROUP	ASSOCIATION OF CALIFORNIA WATER AGENCIES JPIA (Stockett)	CALIFORNIA WEBBING INDUSTRIES (Kelen)
ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS)				
BROKER'S ROLE (COMMISSIONS / MARKETING)				
COST FACTORS / DRIVERS OF SYSTEM	3 X	3		3
DATA (AVAILABILITY / IMPARTIALITY)				
DIVIDENDS		X	X	
EQUITY / SMALL BUSINESS EMPLOYERS	3	3		
INJURED WORKERS' BILL OF RIGHTS				
JOB CLASSIFICATION / CLASSIFICATION RATING		X		
LOSS CONTROL	3		2 X	
NEED FOR WORK COMP REFORM / BENEFIT INCREASES	3			3
POLITICAL MANIPULATION OF RATES				
PROSPECTIVE VERSUS RETROSPECTIVE RATING	X	2 X		
RATE ADEQUACY				
SELF-INSURANCE / POOLS			3 X	
VOLUNTARY / INVOLUNTARY MKT. (RESIDUAL MKT. ANALYSIS)				

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY
1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.5 - Continued

The following Testimony Matrix-B Exhibit concerns:

STATE OF CALIFORNIA OFFICE OF SELF-INSURANCE PLANS (Ashcraft)
Corresponding Narrative Analysis located in Subsection 14.28

ZERO CORPORATION (Godbold)
Corresponding Narrative Analysis located in Subsection 14.29

SCHOOLS EXCESS LIABILITY FUND (Wilson)
Corresponding Narrative Analysis located in Subsection 14.30

STATE OF CALIFORNIA OFFICE OF BENEFIT ASSISTANCE AND ENFORCEMENT (Baker)
Corresponding Narrative Analysis located in Subsection 14.31

ADDITIONAL ISSUES RAISED BY WITNESS: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION	STATE OF CALIFORNIA OFFICE OF SELF-INSURANCE PLANS (Ashcraft)	ZERO CORPORATION (Godbold)	SCHOOLS EXCESS LIABILITY FUND (Wilson)	STATE OF CALIFORNIA OFFICE OF BENEFIT ASSISTANCE AND ENFORCEMENT (Baker)
ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS)				
BROKER'S ROLE (COMMISSIONS / MARKETING)				
COST FACTORS / DRIVERS OF SYSTEM		3 X		
DATA (AVAILABILITY / IMPARTIALITY)				2 X
DIVIDENDS				
EQUITY / SMALL BUSINESS EMPLOYERS				
INJURED WORKERS' BILL OF RIGHTS				
JOB CLASSIFICATION / CLASSIFICATION RATING				
LOSS CONTROL				
NEED FOR WORK COMP REFORM / BENEFIT INCREASES				
POLITICAL MANIPULATION OF RATES				
PROSPECTIVE VERSUS RETROSPECTIVE RATING				
RATE ADEQUACY				
SELF-INSURANCE / POOLS	3 X	1	3	
VOLUNTARY / INVOLUNTARY MKT. (RESIDUAL MKT. ANALYSIS)				

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY
1 LOW
2 MEDIUM
3 HIGH
X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.5 - Continued

The following Testimony Matrix-B Exhibit concerns:

STATE COMPENSATION INSURANCE FUND (Richmond / Hansen)
Corresponding Narrative Analysis located in Subsection 14.32

STATE OF CALIFORNIA DIVISION OF WORKERS' COMPENSATION (Young)
Corresponding Narrative Analysis located in Subsection 14.33

UNICARE (Leatherby)
Corresponding Narrative Analysis located in Subsection 14.34

PACIFIC ACTUARIAL CONSULTANTS / CSAC (Johnson)
Corresponding Narrative Analysis located in Subsection 14.35

ADDITIONAL ISSUES RAISED BY WITNESS: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION	STATE COMPENSATION INSURANCE FUND (Richmond / Hansen)	STATE OF CALIFORNIA DIVISION OF WORKERS' COMPENSATION (Young)	UNICARE (Leatherby)	PACIFIC ACTUARIAL CONSULTANTS / CSAC (Johnson)
ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS)		1		
BROKER'S ROLE (COMMISSIONS / MARKETING)			1	
COST FACTORS / DRIVERS OF SYSTEM			3	
DATA (AVAILABILITY / IMPARTIALITY)				
DIVIDENDS	1 X		3 X	
EQUITY / SMALL BUSINESS EMPLOYERS	3 X			
INJURED WORKERS' BILL OF RIGHTS				
JOB CLASSIFICATION / CLASSIFICATION RATING				
LOSS CONTROL			3	
NEED FOR WORK COMP REFORM / BENEFIT INCREASES				
POLITICAL MANIPULATION OF RATES				
PROSPECTIVE VERSUS RETROSPECTIVE RATING			3	
RATE ADEQUACY				
SELF-INSURANCE / POOLS				3
VOLUNTARY / INVOLUNTARY MKT. (RESIDUAL MKT. ANALYSIS)				

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY
1 LOW 3 HIGH
2 MEDIUM X DISCUSSION FOLLOWED PRESENTATION

EXHIBIT 14.5 - Continued

The following Testimony Matrix-B Exhibit concerns:

INDUSTRIAL MEDICAL COUNCIL (Monosson)
Corresponding Narrative Analysis located in Subsection 14.36

ADDITIONAL ISSUES RAISED BY WITNESS: WEIGHT GIVEN BY WITNESS DURING TESTIMONY

DESCRIPTION	INDUSTRIAL MEDICAL COUNCIL (Monosson)
ALTERNATE RATE MAKING SYSTEM (EFFECT AND ANALYSIS)	
BROKER'S ROLE (COMMISSIONS / MARKETING)	
COST FACTORS / DRIVERS OF SYSTEM	3 X
DATA (AVAILABILITY / IMPARTIALITY)	
DIVIDENDS	
EQUITY / SMALL BUSINESS EMPLOYERS	
INJURED WORKERS' BILL OF RIGHTS	
JOB CLASSIFICATION / CLASSIFICATION RATING	
LOSS CONTROL	
NEED FOR WORK COMP REFORM / BENEFIT INCREASES	
POLITICAL MANIPULATION OF RATES	
PROSPECTIVE VERSUS RETROSPECTIVE RATING	
RATE ADEQUACY	
SELF-INSURANCE / POOLS	
VOLUNTARY / INVOLUNTARY MKT. (RESIDUAL MKT. ANALYSIS)	

LEGEND: RELATIVE WEIGHT GIVEN TO IDENTIFIED ISSUES IN TESTIMONY

1 LOW	3 HIGH
2 MEDIUM	X DISCUSSION FOLLOWED PRESENTATION

14.4 SUMMARY OF TESTIMONY

WORKERS' COMPENSATION INSURANCE RATING BUREAU TESTIMONY OF: ROBERT MIKE AND DAVE BELLUSCI

14.4.1 SUMMARY OVERVIEW

The focus of the Bureau's presentation was to give the Commission an overview of the Rating Bureau's operations, to describe the workers' compensation pricing system in California and how rates are established.

14.4.2 REQUESTS MADE TO THE COMMISSION

Mr. Mike believes that the Commission should determine whether the current system meets the legitimate objectives of a pricing system and whether an alternative pricing system or modification of the current pricing system would better meet these objectives.

Mr. Mike believes the following questions should be answered:

A. to what extent does the current pricing system exacerbate the cost of workers' compensation insurance;

B. to what extent will an alternative system of modification to the current pricing system do the following:

1. reduce the net cost to employers;

2. result in cost shifting from one group of employers to another group of employers;

3. increase or reduce equity in the distribution of cost to employers in relationship to expenses and losses incurred in providing insurance to employers;

4. increase or reduce employers' incentive to minimize losses and promote safety;

5. increase or reduce the risk of loss to insurers and their opportunity to earn a fair profit; and

6. increase or reduce rate, price and market stability.

14.4.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Rate Stability/Predictability	3
Competition Between Insurers	1

(Continued)

ITEM	WEIGHT ASSIGNED
Equitable Distribution of Costs of System	3
Dividends	3
Safety Incentives	3
Profitability	3
Job Classifications	2
Data: Availability/Impartiality	2
Rate Adequacy	3
Rating Bureau Functions	3
Cost Drivers/Factors	1
Prospective vs. Retrospective	3

14.4.4 SUMMARY OF TESTIMONY

Robert Mike is the President of the Workers' Compensation Insurance Rating Bureau and Dave Bellusci is the Senior Vice President & Actuary for the Workers' Compensation Insurance Rating Bureau. Their presentation is designed to explain the Bureau's operations to the Commission.

A. ABOUT THE BUREAU

The Bureau is a licensed nonprofit, private association of all insurance companies who are licensed to write workers' compensation in California. It is organized and operates under the management of a governing committee comprised of twelve members. Seven of the members represent private insurance companies, one member is the State Fund and the other four members are public members. All public members are appointed by the Insurance Commissioner.

The Bureau is organized pursuant to state law primarily to perform the following activities:

1. Provide reliable statistics and rating information;

2. Collect and tabulate information and statistics for the purpose of developing minimum adequate rates to submit to the Insurance Commissioner for approval;

3. Formulate rules and regulations in connection with the issue for approved rates for submission to the insurance commissioner;

4. To inspect employer's businesses for classification and rating purposes; and,

5. To examine policies, to ascertain whether they comply with the commissioner's approved rules, rates and regulations.

We examine every workers' compensation policy issued that provides coverage under California law. Approximately 600,000 such policies are reviewed every year. We inspect approximately 28,000 businesses each year to determine the proper classifications and rates that will apply. In addition, various insurer premium loss and expense reports are received, examined and analyzed for use in determining minimum rates.

With regard to the Commission's charge, employers in California need to determine if the workers' compensation pricing system is exacerbating costs or whether other alternatives or modifications to the California pricing system can achieve the legitimate objectives of the pricing system at a reduced cost.

The basic objective of any insurance pricing system is adequacy of rates. Mr. Mike explained that is the price paid must be set at a level adequate to produce sufficient funds to cover total losses and operating expenses.

He stated that equity is defined as a total cost of the system being distributed among policyholders consistent with insurance principals in a manner which produces a net cost for each employer which reflects the actual cost of the insurance.

B. DEFINING THE OBJECTIVES OF THE PRICING SYSTEM

Mr. Mike stated that there are a number of features which are unique and must be considered when defining the objectives of the pricing system, including:

1. Workers' compensation is a form of social insurance with benefits mandated by law. Neither buyer nor seller have a direct voice in setting these rates;

2. Benefits flow to the injured worker while premiums are paid by employers;

3. The risk of loss varies widely from industry to industry;

4. The cost is estimated over nine billion for 1991, and any error can place a severe burden on an employer; and

5. There are a number of factors which are difficult to measure but must be recognized in order to price their effect. These include judicial expansion in the scope of compensable claims, increase in litigation costs, inflation, high claims frequency, the length of time before the final cost of the claim is known, social and economic pressures for filing new claims.

Mr. Mike feels the pricing system should facilitate the following:

A. It should assure adequate premiums to pay benefits and provide services (claims handling, loss control and cost containment);

B. It should equitably distribute the cost of the system among employers in relationship to the risk of loss;

C. It should provide an incentive to maintain a safe working environment;

D. It should provide insurers with an opportunity to earn a fair profit;

E. It should produce a stable predictable market; and

F. It should permit vigorous price competition.

At this point, Mr. Mike introduced Dave Bellusci.

TESTIMONY OF DAVE BELLUSCI

Dave Bellusci is senior vice president and actuary for the Bureau. His focus was the pricing system, how it has evolved in California to translate the cost of workers' comp to the price each employer pays for coverage. Mr. Bellusci referenced his handout discussing the "5 Tier Pricing System". He explained that the first 3 tiers are prospective, and determine the premiums an employer will pay prior to inception of the policy period based on historical costs.

Mr. Bellusci further explained that the first tier involves setting the average change in rated (a.k.a. overall rate level change). Workers' compensation is intended to be prefunded and each year projected income on a future group of policies is compared to the projected costs on those same policies. Average rates are then adjusted either up or down based on that comparison.

Mr. Bellusci then explained that the second step in the pricing process is to apportion that total premium that is needed to balance income with costs to the individual employer.

He stated that the "manual rate" is established for each industry classification based on historical costs in those classifications.

Mr. Bellusci went on to state that the third tier involves the experience rating and defined that as the significant difference among employers such as skill level of employees, degree of mechanization, methods of operation and commitment to safety. All of these things effect the likelihood of incurring a workers' compensation claim. The premium is then adjusted up or down based on the "Experience Modification Factor".

Mr. Bellusci then stated that the standard premium computed equals the payroll times the manual rates times its experience modification factor and this produces the "Standard Premium".

In addition to these three tiers, there are several retrospective tiers to the pricing process. Mr. Bellusci explained that workers' compensation is different in that the final costs aren't known until well after the policy expires, often many years later. He explained there were two retrospective mechanisms used to adjust the initial price employers paid:

The first is the "California Retrospective Rating Plan", and the second is policyholder dividends. Both are paid after the policy has expired. He stated that about 70% of the employers are eligible for policyholder dividends.

[At this time Mr. Mike addressed the Commission and further explained the "Five Tier Pricing System".]

Mr. Bellusci continued and again referenced page 6 of his handout. He went on to discuss the formula to determine the price each employer ultimately pays for workers' compensation coverage. He explained that the Manual Rate is per $100 of payroll, which is applied to the total payroll and produces the manual premium. He then discussed how large employers can have that amount adjusted up or down based on individual experience relative to the average for that industry's classification. Finally, Mr. Bellusci explained how the retrospective plan would apply to those employers to have the premium adjusted.

Mr. Bellusci further referenced his handout (pages 7 and 8) which covered the main points regarding overall rate change. Mr. Bellusci then went into more detail about page 9 of his handout which lists cost components that are part of the balancing of income and cost. This handout reflects calendar years '85 - '89. Mr. Bellusci indicated that the largest cost component is medical benefits (31 percent of total cost). The second largest was indemnity benefits (25 percent). Vocational rehab benefits are growing -- probably represents about 8% right now. Claims adjustment expenses represent about 9 percent. 10 percent of the

total cost is for "other" costs, such as marketing, general administration, and policyholder services such as safety, cost containment, etc.
Mr. Bellusci stated that other costs include taxes and policyholder dividends.

Mr. Bellusci concluded by stating that the overall rates are established to provide insurers an opportunity to earn a reasonable profit. Mr. Bellusci indicated that profit represented about 3% of total costs.

[Mr. Mike then gave a brief discussion on profits.]

B. OVERALL RATE LEVEL CHANGE

Mr. Bellusci then discussed the data the Bureau uses and the kind of actuarial objectives that are involved in the adjustments. The overall rate level or average statewide change is based on a comparison of costs based on future expectations. Actuaries don't have crystal balls -- the actuarial methodologies used calculate this overall change or the average statewide change. Mr. Bellusci then discussed page 10 (data used in the calculation) which data was aggregated by year of accident. Mr. Bellusci indicated they also collect premium information aggregate from insurance on a calendar basis. Data quality controls exist, but there is also review by independent auditing firms. As a last point, Mr. Bellusci stated the Bureau minimizes error of their projections by using the most current information available.

Mr. Bellusci referenced the next 6 - 8 pages of the handout which discuss these adjustments made to historical data, which include: adjustments to claim information and premium information, adjustments for inflation. Premium is restated as if it were generated today.

Mr. Bellusci then referenced page 18 covering calculating change in average rates. The Bureau does an "Accident Year Loss Ratio". Mr. Bellusci stated that they use a trend method (illustrated on page 19) and project it out to the period the rates are going to be in effect by that trend line. Mr. Bellusci discussed the reason for adjusting for certain inflationary components, and basically these components were easier to objectively identify. Page 20 compares projected loss ration at the current set of rates.

C. DISTRIBUTING COSTS TO GROUPS OF EMPLOYERS

Mr. Bellusci stated that once the statewide average rate needed to fund the costs of the workers' compensation system, the next step is to distribute these costs to employers. All employers can't be charged the same rate. The manual rates are computed for each classification that reflects each industry class. Industry classes combine reasonable homogenous groups of employers. Another purpose of the classification system is to get groups large enough so that a reliable rate can be produced.

Mr. Bellusci stated that the Bureau reviews classifications regularly. There are approximately 435 industry classifications, and the next few pages talk about the data the Bureau uses. Mr. Bellusci then discussed experience rating, which he had previously mentioned. Experience rating adjusts the price employers pay for workers' compensation coverage from the classification average. Page 27 reflects a comparison done between actual losses and the average expected for the class. Mr. Bellusci discussed in detail some adjustments made when actual losses are greater than this average for the classification (Pages 42 -45 of transcript).

D. RETROSPECTIVE RATING

Mr. Bellusci then discussed retrospective rating and the two mechanisms used in California. The California Retrospective Rating Plan permits an employer with premium greater than

$25,000 to agree with an insurer to adjust the premium based on the actual claim costs arising during the policy period, and he referenced page 31 of his handout. Mr. Bellusci indicated that only 1 percent (1%) of policyholders in the state are retrospectively rated.

The more common retrospective mechanism used in California is dividends. 70%-80% of premium is eligible for policyholder dividends. Dividends are established by individual carriers in a competitive market and usually aren't subject to review by the Bureau or the Insurance Commissioner. Mr. Bellusci went on to explain how dividends came about, including a declaration by a Board of Directors, payment to be made only after the insurer's expense and loss obligations are made, the form filed with the Insurance Commissioner, that the whole system is overseen by the Department of Insurance, and there are certain disclosure requirements regulated by the Department. He discussed in detail one type of dividend plan known as a "Retention Plan". He concluded by stating that the dividend system helps safeguard the interest of employers from overt overcharges -- it is the final step in the pricing process. Although it could be argued that dividends don't hold down prices to competitive levels, in Mr. Bellusci's opinion that isn't true because of the nature and structure of the California market and the historical profitability figures -- showing that profits have not been excessive over the long term.

E. PROFITABILITY

Mr. Bellusci indicated there were a number of ways to measure profitability, including: different ways to allocate certain costs; differences in how it is expressed; limitations involving looking on a calendar-year basis so as not to mismatch cost and income from different periods, etc.

He referenced page 35 which summarized historical results, including "return on premium" and "return on statutory surplus". He briefly explained the difference between statutory and "gap" accounting (p. 56 -57 of transcript), and the assets that are recognized under each.

Mr. Mike added that the California system will be shown to meet the legitimate objectives of a pricing system. Classification rates, manual rates, and experience rating equitably allocate premium at the time the insurance is purchased, while the payment of policyholder dividends produces the right net cost to the employer. These dividends are set at a level sufficient to motivate employers to maintain a safe operation. Lastly, competitive pressures to pay dividends minimize insurers' cost. Mr. Mike recognizes that employers are concerned about the cost of workers' compensation insurance. He believes that the Commission should determine whether the current system meets the legitimate objectives of a pricing system and whether an alternative pricing system or modification of the current pricing system would better meet these objectives. Mr. Mike referenced page 1 of his handout which listed several questions the Commission should address.

Mr. Mike concluded by indicating that the Bureau, to the extent permitted by law, would provide the Commission with whatever data they have available to assist the Commission in meeting its "charge". He added that Bureau staff will assist in compiling and analyzing any data the Commission believes is necessary.

14.4.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

The following is a summarization of the questions and answers raised by the Commission following the Bureau's presentation:

A. Is the implication here that the employer can have both retrospective adjustments and

policyholder dividends?

BELLUSCI: Yes. That is frequently done if an employer is eligible for a retrospective rating.

B. One clarification: shouldn't the plus/minus be between the standard premium and the retrospective and just minus be called a retrospective?

BELLUSCI: That's correct.

M: There is a typographical error -- do you follow that?

[The Commission responded affirmatively.]

C. Because of the graph, this is comparable to an underwriting profitability?

BELLUSCI: No. This would be profit after all expenses, including dividends, not just underwriting.

D. I think the question concerned the denominator. Does the denominator include the investment side as well?

BELLUSCI: Yes. In addition to these cost elements, there are two income components. The primary source is through premiums paid by insured employers -- they comprise 87% of the total income. The second component comes from the fact that premium is collected at the beginning of the policy period, but claim cost are paid over time.

E. A question that comes to mind is the experience that other states have in their classification system. Is it similar? Is California's classification system in any way reflective of the classification systems for similar job categories and specific jobs of industries in other states, or is it solely California without any reference whatsoever? What is the degree of reference to other states' experience?

MIKE: There are a lot of parameters to that question, and California is so large -- it accounts for 20-25% of the national premium. We are so large that we are able to rely purely on California experience in establishing a classification system, so the rates established by class are based on California employers. We don't rely on experience from out of state. I believe that 90-95% of the premium generated in California is generated in those classifications which are fully statistically credible -- the size of California gives us substantial advantage over other states and our ability to develop accurate and adequate rates.

There is some similarity in the method in which classifications system are developed from state to state and other speakers may help you more than I can.

F. Concerning alternative pricing systems, if we would go to a competitive up-front workers' compensation rating system -- would you tell me what group or groups of employers you might see most affected, being benefitted or hurt, and secondly, could you give me a candid response as to how insurers would be affected? What areas particularly?

MIKE: Let me qualify my answer. The Bureau is a rate-making and data-gathering organization, and with that in mind, I think your question is better addressed to others, but I will try to relate my experience.

If you want an up-front competitive system, depending on how it is structured, one of the things you lose immediately is equity to the extent that we have it in California. You don't lose it totally, but to the extent we have it in California -- in the form of policyholder dividends -- his net costs aren't going to be based totally on what we think his loss is going to be, but in fact, what the loses were during the policy period. So I think you lose that high degree of equity.

The other thing is because you do it up-front, there is less of an incentive on employers to maintain safe operations. Many employers are concerned for a variety of reasons, but one reason they maintain safety during the policy period, is that they can maximize their dividends. In my experience that is a very real consideration. If they want to get a dividend, they feel it is a reward for their efforts to reduce losses, and I believe it is an equitable way to do it. Who will lose by it? The small employer might find it difficult to find a market for their insurance coverage. Right now they find that market thanks to the uniform expense provision. As in other states, they might have to drop into the assigned risk plan or the involuntary market. We don't have that problem in California right now, partially due to the State Compensation Insurance Fund and partially due to the fact that the uniform expense provision does get the rate up to where private carriers feel that they can compete.

From an insurer perspective, there is clearly an increased risk and in that, when the insurer comes up with the loss projections, there will be uncertainties. There is reduced investment income so I think the risk to insurers increases substantially. When I look at the California system and the things that drive the competition from the policyholder dividend perspective, it seems to me that the same incentives to reduce costs and have reasonable profits are there with the policyholder dividend system as they would be with competitive pricing, but I think you lose equity.

G. So in other states you would not expect employers to be promoting safety because some of them are not receiving dividends, but they are experience-rated which also takes their safety into account?

MIKE: Yes. I think they are concerned with safety and experience-rating does reflect that. Again, I think we are talking about the degree of incentive. With the dividend system you don't get immediacy because you are basing it on historical data. To elaborate, if the coming year is very good, nothing will happen because the mod has already been established. Policyholder dividends allow you to look at it afterwards and say the experience during the policy year was good and money will come back in the form of dividends.

H. But there still would be a dividend system?

MIKE: There could be. To the extent you don't reflect an adequate amount in the expense provisions I think you reduce that incentive. If losses are projected at a certain level and they come in at less than that, then you might have sums available for dividends. From an insurance companies' prospective, they have to be aware that there might be a year where losses come in over and above what is expected.

I. Concerning profitability, on your handout page 36. All of those figures are on earned premium, correct?

MIKE: That's right.

J. You indicated that there are 435 classifications, but I take it that you also talked about a million and a half reports that come in. Is this report per year per employer?

MIKE: That's right.

K. And some proportion of those employers have experience ratings. Any feel for what proportion?

MIKE: Sure. About 20% of the employers are experience rated, but those employers generate 80% of the California premium.

L. So for 20% of the people, I don't necessarily look at the book. I call you and say, "what's Pac Bell's experience rating"?

MIKE: Right.

M. So we have not really got 435 classes, but a couple of thousand different ratings -- .

MIKE: 120,000 experience ratings are issued annually.

N. OK. 120,000. Now if I'm an insurer and I know what the rate is for book stores and a book store calls me that isn't experience rated and wants workers' compensation insurance, my choice is to offer it to them at the rate of book stores of their size or not to offer it.

MIKE: That's correct.

O. Do the people to whom I don't offer it -- do their losses get calculated into your rating for that industry?

MIKE: Yes. Everyone assigned to that classification of losses get into that mutual rate/classification.

P. So if I have to go to State Fund because no one will insure me, the manual rate still reflects my experience?

MIKE: That's right.

R. So the guys with the worst records get calculated into the rate but fall out of the "for profit" system?

MIKE: Please clarify "for profit" system.

S. If the rates were higher -- if the rate for book stores were this rate times two, there's going to be some book stores who could get insurance who couldn't if the rate is were what it was? So the rate serves a decision point for the insurer as to whether they want to take this guy on this level or not?

MIKE: Yes and no. They are permitted to surcharge that risk. They can charge over and above the manual rate. Typically the marketplace doesn't allow that, and the State Fund will do it if no private insurer will.

Even though the employer might be too small to be experience rated, if this employer is a member of a safety group, they can participate in whatever policyholder dividends the safety groups gets.

T. I'm looking at the relationship between the rate that is set and the proportion of employers who are either not offered insurance at that rate or get surcharged. It seems to me that there must be some relationship in that if the manual rate were higher there would be more incentive to accept the particular client?

MIKE: Let me rephrase my answer and tell me if this answers it for you. If the private carrier doesn't want to write this business because it's too small, then it will end up in the State Fund or be surcharged. Surcharging is so minimal that it's not really a significant factor. So the question is what percentage of the smaller employers end up in the State Fund not because State Fund has sought them out. First of all, State Fund should probably answer that question but they probably won't be able to answer that because they are competing with the private carrier. They may be able to give you some feel but I've never heard them respond to that question definitively.

U. Would you ever take into consideration in a rate the idea that a particular type of business is leaving the private market?

MIKE: Not traditionally. Some times when we see this happening we look at the classification to see if something is wrong with the rate for that class. If all these people have gravitated to the State Fund, then that's an indication that the rate is not right for that class of employer. In the past we have looked at that and tried to subdivide. (Mr. Mike gave an example concerning convenience stores that are open all night which were originally classified with all other stores.)

V. You mentioned as examples of actuarial changes, the shift toward rehab costs which would increase -- there was pressure to increase the cost of premiums and as an example of that different kind of claim shifting. Is the length of exposure getting longer?

BELLUSCI: Yes, claims are tending to remain open longer.

(There was a discussion between the Commissioners concerning the fact that rates would be higher for all other employers because other sorts of high risk or bad experiences are lumped into a single group, and the fact there is no assigned risk plan in California.)

W. It sounds as if there is a significant group of small employers who do not have experience rating, who are not eligible for retrospective rating, and who are not eligible to receive dividends. Could you tell me roughly what that proportion is?

MIKE: Retrospective rating is 1% of the employers; 5-6% of the premium, and that's basically your large employers. Experience rating -- is 20% of the employers, 80% of the premium. -- So there's 80% of the employers that are not eligible for experience rating. Concerning policyholder dividends, 70% of the employers representing in excess of 90% of the premium. So there are about 30% of the employers (policies) that aren't eligible for any type of adjustment of that premium and we need to take a look at what this segment is.

X. That's 30% of the private markets?

MIKE: All of it.

Y. That does not include State Fund?

MIKE: No. I think the State Fund does permit all their policyholders an opportunity share in dividends.

Z. So this is 30% then of the total?

MIKE: What you have in that group is a minimum premium policy in which there is no exposure. There are no employees. Employers buy the policy in case they hire somebody at some point in time. With respect to the rest of them, they are so small, one or two employees, that attempting to adjust their premium based on their experience is not sound from an actuarial perspective in that you don't know if their loss history is because of a good loss record or due to chance. You would expect most of them to go 10, 15 or 20 years without a loss. If you asked why we don't experience rate that group, the question is that then you shift that cost.

There's a question of whether an insurance company wants to insure that group below the manual rate.

AA. What percentage of the 30% is in one of these safety groups?

BELLUSCI: That 30% figure excludes safety groups.

AB. In the current system are there any safety incentives for these small employers?

MIKE: I think when you look at what is typically the safety incentive, I think it's pretty attenuated.

AC. It sounds like they pay the manual rate and whatever happens --

BELLUSCI: Most of these have one or two employees and they don't get a claim in a decade. It's hard for insurers -- safety isn't a big feature. They are so small for the most part and have so few accidents because they are so small.

AD. When you look at safety experience, experience rating, for those that you do experience ratings, do you go beyond who has a good report experience and look at what causes good or poor experience, and are there any incentives, or could there be any incentives put in to develop risk management programs?

MIKE: We don't look at it from a rate-making perspective. We used to have what we called Scheduled Rating in California. It was eliminated about 10 years ago as a plan and part of the reason was even when you went out and examined an employer who was safe, that doesn't mean they were going to be safe the next day. So you don't have any real sense that safety was going to continue. We started the Fund with these safety programs. It really didn't provide a better indication of potential cost on any great magnitude. That's my recollection of that type of program. So if you get into other risk management criteria that impact rating, I think you need to deal with all these uncertainties and how good an indication those are of future losses.

BELLUSCI: The rate-making process has really tried to focus on actual historical claim costs. Policyholder dividend is related to the actual cost incurred during the policy period. We focus on actual versus perceived differences.

AE. Since a small proportion of employers are involved in retrospective rating, is it worth it? Should it simply go to a dividend system?

MIKE: To the small percentage of employers that receive retrospective rating, they probably think it's different than dividends in that it is contractually guaranteed. Under dividends, the insurance company is obligated to return only if they have surplus from their operations and by

declaration of the Board of Directors.

AF. Would it be a good idea to encourage the use much more widely than it is?

MIKE: That's a decision under the current system that's not available in California under the current rating law. There is a down side, and for some employers, especially the smaller employers, that are less able to deal with the additionally of premium that could come if they had losses, I think that is a serious consideration.

AG. How many employees does the Rating Bureau have?

MIKE: 290 which includes 20 part-time.

AH. You indicated that the employers who are participating in this dividend program seem pleased with it because it rewards them for what they have done concerning safety. The way I look at these numbers, if I got them correct, (referring to page 36 of the handout) the average dividend declared over the past five years was just under 14% and that is a percentage of the total premium. I guess you said the cost of workers' compensation in 1991 is about $9 billion, but part of that is covered by investment income so the premium would be less than that.

MIKE: No. That is premium.

AI. OK. So that leads me to believe, if this year is like the five year average, we are talking about dividends over a billion dollars would be paid after the fact. Based on my own concept of present value, the idea of having one billion dollars ahead of time, being able to charge lower prices to my customers versus getting one billion dollars back later, that seems to be less likely to get plugged into current prices. It seems an odd thing for a business to prefer. Why, as a business person would I prefer this rather than up-front competition with some kind of experience rating?

MIKE: I didn't mean to imply that if you went out and did a survey of all the early employers they would say: "yes we want policyholders dividends". Clearly it's only those employers who are able to control their losses during the policy year that share in dividends and many don't because their losses indicate they aren't entitled to a dividend.

The other aspect about up-front pricing, the rate would not be realized by 15% or what ever that is. They would be reduced by something significantly less than that because of investment income, and that's earned on premium. That would be less. Even those that are the average, some employers get less, depending on their losses and others get more. So there is that incentive equity question that would be lost. It calls for the dividend yield allowed. But to the extent the employer gets more than 5 or 10%, I can't really respond.

AJ. In other words, the adjustment may be some of those inequities. In other words, it's not impossible to control for the experience of a firm doing up-front competition. You would agree with that?

BELLUSCI: To some extent I think there's experience rating based on -- getting back to the statistical significance of predicting. You're in a predicting mode.

AK. 290 employees would just be doing it the other way around?

BELLUSCI: Could make some kind of refund built into the future -- conceivably, yes. Conceivably its possible to have some kind of full 100% credit built in rather than this kind of

statistical credibility method.

Your an employer with good experience and you're getting back 30 or 40% dividend because you're fairly large in your experience is good. That 10 to 12% up-front cut for the "good experience employer" doesn't balance with the theory.

AL. From the business mans perspective, getting the money after the fact versus having it in their rate for the coming rate --.

MIKE: If it was equivalent, then I think that there may be some merit to that.

AM. The other has to do with, again, the relationship between the dividends and expenses. When I look at column four (referring to the hand out) "Expenses" on page 36 and then I see "dividends declared", and I realize probably the dividend is dwarfed by the loss incurred part of this, I wondering if there is a relationship between -- as an employer I sort of wonder whether I won't rather just have the actual expenses plugged into up-front rates rather than be charged based on a 33% expense provision and that in getting money back in dividends. As an employer shopping for insurance you seem to indicate that I'll know this. Is this really the case? MIKE: Before I address that, I'd like to get into the expense provision because it is commonly a misunderstood part of what the expense provision entails.

BELLUSCI: It's called the "expense provision" but its really much more. That 23% is just a portion of what goes into the expense provision. Basically it's a claims administration expense, some general expenses, and some marketing expenses. Also build in is premium taxes both federal and payroll premium as well. Also built in is the dividends you've recognized. When you add all that up, you get 44 or 45% but then you credit it back for investment income. So the expense provision really reflects not only insurers expenses but taxes allow for profit, policyholder dividends, and on the other side, the anticipated investment income coming back and it really has been set in the past, a balance of all those factors.

AN. As an employer, would I have any way of knowing if I was picking an efficient insurer?

MIKE: You probably need to talk the insurers to find out how they compete and if the price is the same from insurer to insurer.

AO. Concerning the dividend, am I right that a good portion of the dividend reflects losses incurred or not incurred? That's going to be the major determinant as to whether I, as an employer, gets a dividend --.

One dividend. Is there a built-in incentive in the dividend system for the insurers to keep their own expenses down?

MIKE: In order to pay the dividends that are anticipated, they have to dollars that they have accumulated from earned surplus and you increase earned surplus by keeping your expenses down. So I think it's there.

BELLUSCI: And it's part of the real marketing. Policyholders are shown a historical dividend payment pattern and an inefficient insurer whose expenses are higher and losses are higher will not have the same historical dividends as another insurer who is more efficient. The policyholder can see these payment patterns and can see that this insurer pays less in dividends and part of that reflects the efficiency of the insurer.

AP. There's no guarantee that the industry as a whole will be efficient? The could all be equally inefficient?

MIKE: I'm not an economist.

AQ. One last question. In terms of competition, can you tell me if there is a lot of shopping around? Do large employers move from insurer to insurer?

MIKE: I am lead to believe that there is a substantial amount of competition, really cut-throat competition out there with respect to policyholder dividends.

AR. So you don't keep any records on --.

MIKE: We don't do marketplace --.

AS. Even on whether they stay with the same company or they move to the sides of the employees?
MIKE: We have not done that but we could look at that.

AT. Most economists would argue that a system that permits up-front price competition will promote lower prices for consumers and a greater efficiency and greater range of service alternatives and prices service tradeoffs. Would it be your argument that this basic economic theory doesn't apply in this case, and actually you are getting maximum price competition by virtue of doing it through the back end, or would you argue there probably is some loss of price competitiveness, but there are other off setting benefits to make it worth while?

MIKE: I would not argue either of those positions. I think what I would argue to you is that the policyholder dividend applies a substantial amount of competition, Whether it's equivalent to the type of competition and whether it's as effective to holding down costs as up-front price competition would be, I'm not qualified to respond. There are things in this system we have tried to highlight, you don't have any flexibility as a purchaser. You have to buy this coverage and it is defined. The other aspect is that because this insurance is intended to protect workers from their injuries, there are certain things you might not want to do. You might not want to cut costs to the bone if it means that employers will spend less on safety. Yes, the system may be somewhat less efficient. I don't know that, but if it is, I think the Commission needs to look at what the trade offs are.

AU. I was following up on the effect of the expense loading and whether that creates an incentive for inefficiency. Wouldn't it be correct that regardless of what the expense loading is and assuming it were inflated for all companies as opposed to a few companies, that everybody would still have the same incentive that they would have, even if there were no such thing as expense loading to maximize profits by keeping your expenses down?

MIKE: An to maximize policyholder dividends? I think that is accurate, but just carry it another step forward. You have a certain indicated loss ratio and that might be less than the rates that are set. So the same incentive that gets companies to keep bills down to maximize profit, to maximize policyholder dividend in order to compete and expand are there. Generally I'm in agreement with that.

AV. In terms of expense ratios as an expert witness, the total expense ratio for stock companies in 1989 was about 30 cents on the dollar. For non-stock companies it was a little less than 24 cents. For the State Fund it was 17 cents. Even after you knock out commissions, that doesn't begin to account for disparities that exist. I wonder if you have a sense about those substantial

disparities in actual expense levels?

MIKE: The only thing I can think of, is that the State Fund is by far the largest private insurer in California and to the extent there are some savings from scales of economy, I can't believe that accounts for a significant part, but that might be part of it, and there may be others. I really don't feel qualified to speculate on that.

AW. In making the argument for the system, do you consider solvency protection to be one of the important benefits of a minimum rate law now that we have so many multi-line carriers, or whether you would say now that the minimum rate law is not going to take me very far in terms of protecting solvency.

MIKE: I don't feel I can respond to that. I think solvency is still important to the extent that it permits insurers to meet their obligation to injured workers. There is a guarantee fund in the event the insurer is in insolvent and can't make payments, they will pay up to certain limit. But I think that is a judgement as to how much it minimize this potential for insolvency, and with out it, if you didn't have this protection, would insolvency be significantly greater that it has been in the past?

AX. Wouldn't the predilection of the Commissioner in any state toward rate suppression or rate adequacy be much more important in the solvency question than the structure of the weighing system?

MIKE: Clearly, you can not separate the manner in which rates are approved in dealing with this issue of solvency and I think that is definitely a significant factor.

BELLUSCI: All else being equal, having the correcting factor, the dividends which vary with profitability -- when insurers are profitable, dividends are high. I think this is a factor to protect solvency.

AY. On the small business subsidy question, concerning the small business subsidy question, what I don't understand is why an insurer would want to write business that was underpriced by your system (assuming I got one group of risks over here and I'm making a profit on those risks) I don't understand what the incentive is for me to pass some of that profit on to some underpriced risk. The natural thing for me to do is ignore that underpriced risk and pass some of that profit back in the form of dividends or keep it for myself. In other words, I understand how the rate system can build in some underpricing effect, but I don't understand the incentive is for the insurer to respond and actually write those small business.

MIKE: I think you need to talk to the insurer. I am going to speculate. I think part of it is some insurer feel for a group of this size even though the rate might be inadequate for the particular risk, there might be something unique to it and a feeling a profit can be made.

AZ. One of the arguments that has been made is that the system effectively works to subsidize small businesses, and it's not really clear to me how that really works.

BELLUSCI: It subsidizes a group of small business as a whole. If you look at the claim experience as a group of small business as a whole, there's probably some kind of subsidy built in. Within that there are many with good experience and the insurer might be able to write them as part of a safety group because their experience becomes more predictable. Within that large subsidy, there are a significant number of employers that are being viewed by the insurance industry as being favorable.

BA. Concerning the competitive effect pricing through the dividend system, if you actually say the dividend pricing mechanism works a way a competitive market works, then one of the things that would happen in a competitive market is that large purchasers would have more buying power and they would be able to exert pressure to get greater dividends by virtue of that buying power. Does a phenomenon like that exist in your judgement?

MIKE: I hope we didn't indicate that the California system and policyholder dividends provide perfect equity. I don't think there is such a thing. What we do believe, and the work of this Commission would bear this out or not, is that in comparison to other systems it does a good or better job and that is the only thing we are advocating with respect to the larger employer. For employers that are self-rated there's nowhere for it to go any lower.

BB. I'm interested in the safety groups. You establish that 30% of the employers are not benefiting in any way from any kind of premium adjustment when there is a certain percentage. That is only because they are in a safety. Can you tell me what that percentage might be?

BELLUSCI: We know there's about 600 of these safety groups and they insure 10 of thousands of employees. A rough guess, maybe 50,000, about 11% or so of total employers.

BC. Concerning the remedies for either categories of employers or individual employers who may not feel the rating system, classification system, is equitable given their own perspective of their experience and their potential safety and potential workers' compensation claim experience. What remedies do they have -- administrative remedies with the Rating Bureau or with the insurance Commissioner?

MIKE: Once the Commissioner adopts the rates and regulations, the Bureau administers them. Accentually what happens, for experience rated employers which generate about 80% of the California premium, we try to inspect their operations every year to insure that the classification mandated by the rules is applied on the polices. We do have some internal checks to make sure that the classification is reasonable based on historical information.

If the employer disagrees with the classification assignment they complain to the Bureau. We re-inspect it and if they still disagree with us, they can appeal to the "Classification and Reading Committee". If they do not get a favorable response there they can appeal it to the Department of Insurance who will designate a hearing officer and the matter will be presented to the Department of Insurance. I think there's something like 20 or 30 appeals that go to the Department of Insurance out of 50 or 60 that are appealed annually. Beyond the state, if they are dissatisfied with the Departments decision, they can appeal to the Superior Court. There is one every two or three years now but that is a recent phenomenon.

14.4.6 WRITTEN MATERIALS SUBMITTED

Written materials were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEWED BY THESE WITNESSES WHO AGREE THAT THIS IS A FAIR REPRESENTATION OF THEIR TESTIMONY

14.5 SUMMARY OF TESTIMONY

CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION TESTIMONY OF: MARK GERLACH

14.5.1 SUMMARY OVERVIEW

Testimony was received from Mark Gerlach, a consultant, speaking as a representative of the California Applicants Attorneys' Association.

The primary focus of Mr. Gerlach's presentation concerned the Minimum Rate Law itself.

The rate-making system has influence on some factors that are very important. Most important to Mr. Gerlach, were the incentives to insurers to minimize their expenses, reduce the cost of losses so that both competitive rates and dividends can be maintained.

He believes two of the most important goals of a rate-making system should be (1) insurer efficiency and (2) incentive toward workplace safety. The Minimum Rate Law does not provide sufficient incentive in these two areas. If the Commission wants to maximize this incentive, give insurance companies the ability to charge less than the minimum rate so that they can, based on their own experience, drive loss costs and expenses down. Mr. Gerlach advocates a move to a system that allows up-front pricing competition.

He argues that if the Minimum Rate Law was changed to allow front-end (prospective) price competition, the maximum incentive on insurers to hold down both their own costs and the costs of their losses would be effected. Prospective competition would work to improve incentives for safety and incentives towards efficiency in the workers' compensation system. Importantly, prospective competition would not invalidate other rate-making goals such as adequacy, equity, availability or solvency.

Mr. Gerlach believes that adequacy is not dependent upon the minimum rate law and that rates can be and are adequate under other types of rating systems. Dividends could continue under other rating systems. Rather, it is rate regulation rather than the rate-making system that effects rate adequacy.

14.5.2 REQUESTS MADE TO THE COMMISSION

The Commission was urged to review the expense provision.

Secondly, the Commission may want to look at the question of whether retrospective dividend competition actually forces insurance companies to their most efficient level.

Another issue is the question of whether the dividend payout ratio of insurance companies does or does not actually drive their position in the marketplace.

14.5.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	3
Availability of Insurance (Market Availability)	1
Equitable Distribution of Costs of System	1
Minimum rate law	3
Profitability	1
Prospective vs. Retrospective	3
Safety incentives	3
Solvency	1
Dividends	2
Alternate Rate Making System (Effect and Analysis)	3
Political manipulation of rates	1
Rate adequacy	1

14.5.4 SUMMARY OF TESTIMONY

Mr. Gerlach testified that the focus of his discussion would be the minimum rate law itself which is a unique feature of the California rating system.

The minimum rate law sets a minimum. Companies are free to charge above that minimum but cannot charge below the minimum. As a practical matter, almost all policies are written at that minimum rate because it is, in Mr. Gerlach's opinion, excessively high. Nevertheless the system the Commission is evaluating is an administered pricing system. The minimum rate system has a "floor" but no "ceiling".

The first obvious "defect" of that system concerns the expense provision. Mr. Gerlach, on behalf of the C.A.A.A. has urged the Commission to review the expense provision. He points out that legislation has statutorily reduced the expense provision from 35% to 33% this year. Next year it will be reduced to 32.8%. However, there is still a considerable margin between the 26% average expense of the industry and the 33% that it will be allowed next year. This is a considerable amount of money being built into rates beyond what is expected to be paid in losses. The insurance companies' claim is that its not unfair because of the dividend system.

Mr. Gerlach's second point was that since the Commissions' charge is to determine the effectiveness of our present rate-making system with alternate systems, the Commission is being asked to determine if it is more effective to have a rate-making system with competitively established rates that are adequate, but not excessive, or is it more effective to have the minimum rate system with excessive rate levels but insurers have permission to return the excesses.

Mr. Gerlach proceeds by stating that it is important to define "effectiveness". The goals of the rate-making system in theory, such as safety, efficiency, loss prevention, equity, availability of coverage, profitability and rate adequacy, are not controversial, but how the system meets those goals may be.

The two most important goals of a rate-making system should be (1) insurer efficiency and (2) incentive toward workplace safety. The minimum rate law does not present maximum incentive in these areas.

Mr. Gerlach then discussed his analysis of individual insurer expense relying on Form 46 submitted to the Insurance Commissioner every year and which is designed to show whether they earned a profit in a given year. He pointed out the wide variety in "Lost Adjustment Expenses". He points out a tremendous range in profitability. It is Mr. Gerlach's view that retrospective dividend competition claims to force all insurers to their most efficient level, but looking at the wide range of profits and dividends on this chart, it doesn't seem to be doing that. This is an area the Commission might want to study: under the current system does retrospective dividend competition force every insurance company to a most efficient level or not?

Benefit levels are set by the legislature, so the only way to control increasing benefit costs is to reduce the number of injuries and accidents in the system. Mr. Gerlach discussed a study done in Michigan showing the difference between a safe and unsafe employer can be as much as 10 times in the intensity of losses. Mr. Gerlach believes that employers can have an effect on losses, and our system should maximize incentives so that employers will have the maximum incentive to do something about losses. The minimum rate law does not provide sufficient incentive. If you want to maximize the incentive, give insurance companies the ability to charge less than the minimum rate so that they can, based on their own experience, drive loss costs down.

Mr. Gerlach saw several problems with the Rating Bureau's testimony that dividends provide incentive toward safety. He pointed out: (1) If we build the dividend percentage into the rates and maintain the same losses that you had, you are going to be able to get the dividend -- you lose some of your incentive; (2) Dividends are not exclusive to the minimum rate system. A review of the National Association of Insurance Commissioners (N.A.I.C.) "Profitability By Line" report points out that dividends were paid in every state in the area or workers' compensation, they are not unique to and do not depend on the minimum rate law.

Mr. Gerlach then addressed his analysis of Liberty Mutual's dividends that were declared over the past four years. He pointed out that they returned anywhere from 20% to almost one third of their premium each year for the past four years to their policyholders. He proposed what he called the "Liberty Mutual Test" as follows:

We give Liberty Mutual the option of reducing their rates so that they charge 15% less than the manual rate established by the Rating Bureau. If they charge that rate, would it cause problems as far as (1) solvency, (2) availability of coverage, (3) equity, (4) safety, or (5) service levels?

Mr. Gerlach addressed each of those items and determined that there was no problem with allowing Liberty Mutual to charge less than what they were charging. On the contrary it would put pressure on other insurance companies to try to match whatever Liberty Mutual was doing, whether that was reduced expenses, or helping the insured employer reduce their losses.

He feels we should want to reward companies that have low expenses and encourage other companies to do the same. We don't want the rate-making system to subsidize inefficient insurers.

Mr. Gerlach then discussed equity and what it really meant in the present situation. He concluded that anytime you have insurance you have an inequitable type of situation. Equity is a consideration, but the most important consideration in trying to assign loss costs to employers is the incentive it gives them to control their losses.

As to rate adequacy, Mr. Gerlach stated that it really isn't dependent upon the type of rating system you have. Mr. Gerlach pointed to a chart that had been provided to the Commission showing the Insurance Commissioner had approved rates less than the Bureau had asked for during the past 5 years. In theory that could have established inadequate rates. It is just as easy for the Insurance Commissioner to

succumb to political pressures and approve inadequate rates under the minimum rate system as in any other system.

Rates can be and are adequate under other types of rating systems. Adequacy really is dependent upon rate regulation rather than the rate-making system itself.

As to availability of coverage and the subsidization of small employers, Mr. Gerlach began by addressing the issue of profitability and how it is defined.

Mr. Gerlach indicated that Insurance Commissioner Garamendi was holding hearings on what is "profitability" for purposes of property / casualty insurance. These findings should be adopted by Commissioner Garamendi for workers' compensation also.

Profitability raises several points. It is dependent upon both rate adequacy and the efficiency of an insurance company, neither of which is dependent upon the minimum rate law. Industry-wide profitability data doesn't tell you whether the minimum rate law is good or bad. Profitability varies among insurers and Mr. Gerlach questions why insurers with high profits and high dividends should be forced to charge higher rates than they need.

Mr. Gerlach summarized that the original justification for the minimum rate law was to assure solvency, and he does not believe solvency is currently a legitimate reason to maintain the minimum rate law. Solvency depends upon adequacy, and adequacy is regulated through actions of the Insurance Commissioner not through the form of the rating law.

Mr. Gerlach had the same conclusion concerning profitability and availability of coverage, that these are mostly dependent upon rate adequacy which is regulated by the Insurance Commissioner.

As to dividends, a dividend system is not incompatible with open competition or any other kind of rating system. If the minimum rate law were changed to allow front-end (prospective) price competition, the maximum incentive on insurers to hold down both their own costs and the costs of their losses would be effected. Prospective competition would work to improve incentives for safety and incentives towards efficiency in the workers' compensation system.

This ends the testimony of Mark Gerlach.

14.5.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. Gerlach's testimony:

A. What individuals do you represent that make up the California Applicants Attorneys' Association?

   ANSWER: The C.A.A.A. is an association of attorneys who represent injured workers in disputes with their employers over benefits under the workers' compensation system.

B. You are proposing a change in the minimum rating law, but at the same time I heard you say that the type of rating structure that we have is actually irrelevant, it is the regulation implementation of that rating law that is the primary concern, correct?

   ANSWER: You are going to be told that a number of goals are important goals that the rate-making system can effect, such as profitability. Profitability is not a subject directly effected by the type of rate-making system. The Commission can spend a lot of time trying to define

profitability, what it is, etc., but that would be a waste of time.

I believe the rate-making system has some influence on some factors that are very important. Most important from my point of view are the incentives to insurers to minimize their expenses, reduce the cost of losses so that you can maintain both competitive rates and dividends. The rate-making system does not affect certain factors that you might be inclined to study, but it does affect other factors. I believe we should go to some sort of system that allows up-front pricing competition.

C. To what extent is the experience of a company like Liberty Mutual, which returns a very large dividend to its customers, related to its marketing strategy when it selects customers?

ANSWER: Every insurance company does some sort of risk selection. Even the State Fund is doing some sort of selection process because it has the ability to surcharge. But I don't know if Liberty Mutual is better at that than other companies.

D. Is size a major factor in this? Would a company tend to say "I'd rather have three great big guys rather than 50 smaller guys"?

ANSWER: It has been for several reasons:

1. The percentage expense costs for a larger employer are less, so the excess that you are collecting for expenses is even higher for a large risk.

2. The insurance industry also goes through cycles every five to seven years with what is known as "cash flow underwriting fever". When this happens they try to write as many risks as possible, earn as much investment income as they can and hope that they will be able to pay the losses when they finally come in. Larger risks are better for cash flow underwriting purposes.

3. In general larger employers are more favorable risks.

4. They are also more likely to have their own risk managers and to have safety programs.

E. Following your "Liberty Mutual test", could I conduct the same test for another company using the data you provided? Is there a relationship between the amount of money that you spend, for example, litigating as an insurer and how much control you have over your loss expenses? Is this an incentive to keep your safety record good? I'm getting at whether the relationship is between the cost of avoiding a claim or with preventing the claim in the first place?

ANSWER: I don't know. If you look at the three companies on the sheet I have provided, you have three very different loss ratios which indicates there is not a direct comparison there, that you don't have a direct relationship.

F. Under your recommendation for a regulated competitive system, please elaborate about the mechanism, how would it work, and how similar or different from the current system would it be structurally? For instance, would there still be a rating bureau?

ANSWER: Yes. the system would be extremely similar to the current system. I would envision maintaining the Rating Bureau, maintaining their calculations of a statewide rate level, but allowing insurance companies to go to the Insurance Commissioner to say that based on their own loss or expense experience they can justify the use of lower rates, submitting proof, to justify these lower rates. The Insurance Commissioner would either approve or disapprove the application of

this insurance company. Very similar to what the Insurance Commissioner is now doing under Prop 103 for other lines of insurance.

G. Would this process you envision include an open process where others could challenge or present information?

ANSWER: I would envision it working in the same manner as the process works under Prop 103 which allows the public to contest what they wish, or the Commissioner is entitled to call a public hearing if he desires. If neither occurs the Commissioner can take action on his own. I would envision it being a process in which others could get involved and the interested policyholders of an insurance company would have input it they felt it was important.

H. Concerning regulated rate-making, if what you envisioned were to take place and a significant number of companies applied for permission to deviate downwards in their rate, would the Bureau's set rates over time come down? Is that what you think would happen or would that be irrelevant?

ANSWER: No, the Bureau's set rates over time would come down. It's my contention that the use of these lower rates in the marketplace would force other companies to try and meet them or to give up. Our target would be the level of the most efficient company, the company that is best at controlling losses, and force other companies to come to that. We'd reduce the average over a period of time.

I. Why aren't you recommending that the Bureau get into the maximum rate-making? Why are you recommending what you have recommended?

ANSWER: Maximum rate-making meaning that companies are free to use whatever rate lower than the Bureau rate?

COMMISSION RESPONSE: But they would be setting a maximum rate that would be a target for a lot of companies.

ANSWER: Companies would be free to use, without any regulation from the Insurance Commissioner, lower rates?

COMMISSION RESPONSE: Is that a down side you're afraid of?

ANSWER: Yes

J. You are afraid of cut throat competition?

ANSWER: A number of points the Bureau made I agree with. Worker's compensation should be treated differently from other lines of Insurance and there is a greater need to protect solvency of carriers and to make sure rates are adequate and the amount of money collected will be adequate to pay the losses. Benefits to injured workers are a constitutional guarantee. I think we might want to stick with an approval process for deviation under this rating system.

K. In your process, do you have a maximum deviation below the rate set by the Bureau or would that be left to the discretion of the Insurance Commissioner?

ANSWER: The discretion of the Insurance Commissioner based on his review of whatever factors go into approving rates.

L. You think this one change to the system would make a significant difference in competition? You believe having this discretionary ability to charge lower prices is truly a competitive industry?

ANSWER: Yes. Since workers' compensation is state mandated coverage, every employer in the state has to insure or self-insure, and there are very few self-insured. I would envision that competition would be fairly high in workers' compensation.

M. Can you share with us what percentage of states or which states have similar minimum rate laws?

ANSWER: None. The minimum rate law is unique to California. As far as the actual set up, where insurance companies are prohibited from charging lower but are free to charge higher, this is the only state.

N. The rationale of the minimum rate law was principally to ensure solvency. Could you share the history of that?

ANSWER: New York was one of the first states to adopt workers' compensation laws in 1912, 1913. At that time the only insurance you wrote on an employer was employer's liability insurance. The way you make rates is to use historical experience. At the time workers' compensation went into effect there was no historical experience and without the ability to collect and tabulate losses, some insurance companies became insolvent writing this new coverage. There was no guarantee association and without these two factors, the injured worker was left without any benefits. The minimum rate law passed as a method of trying to assure solvency in insurance companies at that point.

[A discussion followed between Mr. Kramer and Mr. Gerlach concerning profitability for insurance companies; applying the factors Insurance Commissioner Garamendi develops in the property/casualty hearings to workers' compensation; expense provisions percentages; difference in expense ratios as an indication of inefficiency].

[Following lunch further discussion between Mr. Kramer and Mr. Gerlach concerned whether rates are lower in States which permit more pricing flexibility].

[Discussions continued between Mr. Kramer and Mr. Gerlach about safety, profit for safety incentives, the question of equity, whether it was achievable or desirable, and the definition of equity].

O. At least in theory, the way the dividend system works there are some market forces that would either lead to efficiency or to choose those who you insure based on what you think their losses are going to be. You don't seem to think it's working very well. Do you have evidence of that?

ANSWER: My own personal knowledge of the marketplace is not extremely broad. Sophisticated insurance buyers probably do shop for dividends. Dividends, however, cannot be guaranteed. Consequently, the dividend you get can be significantly different than what you are informed of initially. When I worked with the insurance department in the mid '70s, the number one complaint we got had to do with dividends, that they weren't as high as they had expected. There was nothing we could do about it.

14.5.6 WRITTEN MATERIALS SUBMITTED

Written materials were submitted to the Commission by this witness

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.6 SUMMARY OF TESTIMONY

CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION TESTIMONY OF: MERLE RABINE

14.6.1 SUMMARY OVERVIEW

Merle Rabine represents the California Applicant's Attorneys' Association and the focus of his testimony concerned benefit levels for injured workers and the "conspiracy of silence" on the part of major insurance carriers and large employer groups that lobby to control the way in which insurance rates and benefit levels are legislated. He believes that small employers are left out in the cold.

As to the minimum rate law, Mr. Rabine believes it needs to be reformed. Specifically, the rate-making process needs to provide incentives for job safety, and incentives for insurance carriers to adjust claims efficiently. These two factors would help to stabilize rates. The present system does nothing to encourage claims efficiency.

14.6.2 REQUESTS MADE TO THE COMMISSION

This Commission may want to take a look at whether an exclusive state fund would offer relief for the small employer.

14.6.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	3
Cost of Actual Operation	1
Equity/Small Business Employers	3
Minimum Rate Law	3
Safety Incentives	3
Appropriate/Expeditious Claims Services	3
Rate Stability/Predictability	3
Brokers Roles (Commissions/ Marketing)	1
Exclusive State Fund Advantages/Disadvantages	3
Need for Worker's Comp. Reform/ Benefit Increases	3
Alternate Rate-Making System (Effect and Analysis)	1

14.6.4 SUMMARY OF TESTIMONY PRESENTED

A. BACKGROUND

Mr. Rabine is the chair of the legislative committee in the California Applicant's Attorneys' Association. This association consists of seven hundred attorneys who represent injured workers before the workers' compensation appeals board throughout the state of California. Mr. Rabine was president of this association in 1989 and involved in the hearings that produced the Green-Margolin Act for workers' compensation reform which produced this Commission. Mr. Rabine indicated that as a representative of injured workers he is paid a fee on a contingency basis which is regulated by the appeals board, usually in the amount of nine to twelve percent.

Mr. Rabine does not have a background in insurance and could not be considered a "expert", by his own admission, but he and the CAAA have been forced to become involved in the process and the issue of rate-making, because of the politics of workers' comp benefits.

Mr. Rabine went on to state that benefit levels were set by the legislature (temporary and permanent disability), and injured workers are the only participants in the workers compensation system who have to go to the legislature to get their benefits adjusted for inflation and other factors. He compared this to treating doctors and the fee schedule that is adjusted periodically by the Administrative Director without relying upon legislation. He also compared this to insurance rates which are set by the Insurance Commissioner at public hearings.

He felt it was difficult for injured workers to get these raises through the legislature and then signed by the governor, especially when you have one party controlling the legislature and another party controlling the executive branch.

B. INSURANCE RATES

Mr. Rabine indicated that Workers' Compensation rates have increased in the last seven or eight years by more than fifty percent. He pointed out that these rate increases are felt immediately by employers. When his association and organized labor try to get benefit increases through the legislature, they are met with "outrage" by employers.

This has put Mr. Rabine's association in the position of having to understand how the rate-making process effects employers cost.

Mr. Rabine indicated that his group has found a "conspiracy of silence" between the major employers in the state and the insurance carriers concerning the real cost of this system and how these rates are handled.

Major employers are either self-insured or they are large enough to be able to bargain with carriers concerning dividends. Mr. Rabine referenced Mr. Gerlach's presentation which pointed out that some employers who have loss ratios greater than 100 percent are still getting dividends because they are large enough to demand them. Mr. Rabine stated that small employers are not big enough to bargain in this way.

Mr. Rabine also pointed out that the major carriers are represented in Sacramento by several organizations including the California Manufacturers Association and the California Self-Insured Employers Association as well as the Chamber of Commerce which includes insurance carriers. Mr. Rabine reiterated that small employers aren't represented at all. Mr. Rabine feels that these small employers are under-represented, have no impact on negotiations concerning workers' comp and don't participate in hearing before the Insurance Commissioner. Mr. Rabine pointed

out that his association was the only association that appeared regularly at the Insurance Commission hearings to argue for a reduction in rates.

Mr. Rabine indicated that small employers do turn out to their own legislators in their own areas. Their point of view is that they are being "screwed by the system". Mr. Rabine then discussed the negotiations that took place prior the 1989 Reform Act and hearings his assemblymen had in his district. There were seventy or eighty small employers that turned out in the audience and when they got up to speak they talked about how they were being abused by their insurance companies how their rates were going up even though there wasn't any cost; how they had good records for over twenty years, but one serious injury caused there rates to triple; and they couldn't understand what was going on. Mr. Rabine indicated that these small employers had no notion of how they could impact what was actually going on.

C. THE MINIMUM RATE LAW

Mr. Rabine believes that the minimum rate law needs to be reformed. He believes it operates to benefit major employers and insurance carriers at the expense of small employers and injured workers. Mr. Rabine believes that temporary and permanent disability rates need to be increased to reflect inflation and that this will not occur until rates are stabilized.

Mr. Rabine indicated that in discussions with legislators, the legislators appear to have accepted the equation that if there are increases in benefits they have to be matched by savings in other places. Mr. Rabine's organization believes that significant savings can be made by reforming the minimum rate law.

Mr. Rabine argues that rates can be stabilized if the rate making process provides incentives to employers to increase job safety and to reduce injuries. Mr. Rabine refers the Commission to Mr. Gerlach's testimony.

Mr. Rabine also believes that incentives for insurance carriers to adjust claims efficiently would stabilize insurance rates.

Mr. Rabine argues that the current system does not encourage claims efficiency.

The minimum rate law does not do either of these two things (provide incentives for employer safety or incentives for appropriate expeditious claims handling). Mr Rabine and his association believe that regulated competition will establish both of these goals.

This concludes Mr. Rabine's testimony.

14.6.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

A. You said that small employers don't seem to get involved in the process. How might we encourage input from them in this process?

ANSWER: I don't know why small employers don't get involved unless this is just another cost they have to deal with. They are not organized in any way and the Chamber of Commerce does not represent them--at least there is no sign of it. If this Commission has any capability of publishing its proceedings or findings to the employer community that might be very helpful. I think that the theoretical discussions you are having will be interesting to an economist, but many others will have a difficult time understanding it.

B. It's becoming interesting to me that the small employer is subsidized and yet being screwed by the system. Obviously there are differences of opinion but also of interpretation of facts. We hear this morning that thirty percent of employers do not experience rating or dividends or have retrospective ratings and my question is: Beyond reforming the minimum rate structure, are there other measurers that could be adopted to aid small employers -- expanding safety groups to encompass other employers? Are there other measures?

ANSWER: It is my understanding that the state fund pays dividends to everybody. Our law firm receives dividends and we are a small employer with only twenty-five employees. Many employers are ignorant about the existence of the state fund. Now another thing you are asked to look at and which is an interesting question, is an exclusive state fund. If you have an exclusive state fund you immediately get rid of agent commissions which is a significant part of premium. I don't know if that is a solution that would be better than what we proposed (regulated competition). It might be. It is more radical than what we have proposed, but some states are happy with it. Ohio is fairly happy with it.

C. Would there be less radical measures that would mitigate the bad position that small employers find themselves in.

ANSWER: There might be, in terms of the details of how rate-making works.

D. You raised the issue of appropriate and expeditious claims handling. In the testimony of Mr. Gerlach he had interesting numbers which he compiled from Form 46, and as an economist I am interested in a relationship. Is there any that you know of in these loss adjustment expenses (relationships between losses incurred, loss adjustment expenses, and dividends)?
ANSWER: I was going to ask Mr. Gerlach what to make of this. I can tell you among these people (referring to Form 46) who does decent claims adjusting and who doesn't. Fairmont Insurance went out of business because it was bought by TransAmerica. It was an absolute disaster in terms of claims adjusting.

E. If you look at a percentage of earned premium there doesn't seem to be a direct relationship which indicates that a high loss adjustment expense translates to a low dividend or vice versa. Do you have an intuitive guess -- do companies litigate a lot in the hopes of not paying for losses, and their dividends go up? Is there a relationship there?

ANSWER: For example, I'm looking at 1989. Industrial Indemnity does a relatively decent job of adjusting claims and has a relatively low litigation ratio. They are decent to deal with; they try to pay the benefits they are supposed to pay; they don't hire a lot of outside private defense carriers; and they have a loss adjusted ratio that is the highest on this chart. I can't tell you why.

F. We haven't heard too much about claims efficiency but where would we seek objective data on claims efficiency?

ANSWER: The Green-Margolin Act established a new category of bureaucrat called auditors who audit claims to determine if benefits are paid timely. This only effects injuries occurring after January 1, 1990. These auditors are part of the Office of Benefit Administration and Enforcement, and they could give you information about what carriers are doing on post-1990 injuries.

G. Has there been no previous systematic attempt to evaluate that?

ANSWER: Right. The only other data I have seen concerns the amount of time between the injury and the payment of the first benefit. The last thing I got from (Mark Gerlach) indicated that in 1989 it was twenty-one days. The law says they were supposed to be paid in four days. The

Green-Margolin Act says fourteen days. Prior to 1989 it was the statistics we saw indicted between twenty-seven and thirty one days but those were the only statistics that were collected that I know of.

H. We haven't heard much about the "hearing examination system" in the claim adjustment process, so you can educate us. What if process in California of guaranteeing that there are appropriate medical examination of claimants; that there is some objective third party; that there is a state interest; a hearing examiner who represents the state, not the claimants or insurance company?

ANSWER: The agency call the "Workers' Compensation Appeals Board" employs workers' compensation judges who are administrative law judges and do nothing but adjudicate claims. It is an administrative court. There are no juries but otherwise there are court reporters and an appeal process. Disputes are taken before that agency and it has exclusive jurisdiction over industrial injuries. These judges and settlement referees also approve all settlements, either stipulated or compromises (which are lump sum settlements). These settlements must be reviewed by a judge to be sure it is adequate before it can be approved.

The labor code in terms of medical evaluations has two systems depending on the date of injury. For injuries after January, 1991, the Green-Margolin Act set up a system involving qualified "Medical Examiners" who are doctors certified by an industrial medical council who evaluate unrepresented workers or a represented worker on behalf of either the represented worker or the carrier / employer. The labor code provides that payment of the evaluation is paid for by the employer -- that is the medical-legal cost that you have probably heard about.

The 1991 scheme requires that if there is an admitted injury, the parties agree to a single doctor for evaluation prior to going out and getting separate evaluations. Prior to 1991 each side could get it's own evaluation and if the parties did not agree, then the case would go before a workers' compensation judge and the judge decided. This is really a simplified version.

I. For injuries after January, 1991, has the role of the attorney become moot?

ANSWER: I don't know any states that have a system similar to the 1991 scheme. This was "invented" towards the end of the 1989 negotiations and was a compromise between what the insurer's / employers proposed and what the applicants attorney's proposed. As far as the involvement by attorney's, my feeling is that the complexity of the reform that was added to the system, which was already fairly complicated makes it difficult for an injured worker to get through the system by themselves.

J. Is there a mechanism in place that would guarantee that both employers and insurance companies report progress on cases involving serious injuries so the claimants aren't left to their own devices -- in other words -- isn't there a state interest in making sure that doesn't happen?

ANSWER: There are problems trying to set-up such a system. The Reform Act requires a lot more notices going to injured workers to explain what's happening. Some people don't read English, and some people are functionally illiterate. Others read Spanish, Vietnamese, Cambodian, Samoan, Yugoslavian, and so on and these notices don't come in those languages. The other problem if you try to have a state agency do this is to define the role of state agency. The legislature wrestled with this in 1989 and ultimately rejected that idea.

K. I want to go back to your position as a small employer. Did I hear you say you would favor a stable rate rather than a rate that might fluctuate but would reflect your group's loss costs?

ANSWER: Sure. A law firm is not hazardous industry. I would be happy to pay nothing for no

injuries. That's not my understanding of how insurance works, but if it did, I'd be real happy with. What i don't want to see as a small employer, is to have no losses and have my rates go up every year. That doesn't make sense. The other thing that makes mo sense is having my rates go up, and this is since we insure with state fund because we pay attention to these things, to have my rates going up ever year and then three years later getting a chunk of it coming back as dividend. We would rather have the money up-front. We could invest it ourselves. I'd rather have it up-front.

L. You would favor that system that would give you a fairly stable rate verses the system that would give you a fluctuating rate but might be a little more competitive?

ANSWER: Right. To the extent I run my business, I would rather know, plan what my rate were going to be. What I wouldn't want to see is no matter who I go to, the rates are going to be fifty percent higher no matter what happens to me as an employer.

M. So it's very much tied to what happens to you?

ANSWER: Sure. As an employer, what else can I know?

N. This has come up before and we've had other comments concerning whether a business would favor a more stable rate verses a fluctuating rate. Would businesses be willing to pay for that stability. Also, the question was raised; do you expect your other expenses to stay stable? How stable are your other business costs? Do you treat insurance differently? Do you treat workers' comp differently?

ANSWER: I'd be really happy if my health insurance cost were stable. Right now we are paying for what the minimum rate law intends to be stability but it's not stable. The rates go up significantly no matter what happens to my experience as a small employer. Since I can't control what the losses throughout the state are, I'd like to see some way, as an employer, of not having the rates go up every year.

14.6.6 WRITTEN MATERIALS PRESENTED

Written materials were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY

14.7 SUMMARY OF TESTIMONY

ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES TESTIMONY OF: THOMAS F. CONNEELY, JOHN PASQUALETTO AND DR. DAVID APPEL

14.7.1 SUMMARY OVERVIEW

This testimony involved a joint presentation from the ACIC. Mr. Conneely coordinated the testimony for himself, Mr. John Pasqualetto and Dr. David Appel.

ACIC favors the retention of the current rate law which provides for regulated competition over a system that would provide for open competition. Dr. Appel presented research ideas and methodology approaches for this Commission to examine profitability and dividends. Mr. Conneely's focus was the minimum rate law itself which he believes serves California well.

Mr. Pasqualetto also addressed the minimum rate law from the perspective of someone that had started up an insurance company. His focus was competition, approach to marketing, analysis of other rate-making in other states, dividends, and incentives for work place safety. He believes the minimum rate law fosters all of these items and that California is well-served by it.

14.7.2 REQUESTS TO THE COMMISSION

Mr. Conneely advised that at subsequent meetings of this Commission they would like to offer additional testimony, but the intent this time is to bring executives from their own member companies.

Mr. Pasqualetto suggested that the Commission evaluate other rate-making environments in other states and determine whether these environments actually do contribute to lower cost of doing business.

Dr. Appel recommended the Commission decide what is the scope of it's review, does the Commission review the entirety of the system or the rate-making system only, and that the Commission review it's time and resource constraints.

14.7.3 MATRIX ITEMS DISCUSSED

Mr. Conneely on focused on the following:

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	2
Equity/Small Business Employers	3
Equitable Distribution of Costs of System	1
Minimum Rate Law	3
Dividends	1

Mr. Pasqualetto focused on the following issues:

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	1
Equitable Distribution of Costs of System	1
Minimum Rate Law	3
Profitability	3
Retrospective vs. Prospective Rating	3
Safety Incentives	3
Dividends	3
Solvency	3
Alternate Rate-Making Systems	3
Rate Stability	1

Dr. David Appel focused on the following:

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	1
Equitable Distribution of Costs of System	1
Minimum Rate Law	3
Profitability	3
Rate Stability	1
Data: Availability/Impartiality	3
Dividends	3

14.7.4 SUMMARY OF TESTIMONY

This presentation involved the testimony of three individuals: Thomas F. Conneely, President of the Association of California Companies (A.C.I.C.), Dr. David Appel and Mr. John Pasqualetto.

TESTIMONY OF THOMAS CONNEELY

Mr. Conneely began the testimony with a brief statement explaining what the ACIC is. ACIC is the Association of California Insurance Companies, a trade association of Property Casualty companies which focuses solely on California. The ACIC consists of some of the largest writers premium as well as some of the smallest writers of workers' compensation premium in California.

The ACIC has had an interest in these proceedings for some time. Mr. Conneely took exception to Mr. Rabine's representation that small employers were not being represented or spoken for with the 1989 Reform effort.

Mr. Conneely pointed out that this Commission would not be in existence if not for the advocacy on behalf of all employers, particularly small employers, by the California Chamber of Commerce.

Mr. Conneely explained that when the Green-Margolin Act was being negotiated, a question arose as to whether the rate law in California acted equitably. the groups involved in developing the reform act included employers, organized labor and insurers. Mr. Conneely indicated he did not want to be argumentative as to whether the law was good or bad but on behalf of the ACIC they want to be of whatever assistance they can be to help the Commission's inquiry and to provide any information they have or can produce.

Mr. Conneely indicated that the ACIC believes the rate law has served the California workers' compensation marketplace very well, even though his association recognizes that it does make "trade offs". He explained that the rate law trades "an open competition environment" for "regulated competition", and the trade off includes up-front pricing and whether or not dividends are correct, etc.

The ACIC believes that the marketplace that is established has a basis in the California Constitution. The Constitution essentially sets the structure of this marketplace by providing for private insurance and a state fund which is mandated by the Constitution. The minimum rate law was designed to assure that the parties in this marketplace from the insurance side met the standards of accountability that the public expects. The ACIC believes that this system does that. They believe that it provides accountability through the rate-making process conducted before the Insurance Commissioner. The existence of the Rating Bureau provides a basis of decision-making and a database that's very well maintained and very accurate.

This concludes the testimony of Thomas Conneely.

Mr. Conneely introduced Dr. David Appel who is a Brooklyn college graduate with a Masters and PH.D. degree in economics from Rutgers University. Dr. Appel has been an adjunct Professor for the past ten years, has taught examination courses for regional actuarial societies, has worked extensively in the application of economic and financial models to property-casualty, and in the application of those models to property-casualty insurance issues. Mr. Conneely explained different assignments that Dr. Appel had been involved with, including development of cash flow models, etc. He explained the issues Dr. Appel had spoken on and that Dr. Appel was a member of the editorial board of the Journal of Insurance Regulation, and explained several other credentials that Dr. Appel had. He explained that Dr. Appel was appearing today on behalf of A.C.I.C.

TESTIMONY OF DR. DAVID APPEL

Dr. Appel gave the following presentation:

He began by indicating he did not come before the Commission to advocate any position that the Association of California Insurance Companies may espouse in conjunction with this Commission's deliberations.

Dr. Appel stated that the ACIC is an interested party in the outcome of these deliberations and that he had not inquired of their position. Dr. Appel stated that the best advice he could offer his clients is to provide them with factual information and allow them to make sensible decisions as to the positions they should take. Dr. Appel then stated that his objective in speaking to the Commission was to recommend certain tests, empirical and statistical tests that could be conducted with available data and may help the Commission get factual answers on the question or issues that it has to evaluate.

Dr. Appel indicated that one issue that had come up today was whether small employers are served or "screwed" by the process. Dr. Appel shared information he had just received from the Workers' Compensation Insurance Rating Bureau.

This information revealed that there are 217,500 small risks in California (less than $1000.00 dollars in premium) and the average loss ratio for this group of risks is 81%. The average loss ratio for the entire 560,000 risks in the state is only 50%. Dr. Appel suggests that there is some factual evidence that would allow an initial conclusion that the rate levels for small risks are less adequate than they are for the average risk. Dr. Appel stated that if a regression of loss ratio against size of risks was run you would find a continually declining slope. He stated that as a size of risk increases, loss ratio decreases, Dr. Appel summarized that the only important piece of information the Commission would get from this is that there is data available that would allow the Commission to come to some conclusion.

Dr. Appel discussed his career and that it has been spent almost exclusively in the analysis of workers' compensation issues. To highlight Dr. Appel's testimony, he indicated he had worked for the NCCI and that the NCCI's sole objective was to conduct research into the underlying determinants of workers' compensation costs to evaluate the financial characteristics of workers' compensation insurers and to provide a general research program. Dr. Appel discussed the research papers he had written, the material he has evaluated, papers written on the probability of litigation in California, and financial models he has developed, he summarized by saying that he had a long term interest in research in this area rather than advocacy. Dr. Appel indicated that the only condition of his appearance before this Commission today was that he be allowed to recommend research studies this Commission should undertake. Dr. Appel stated he had not asked what position the ACIC may take regarding the Commissions' goals and he recommends a research agenda. Dr. Appel indicated he was referring to the seven goals of the rate-making process which were articulated by the legislation that created this Commission.

Dr. Appel continued by stating his "priors" and that his priors are derived by his training as a economist. The following represent his "priors".

A.First, it is important to distinguish between the positive and the normative. Dr. Appel added here, whether the minimum rate was good or bad and whether it promotes equity or not is a public policy decision which he did not feel confident to make. That is up to the people of California to make and we need facts to determine that.

B.The second prior is that one ought to evaluate the need for making change before recommending changes.

Dr. Appel discussed the areas that he teaches. He indicated that when he teaches he begins by talking about the optimality of competition and then discussed why government would intervene in private markets, which is usually to promote certain social policy goals which might not be attainable given the current market structure. Dr. Appel then stated that the social goals that we attempt to achieve with a workers' compensation system broad and designed to bring swift settlement to work place injuries.

The workers' compensation system is an example of an area where the government intervenes in the market. Dr. Appel indicated that in a perfect system there would be no need for a workers' compensation system because employers would provide the optimum of safety and employees would purchase private insurance to compensate them is they were injured. The workers' compensation system interferes with that process and does so for a good reason. The rate-making and rate regulatory systems are an additional aspect of that interference. Dr. Appel believes the critical issue to identify is whether the California system as it has evolved serves the appropriate political goals. Has it adapted in such a way as to produce reasonable outcomes to those goals and does it work well for California? He summarized it by stating that the question should be: What are performance goals and what are the criteria for evaluation? What research can be done to address those goals?

Dr. Appel answered that question by stating that the goals of the Workers' Compensation system are efficiency and equity. This includes a swift payment of claims, low administration costs, and reduction of transaction costs.

Dr. Appel then discussed the "charge" the Commission faced.

Dr. Appel indicated that he had given some thought as to whether this Commission could evaluate the rate-making process without considering the other aspects, the benefit structure, administration of the system, degree of litigation, industrial composition of the work force, etc.. He believes the rate-making system is one adjunct to the workers' compensation system.

Dr. Appel recommended the Commission decide what is the scope of it's review, does the Commission review the entirety of the system or the rate-making system only, and that the Commission review it's time and resource constraints.

Dr. Appel indicated that if the scope of the review was limited to the rate-making system alone, there would be several reasonable research question's that would come up. He suggested the following questions:

What are the goals of the rate-making system? He indicated that almost every Insurance Code says that rates shall be neither excessive, inadequate, nor unfairly discriminatory. This means that policyholders should pay reasonable costs, that they should promote solvency of insurers and not lessen competition, they should allocate costs or assign costs across all the participants in the system.

He then asked: What is equity? Dr. Appel believes we can define equity and we can also define profitability. He indicated he had spent a good deal of time working with those data sets and has some insights that might be useful to the Commission. He stated that the "acid test" of competition is performance.

Dr. Appel indicated that a profitability study could define rate of return and indicated how he would do that type study. He went into some detail about preparing a study that would describe rate of return. After explaining his approach, he indicated that he would want to come to the Commission and advise them the way in which he would estimate a rate of return and allow the Commission to evaluate whether the procedure or methodology is appropriate.

He indicated that he testifies as to fair and reasonable return for insurers and uses the methodologies that are routinely accepted in public utilities regulation. He applies them to well known data sets. He summarized by saying that if he describes the methodology and the source of the data, the Commission is capable of determining whether that methodology is appropriate and whether the conclusions are reasonably derived from the methodologies.

Dr. Appel went on to discuss dividends and what type of material could be used. He indicated that California collects dividend data that no other states collect, specifically data by size of risk, by loss ratio.

Dr. Appel indicated that he would develop regression models of dividends as a function of loss ratio and premium size, and went on to discuss the various way he would apply this test. He discussed research that he did when at the NCCI and regression models set.

He suggested running a model dividend ratio as a function of appropriate variable, for example, the loss ratio in the state, the average size of employer in this state.

He further discussed the complexity of this type of research analysis, and stated that he would be delighted to do research in these areas.

He went on the discuss whether the market was competitive and the discussed a paper he wrote in the Journal of Insurance Regulations entitled "Regulating Competition in the Case of Workers' Compensation Insurance". Dr. Appel then stated that if any of what he had discussed interested the Commission he would be happy to discuss with A.C.I.C. whether they would be interested in sponsoring this research and providing the results to the Commission at it's next meeting. He felt he could do a profitability study and

one or two dividend studies by the beginning of April and brought that to the Commission's attention. A discussion followed concerning whether Dr. Appel could preform the work he had indicated he had an interest in and whether the ACIC would pay for this work and provide it to the Commission. It was concluded that ACIC would have Dr. Appel do this on behalf of the Commission because of its interest in helping the Commission. This concluded the testimony of Dr. Appel.

TESTIMONY OF JOHN PASQUALETTO

As part of the joint presentation from the Association of California Insurance Companies, Mr. John Pasqualetto gave the following testimony:

Mr. Pasqualetto began by indicating that he was a unique presenter in the sense that he represented an active practitioner in the insurance system. On a personal note he advised the Commission that he had started in business 26 years ago and entered the workers' compensation insurance system right out of college. He indicated he began with the State Fund working in industrial safety, marketing, and underwriting. From there he went into the private sector with several workers' compensation companies and finally decided to become an entrepreneur.

He indicated it was a reasonable conclusion that the California system over-all, with the minimum rate law being some 76 years old, has tended to out-perform the other states in terms of it's overall long-term performance in rate stability, in terms of rate adequacy, in terms of availability and affordability and along with the other issues need to be addressed.

Mr. Pasqualetto indicated that they first started writing Workers' Compensation policies in 1989. He indicated that the fact that he could gain entry into the system is a positive attribute to the California system.

Mr. Pasqualetto assured the Commission that competition in the Worker' Compensation system does exist. He indicated that there were over 300 participants in the workers' compensation system who actively compete for business. The largest market segment holder is State Fund which is also the residual market mechanism in the state. There is no real dominant buyer in this system.

Mr. Pasqualetto indicated he had some experience in looking at the rate making systems in other states. He suggested that the commission evaluate those other states in terms of those environments and whether those environments actually contribute to a lower cost of doing business.

Mr. Pasqualetto believes the Commission will find that is not necessarily the case. Mr. Pasqualetto indicated that concept workers' compensation is a social line of insurance and it is important that we protect the solvency of the players in the system. Solvency is extraordinarily important when you are dealing with a social line of insurance. Competition take place on two levels: in the first insistence on the level of service and in the second instance on the ultimate price. We have a minimum rate law, but we also have mechanisms that shift to review "the after the fact -- pricing mechanism".

Mr. Pasqualetto then discussed the dividends that are paid in California and pointed out that they are paid to a fairly substantial degree. He indicated that he believes the marketplace requires a carrier to pay dividends in California. He indicated that we have fairly sophisticated buying system in this state. The large risks have full time risk managers. We also have insurance brokers and agents that advise the small clients as well as the large client on how to buy their insurance and those agents and brokers are quite sophisticated about the dividend "track record" of writers in the system and where their customers are going to get the best price. Mr. Pasqualetto pointed out that you have to selective in the risks that you underwrite because another part of that variable is your loss ratio. California dividends can only be paid out of surplus California profit in workers' compensation line of business. You can't use your profit from other lines and

you can't use your profits from other states. You have to concentrate on doing a good job from a risk underwriting standpoint especially with respect to efficiency. Some carrier's are very efficient and their dividend track records shows that this efficiency leads to results indicating that dividends are a motivator for efficiency and a motivator for good underwriting.

Mr. Pasqualetto stated that he thinks one of the objects of the worker's comp system is the motivator of employers towards accident prevention. He believes there are definitely incentives for motivator to safety. The dividend mechanism is a motivator for safety. He believes it is a very fair mechanism because it allows you to look at the individual track record of the employer. He indicated that most carriers in their dividend mechanism adopt a "merit distribution" and that is why they produce a higher dividend dollar for those with lower loss ratio.

Mr. Pasqualetto pointed out that in some states they use a mechanism called "flat dividend" approach. Under this approach a uniform dividend is placed across the entire book. This is not done in California because we view dividends as a motivator.

Mr. Pasqualetto then indicated that a second motivator towards safety concerns the experience modification system which adjusts the manual rate for the individual performance of a risk. Overall he believes it provides an incentive.

Mr. Pasqualetto concedes that the system is not perfect but he discussed a plan called retrospective rating, which guarantees a return after the fact if the employer has a good track record. He indicated that this is not a plan used by small employers but has been used selectively by large employers. Mr. Pasqualetto offered his opinion that the pricing system should promote the availability and affordability, not foster irresponsible rate cutting. He stated that the minimum rate law was passed in 1915 as a response to what was perceived to be indiscriminate rate cutting and the legislature was concerned about solvency. We shouldn't throw this away.

Mr. Pasqualetto then discussed the difference between our system and a normal property casualty system. The difference is that the employer is paying the "freight" for the product that is dictated by the legislature and they are buying a product for payment to their injured workers. There's not a lot of negotiations whether to buy a deductible or whether you get co-insurance or a lot of other factors because the real concern is getting the injured worker back to work. Mr. Pasqualetto indicated that they did not have a lot of risks they insured. He Indicated that he competed in the open market for those risks and there were a lot of participants that would like to insure the same good risk that he insures. He indicated that he competes on the basis of cost control, innovation and service. "Service" cover the gamut from safety, to loss adjustment expenses. From Mr. Pasqualetto's view the real bottom line is that we have an extraordinary system with respect to data that we collect and the integrity of that data. He stated that in other states data integrity and creditability was always a question mark. He believes we have a very disciplined system in California and we have quality checks. The Rating Bureau does a good job in doing a test audit program.

Mr. Pasqualetto believes this leads to a very measurable system and that it came about as a direct result of the kind of discipline that a minimum rate law in California instills. It is not perfect but compared to what's around, it has out performed all others.

14.7.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

The following is a summarization of questions and answers raised by the Commission following the testimony of the three presenters for ACIC:

A. I'd like to understand a little bit about this offer. Are you conducting a job interview? The things you suggest are things we would try to accomplish one way or another. We need to

understand about the offer. Is the offer that you would be interested in doing this for us, working for the Commission, or as in affiliation with the Association?

APPEL: Probably the latter. I have a number of clients who are in the insurance industry currently, I work for the NCCI, etc. It's up to the ACIC to decided whether they have an interest in sponsoring this work. I would be happy to do it.

CONNEELY: It is our attempt to be as helpful as we can by providing information that the Commission can use. The only condition we would place on Dr. Appel is that the work be done with complete academic integrity, that it be done as objectively as it can be done. If it is something the Commission could use and that's the spirit in which the offer is made we would sponsor it.

B. What do members of the Commission think? [my only concern is that if, in two months from now we contract a consultant to do research for us, that we should not be in the position of saying don't look at a certain area of research which we have already allowed you to look at.]

CONNEELY: I wasn't suggesting that.

C. It's very clear over the course of these meetings concerns about what data exists have come up, whether it has been analyzed, and we have an interest in this area.

[At this point Orin Kramer, the original Executive Director for this Commission asked Mr. Conneely to clarify the work that they would sponsor which Dr. Appel would perform.]

CONNEELY: Our resources are limited and if we were not to provide this kind of information we will provide something else.

D. Could you lay out your entire methodology and make the original data available so that anybody else who wanted to replicate or change a variable could?

APPEL: Anything on the profitability study would all be publicly available and would be gathered by me, that data would be made available. The dividends study, the data is aggregated by size of class of risks and by loss ratio and those data are publicly available. Some data I'm not sure whether it would be available, whether it is protected by confidentiality at the Rating Bureau and I couldn't speak as to that, but anything I would collect directly I would be happy to make available to you.

[Mr. Kramer then discussed the need for the Commission's independence in the process and in having the data be credible because Dr. Appel would be sponsored by ACIC. He indicated that he assumed that Dr. Appel would develop the research design, the methodology, run it by the Commission, and the Commission would either bless it or not, and at that point Dr. Appel would undertake it. It wouldn't be a question of somebody else imposing a research design upon the Commission.]

APPEL: That's certainly one model, but an alternative model is that we do the research, we do the first two steps you talked about, then we do the work, and if it is laid out in clear detail, then the Commission can decide if it's credible or not.

E. I prefer that model. It puts us in an independent position without having blessed anything.

APPEL: I hadn't thought of that but it's probably better for you. It also leaves ACIC in a position to use that research should they disagree with your conclusions.

CONNEELY: I prefer that.

[At that point the Commission asked Robert Mike with the Workers' Compensation Insurance Rating Bureau about the data available from his agency.]

MIKE: We will make data available to the extent there aren't restrictions in the law or confidentiality restrictions. When you look at California data we have a lot more data than other jurisdictions. It's important to have something to compare it to. With that caveat I suspect we can provide Dr. Appel with whatever is necessary.

F. When you look at an in depth analysis of profitability or rates of return, that's not quite as crucial that you would have to compare it across states because you have all kinds of comparable industries within California.

[The following response was given by Mr. Mike with the Workers' Compensation Insurance Rating Bureau.]

MIKE: The results, the indication on profitability will be significant under any of those models. To the extent you can get a model that allows you to be uniform from state to state that would be desirable. Even though I might argue for California, the database we use in California is better. The difference between the California model and the uniform model is going to be so significant that we need to be overly concerned about it.

APPEL: I originally gave a good deal of thought to how one would address these questions. I originally configured a dummy variable test where you have a set of dummy variables for rate systems. It could be a competitive rate versus a prior approval on the variable and one for the minimum rate law and so on, but what Bob just said is correct.

There are a lot of outcomes in these seven goals for which California data is far better than data from other states. If I were taking the advocate's position, I would say that is one of the benefits of the minimum rate law in that it permits sufficient revenues to allow that form of data collection in that kind of analysis. I don't think the rate of return issue needs comparison. On the other hand whether California dividend plans are reasonable compared with the competitive pricing plans existing in other states, might be something upon which a comparison of states is appropriate.

G. So that's a completely internal study?

APPEL: The latter one is, and the alternative is multi-state cross-sectional.

H. Are we interested in letting him go ahead and report to us? [The commission indicated that they would.]

CONNEELY: Thank you.

I. That is why I don't believe he is a real academician. Nobody here would promise to get any sort of research in three and half weeks.

[Mr. Kramer explained that Dr. Appel was one of very few people who had done a great deal of work on California system, and that was the advantage in terms of what he was doing. It was indicated that Dr. Appel's work would be included in the April 8th Commission meeting as part of agenda. The Commission indicated it was input from another "interested party", just part of the hearings].

J. You mentioned "reality", would you, as an insurer, use a rate that was higher than justified on purely objective factors or a large employer to somehow subsidize your being able to sign up a whole bunch of smaller employer? Any subsidizing of the rates to smaller employers by the rates you charge larger employers?

PASQUALETTO: I don't see that. From a standpoint of overall risk selection we try to select the safest employer and look at the individual merits of that risk. I don't deal on a macro level. I'm a small carrier.

K. But you know the industry. Do you think that's a wide spread practice?

PASQUALETTO: Yes, because of the nature of its relationship with the distribution system it tends to look at things on a macro level. There are three distribution systems you can look at. The first is the direct writer such as State Fund or Liberty Mutual. The second is the one that works through an independent agent, where the agent has binding authority, and the third is the broker system. The brokers have no binding authority. They represent the buyer not the seller and act as an expert and assist the employer in selection. All three of these "distribution methods" exist in California.

L. The agents often commit for you?

PASQUALETTO: The agents have binding authority.

M. Is it a reality that the agent who is out there committing is using whatever selection process he is using?

PASQUALETTO: Yeah, and we hope he is using the right one.

N. Does he get to commit the price?

ANSWER: No. The price (with the minimum rate law) is 99% of the time what the published rate is for the classification and what the published experience modification is. Dividends are essentially a privilege of the carrier and the carrier does provide a dividend disclosure letter. For accounts over ten thousand that letter is mandatory.

O. But the agent is still critical in the process.

PASQUALETTO: Absolutely.

P. The agent selects who you are going to be underwriting and there is a tricky thing that can happen in the classification process, it's not always that clear cut which category to put someone in.

PASQUALETTO: One of the things we do is a test audit of every risks we write. Within thirty

days I dispatch a payroll auditor and his job is to look at what the risks does, what's the process, and what's the end product, and then what it looks like in with respect to the manual.

Q. In your experience in the market is there propensity among some companies to look at certain risks and say they belong in a certain classification and they end up being misclassified?

PASQUALETTO: They would get away with it for a short period of time but I am amazed how little of that actually does go on. Secondly some of those ratings could come back to haunt an account because if it is misclassified and it is not experience ratable risk, then what will happen is the losses will be larger than the rates contemplated. So you end up with a debt experience modification instead of paying what the published rate is.

APPEL: As an adjunct to that, isn't it true that the inspection program of the bureau is more active and aggressive in California?

RESPONSE FROM MR. MIKE WITH W.C.I.R.B.: For every experience rate risk we inspect in within one year. In our data base we have a "bureau assigned classification". When a new policy comes in and there's a classification on that policy that has not been approved by the bureau, we ask the insurance companies to substantiate the change in classification. It is possible to manipulate the information but we do so much more in California and even when a risk isn't experience rated we have a history of the class assignment the prior carrier has put on it. So when a new policy comes in that changes the class we immediately begin this inquiry process.

PASQUALETTO: One of the speakers earlier today suggested that dividend performance may not be a reason for a carrier writing or renewing business. It is a reason for carrier writing if the system is sufficiently competitive enough where, if you don't perform up to some expectation, it's not perfect. You will have an opportunity to have other people look at your business because that's the way the marketplace operates.

R. Did you mention what kind of companies you primarily write? What industries?

PASQUALETTO: We don't specialize in a given industry. We specialize primarily in risk than have an annual premium of fifty thousand or more.

S. So you're looking at a larger risk?

PASQUALETTO: Middle market. Fifty thousand to about five hundred thousand in annual premium.

T. If I was going to characterize your remarks, they would be with your experience with those kinds of companies, right? Those kind of industries?

PASQUALETTO: Yes and No. Don't forget that I was at State Fund.

U. So you're looking at both?

PASQUALETTO: I have seen the performance of small risks and part of the problem with small risks is you don't generally get the payroll you want to get for a small risk because they, frankly we don't have the same kind of ability to control and audit those smaller employers and some premium gets away from us.

V. So your remarks could be characterized by your experience from both?

PASQUALETTO: I'm trying to speak broadly.

W. You said you use public utilities as a base in your theory -- the rate of return.

PASQUALETTO: I said I get concerned when you adopt a public utility model as it applies to the insurance industry.

X. That's my question...

APPEL: Can I qualify that please? When I said the public utilities model I did not mean to say that I would impute the rates of return permitted to public utilities as a fair rate of return for insurers. In public utilities proceedings witnesses on both sides of the issue routinely present methodologies. One is known as the discounted cash flow or the Gordon growth model or dividend valuation model. Another approach used less frequently is the capitol asset pricing model. I would apply those methodologies using insurer data. That doesn't mean I would suggest that the rates of return typically allowed in public utilities -- I wouldn't suggest those are proper fair rates of return for property causality insurers.

I ran these models up based on the last quarterly data and the indications are that in the range of 16-1/4 - 18-1/2% of the returns that seemed fair and reasonable for the average risk investment of a property causality insurer and that's a return on equity. I think that if you believe the methodology is appropriate and you think the returns that the data set to which that methodology is applied is appropriate then you can't help but say the conclusions are reasonable. Venture capitol requirements are significantly higher than the 16 or 18%. If you are trying to start up a property causality insurer and trying to acquire venture capitol, minimum returns are in the 20 to 25 percent range.

So the larger, more stable companies have lower costs of capitol because they are less risky. There are some questions or some issues than were raised today about disallowment of certain expenses for insurers because that's what we do in public utility. I think that's totally inappropriate for insurers. It's my opinion that consumers have a great deal of options. Consumers have every option to move to another supplier of that product. You don't have that option with public utilities. As a consequence, it may be appropriate to limit political contributions, to limit the type of expenditures those companies can make in the rate making process. But that is not appropriate where consumers can move elsewhere.

Y. In speaking of the competitiveness of workers' comp in California you alluded to there being competition both in price and service. Do I understand you to say in California the competition is predominantly in the area of service rather than price?

PASQUALETTO: To the extent service can be demonstrated in convincing a new customer to come to you, absolutely. I'm suggesting that safety service and claims service are probably the two most important front line services. Workers' compensation safety is a people business, so you do a lot of training. At another level, the claims services are extraordinarily important because you want to deliver the injured worker the benefits they are entitled to, quickly and expeditiously.

Z. Do you believe that primarily because of the minimum rate structure?

PASQUALETTO: I think the minimum rate provides an expense provision to allow us to do that, in that when you tend to get up-front pricing discounts you will tend to have greater emphasis on price and a greater emphasis on keeping expense down, maybe some shortcuts.

AA. You also talked about competitiveness in dividends. If I understand you, it seems what you are saying that it is directly a function of the minimum rate structure, that you get competition on the dividend side because you're not getting it on the rate side.

PASQUALETTO: No. It's a function of the market. I really mean that. If you look at the marketplace you'll find it is the driver of the dividends. If you don't pay a dividend your competitor will -- that's the history of the system.

AB. If we had a situation where there wasn't a minimum rate structure, then would there be more competition on rates an less on dividends because dividends would be smaller?

PASQUALETTO: That's a fair conclusion.

APPEL: It is true that dividends in California are higher than in any other state. Workers' Compensation as a line of insurance has historically been the only one to paid returns to policy holders in the form of dividends.

PASQUALETTO: I think the notion of issues of fairness and equity are those price reductions being made for folks that deserve those kind of reductions. You can allocate how you do that dividend a lot easier than up-front trying to deal with it prospectively.

AC. In the context of a regulated system (I mean there's no potential workers comp being openly competitive with no regulations) within that context, is solvency a matter of concern to this Commission whether we are talking about minimum rates or open competition?

PASQUALETTO: Sure.

AD. What I'm saying is do you think in solvency is a real worry?

PASQUALETTO: Yes.

AE. Could it be?

PASQUALETTO: Yes. Solvency in terms of a social line of insurance is very important. You have to have a solvent carrier around to pay benefits to that injured worker.

CONNEELY: It's part of a whole. The rate law alone doesn't assure that but the rate law plus a good regulatory structure plus a lot of other things, do.

APPEL: Based on Orin's data there are fifteen companies for which ninety percent of their business is California Workers' Compensation which is quite startling. Those are the companies for which the minimum rate will mean a great deal in terms of solvency. Liberty MutUal is not going to be effected, but it's a big line of business. On the other hand, there is an example in the state of Texas just last year that became insolvent solely because of the rate inadequacy in that state. It has to be because that is the only business they were permitted to write. For specialty companies it's a particularly important problem.

AF. You said as long as there was competition and there was other options for an insured, then you do see that as different than a public utility.

APPEL: It's different.

AG. Could there be classes where that's not necessarily true, that you have that many options?

That really there's only one carrier?

APPEL: I don't believe it's a case where the state fund writes one hundred percent of the small risks.

AH. Not small risks. Maybe by industry, by size?

APPEL: It's conceivable that there is that situation; if it is the case and the state fund is the market of last resort, then there need not be concern about unreasonable political contributions or lobbying expenses or anything else. The State Fund's price will reflect the cost of the State Fund which does not include those other items which are of concern to the Insurance Commissioner.

AI. As a new entrant in the market, you had obviously had no dividend track record to bring with you?

PASQUALETTO: That's true.

AJ. And the law says you can't promise a specific rate?

PASQUALETTO: That's right.

AK. During your first year, how did you sell yourself?

PASQUALETTO: Number one, we went on the service side as a first direction, that a customer would not get lost among thirty thousand policy holders. We did tailored service issues in Workers' Comp and workers' comp is a service driven business. It's a frequency business and it's a people business. You have to be geared up from the start to serve these accounts. Secondly we had to disclose to the customers that we had no track record and that disclosure was made. The Board of Directors did adopt a dividend scale but we didn't have a track record so we didn't write pieces of business because the competition pointed out that we hadn't performed against them. We kept working harder. We will pay our first dividend this month. It was a hard start but it was not an impediment sufficient to prevent me from entering.

AL. How about competing on the small business. You said you had to provide services. Is there any incentive to provide safety service for small businesses?

PASQUALETTO: There's an incentive on two levels: first, the insurance broker or agent either provides safety service themselves or sees to it that we provide those services to the small account.

AM. But there's incentive reflected in a manual rate?

PASQUALETTO: There is no incentive directed in the manual rate in terms of providing or not providing that's true.

AN. So for the small business you're really looking for non-price competition, strictly the claim service.

PASQUALETTO: That's 99% of the time. The exception is safety groups. It is lawful in California for light businesses to come together and purchase insurance through a safety group. By their very nature safety groups are there for promotion of safety, not marketing. There are some programs that safety groups have done an extraordinary job. That's a good way for a small risk to try to get together to try to do some of the safety stuff that does promote safety in

the work place. You have two additional dynamics: SB 198 which requires preventive programs on behalf of all employers and that's going to be implemented July 1. And you also have an extreme perhaps even some criminal liability, if employers that don't behave safely.

AO. You defined your business as this middle market. What factors would you consider if somebody came to you that was outside your normal risk level/size with respect to whether you would simply turn them down or surcharge them?

PASQUALETTO: We don't surcharge risks because of the nature of what we do. That has not been our practice. The system does surcharge and State Fund does surcharge.

AP. You don't do it by looking at the clients.

PASQUALETTO: No. We look at the producers book of business (the specific agent) and try to determine if it is a good book for us.

AQ. But in most cases your decision is "yes" or "no" not "we'll insure it for extra".

PASQUALETTO: Pretty much, that's us.

AR. Just in terms of net price for consumer insurers price competitiveness, does the system produce as low prices as would be produced by other jurisdictions that have greater price competition, or would you say maybe a little less price competition?

PASQUALETTO: My experience (personal response) is that I think this system produces on a net-price basis as low a price as you're going to get produced whether you do it on an up-front basis or on an after-the-fact basis. The advantage of the system after-the-fact is more equitable because you have good data to make your decision.

AS. Would it be your guess that you probably lose something in the way of price competition in California that you make back in terms of other benefits or not?

APPEL: Any economist worth his soul would have to be skeptical of a system which did not have up-front price competition because that's the foundation for our approach to markets in general. I think there are ways to try to address whether the net costs are lower or higher than in other states but that's not a simple problem. Mr. Gerlach referred to John Burton's data which is very useful in that regard. It calculates for a fixed sample of classification codes, a price adjustment for many of the pricing programs that are observable. It does not give you the true economic price of insurance because it doesn't include deferred payment plans as part of the price adjustment mechanism. All of these things have to be taken into account when considering what the net cost is.

AT. Do either of you have any theory as to why claim costs per premium dollar is substantially lower in California than in any other jurisdiction?

APPEL: Is this earned dividends as compared with earned premium as reported in other states?

AU. I don't remember the data.

APPEL: The problem is that those are very important details that make a difference because if it's direct earned premium, then you are including the effect of the residual market. If it's net earned premium, that's netted out. I couldn't respond unless I knew a little bit more about the source of the numbers.

14.7.6 WRITTEN MATERIALS PRESENTED

Written materials were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.8 SUMMARY OF TESTIMONY

NATIONAL ASSOCIATION OF INDEPENDENT INSURERS TESTIMONY OF: NANCY SCHROEDER

14.8.1 SUMMARY OVERVIEW

Ms. Schroeder presented a comparative analysis of various states and rate making mechanisms. Many of California's problems also exist nation-wide. No one approach is the only approach.

Ms. Schroeder also examined the trend towards competitive rating and policy decisions behind the change. Such changes to the rating law alone, without considering other system problems, are not "magic bullets". The rating law has an impact, but is not a cure to the overall problem.

14.8.2 REQUESTS MADE TO THE COMMISSION

Workers' Compensation has been an issue of political controversy in other states that have adopted changes in the rating systems. For the most part it continues to be an issue of intense political controversy primarily over the cost of the system. The Commission might want to examine these other states and the actions taken, as a comparison to California.

14.8.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	3
Equity/Small Business Employers	3
Minimum Rate Law	1
Safety Incentives	3
Dividends	3
Alternate Rate-Making Systems	3
Political Manipulating of Rates	3
Rate Adequacy	3
Rate Stability	**3**

14.8.4 SUMMARY OF TESTIMONY

Ms. Nancy Schroeder represents the National Association of Independent Insurers. This is a national property and casualty trade association whose members write approximately $800,000,000 in California Workers' Compensation premium.

Ms. Schroeder indicated that many of the problems that the Commission is looking into (incentives for safety, equity/small business employers) are not just California problems; other states are trying to handle

these problems. Ms. Schroeder believes that California does offer greater possibility for small employers through the dividend provision.

Ms. Schroeder presented a chart to the Commission which covers the rate approval process where there is "prior approval", "file and use" or "use and file", "flex rating". She indicated there was another category that covered whether a carrier was allowed to file individually or whether the file was made by the Bureau. Lastly she looked at whether the state allowed the Bureau to make full Bureau rates or simply loss costs. She pointed out the most striking feature of the chart was a considerable variation among the states.

She pointed out that California was similar to the first two prior approval approaches in that the law allows upward deviations from the approved rate but not downward. She pointed out that California was unique in a number of specifics, particularly in it's reliance on dividends to reflect individual employer's experience.

She felt loss sensitive dividends are present in other states but not to the extent they are in California. Safety groups are much more a factor in the marketplace in California. She indicated that some states beginning to look at safety groups as a way to give greater equity to smaller employers and include incentives. She discussed a Texas law recently adopted to implement safety groups, but said there's some question as to whether that is going work because of the differences between the rating laws and rate adequacy problems that exist in Texas.

Ms. Schroeder pointed out that the lesson in diversity of approaches shows there is no single approach.

A. HISTORY

Ms. Schroeder went on to discuss the history in the rating area. She indicated that prior to 1980, Workers' Compensation rating systems were uniformly "prior approval". Some states allowed for deviation, but others did not. The NAIC (National Association of Insurance Commissioners) began to examine the application of competitive rating in the late 1970's. In 1980 it temporarily included Workers' Compensation under an "all-lines rating model" but there were questions about whether it was appropriate to include workers comp under that model and the NAIC ultimately created an alternative model in 1982 /83. The NAIC did not recommend that model but just indicated that it was a good model if states wished to go that way. The basic premise was that it might be appropriate to substitute regulation by the market-place for some of the administrative rate regulation.

Ms. Schroeder went on to state that between 1980 and 1985 eight states adopted some sort competitive rating including Minnesota, Oregon, Kentucky, Michigan, Illinois, Georgia, Maine and Vermont. Maine's law never took effect and was repealed. Oregon and Georgia later instituted prior approval. Kentucky instituted flex rating and Arkansas and Rhode Island have been characterized as competitive rating but they are closer to an individual filing prior approval model.

Ms. indicated that the basic difference between those is that one allows the marketplace to be the regulator (a competitive market).

B. POLICY DECISIONS PROMPTING A CHANGE TO COMPETITIVE RATING

Ms. Schroeder went on to discuss some of the general policy decisions which prompted states to adopt competitive rating. She thinks there were a number of similarities in differences among the various states and indicated that in some instances there was a belief that competitive rating was a superior concept. The thought was that competition would lower rates. In some situations the rating issue was a part of an overall debate on the Workers' Compensation system or viewed as a politically accepted alternative or trade off for other changes.
Ms. Schroeder pointed out that one of the difficulties in determining the impact of all this is that as many states adopted competitive rating, workers' compensation was entering a soft market.

Ms. Schroeder cited in 1986 U.S. G.A.O. study which compared some rate level changes in the early competitive rating states which showed that rates on the average did decline more rapidly in the very soft market in the early mid- 80's. However, the report expressed caution because of the timing -- the market had just begun to harden. An independent Kentucky Insurance Department survey of agents and others for NAIC indicated when the market turned, rates in Kentucky increased more rapidly, but there were no follow-up studies to indicate whether this was true in other states.

C. LOUISIANA AND NEW MEXICO

Ms.Schroeder went on to state that in the later 1980's when Workers' Compensation became an issue of greater controversy, the focus shifted from competitive rating to individual filing prior to approval. Louisiana and New Mexico adopted a variant of this -- both states had been experiencing rapidly escalating cost. Both of those states had suppressed rates due to political pressure in the late 80's. She indicated that in both cases neither state was willing to let the market become the regulator. The states continued to politically suppress rates and the markets in both states continued to deteriorate. Both states have over fifty percent of their premium in a residual market.

D. NAIC

Ms. Schroeder stated that in 1989 the NAIC began to look at loss costs of filings or limiting workers' compensation, which was an extension of examination of the issue in other lines. This was driven largely by the McCaron-Ferguson debate and NAIC's strong support of the McCaron law.

In discussing the NAIC, Ms. Schroeder indicated that many NAIC Commissioners felt that up-front pricing would effect safety incentives. Some states indicated they would not make any move or change until after 1994.

Ms. Schroeder indicated that insurers must have an acceptable level of confidence in the accuracy of rates. Part of rate adequacy is the timely implementation of rate changes. Process and procedures that delay rate filing in an upward moving market adversely impact rate adequacy. She went on to state that insurers are interested in economic setting of rates. It is a particular concern for smaller companies. In general, the more the law restricts the Bureau activities, the more companies have to invest in making rates.

Ms. Schroeder opined that for insurers, the move to competitive rating has created additional burdens involving cost and uncertainty. The greater the restrictions on the Bureau, the greater the impact on insurers. Additionally, small insurers have less data and must rely on the data of others.

Ms. Schroeder said that it is obvious that employers have an interest in accurate rates so that they can obtain the lowest rate possible. She assumes they would want stable rates from a stable market. The employer's primary interest is the lowest rate feasible. As Ms. Schroeder previously mentioned, most of the studies on the impacted competitive rate levels were done during a soft market but one clear impact has probably been greater instability of rates where you do see greater rate changes. In some other states there is quite a bit of political reaction to rate changes.

One of the things we've noticed that you might want to look at is that Workers' Compensation has been a issue of political controversy in the states that have adopted changes in the rating systems and for the most part continues to be issue of intense political controversy primarily over

the cost of the system.

E. OREGON AND MICHIGAN

Ms. Schroeder then discussed and pointed out that Oregon was a state where this was the case. Oregon had a state fund up to 1966 and it is still a dominant player. But in the last eight years since Oregon adopted competitive rating, that market has been highly concentrated between state fund and one other carrier. The Michigan market experienced some degree of concentration since the rating change and now has to indicate whether or not the market is competitive each year. Ms. Schroeder thinks there may be other factors at work here.

Ms. Schroeder reiterated that there has been some concern that the emphasis on up-front price has adversely impacted safety.

F. DIVIDENDS

Ms. Schroeder then discussed dividends. Dividends were a factor in other states. The NAIC publishes some dividend information and Ms. Schroeder pointed out that dividends have been driven down not just in the competitive rating states but in the states that allow deviations as companies have moved to more competition. Ms. Schroeder thinks there are a variety of ways to address this problem but many of the changes have been made on the basis of general perceptions and political discussions rather than a true examination of the current systems, how they are working and what impact the changes might have.

Ms. Schroeder pointed out that some of the lessons learned would include the fact the states which had healthy markets and are willing to address the underlying costs at the time the change in the rating system was made, probably had reasonably good markets, but states which did not address the underlying problems but looked to a change in the rating system as a "magic bullet" were disappointed. They continued to experience problems and there were a number of factors within the state which will have an impact on the rating system changes.
This concludes the testimony of Nancy Schroeder.

14.8.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Ms. Schroeder's testimony:

A. In reviewing your chart I noticed that Ohio is missing. Is that because of the State Fund?

ANSWER: I didn't include Ohio because of the state fund.

B. Could you describe generally the market environment in those states where Workers' Compensation carriers are leaving the market, are leaving the state -- not carrying policies in that state -- not covering in that state, leaving the state?

ANSWER: I don't know if they are leaving the state and there are about five or six particularly (Louisiana and New Mexico are certainly two of them) where there is serious rate inadequacy. Carriers are very selective in what they write, incredibly selective.

C. How is that exhibited -- do they simply refuse to sell policies?

ANSWER: There are residual markets. I think the underwriting process in those states is much

tougher. An average risk in those states is a money loser and what's happening in these residual markets is that they are markets of last resort and are becoming larger. Every state has a market for Workers' Comp employers -- it's mandated; you have to have it. In California it's State Fund. In some other states it's a pooling mechanism.

D. Those markets are increasing?

ANSWER: Yes If you look at residual markets in those states they are increasing rapidly.

E. Is this published data?

ANSWER: Sure.

F. Of those six states that have exclusive state funds, have any of them gone from a competitive or regulated--

ANSWER: No

G. They are vestiges of earlier in the century?

ANSWER: No. The last State Fund, Oregon went the other way, and that was the last major movement in exclusive to competitive.

H. Your findings on page 5 are interesting, in that it seems to me that it really doesn't matter what kind of rate setting mechanism states have.

ANSWER: I think it does.

I. Those other factors are much more important?

ANSWER: I don't find that. I think it makes a big difference. You have to realize my perspective is different. I have observed states that have looked at rating changes as a magic cure because they don't want to deal with the underlying problem, and that hasn't worked. If there is dissatisfaction with the system, a rating change has usually been an unsuccessful way to deal with it.

J. Is it your conclusion that the rating system is not the most important factor in a health or lack of health of a Workers' Comp system -- that there are other factors that are more important?

ANSWER: I think there are a number of factors. All of which are important. The rating system is very important to insurers from an insurer viewpoint. Two factors are going to be the most important as far as insurers are concerned. From an employer viewpoint you're looking at cost -- overall cost and equity, the ability to find a stable market, and perhaps plain cost of the system. It depends on how you look at it. I am looking at it from more of a political viewpoint in terms on how these changes impact the employers' perception.

K. How would you rate the overall health of California's Workers' Comp system?

ANSWER: In terms of the insurers perspective it does well, and I think so in terms of the employers perspective. There are a lot of questions about cost but that's not unusual in California. That's going on in a number of states. I think California is very healthy, probably one of the very healthiest. If I were a carrier I would be more likely to write in California.

L. What are the worst mistakes that have been made in other states in recent years.

ANSWER: The most basic mistake has been in not identifying problems that are real and not looking at an in-depth accident analysis to determine what those problems are. Workers' Compensation is in a state of transition right now. There are a lot of pressures.

M. Can you give us one or two concrete examples of what you mean by not identifying the problem and going for the wrong solution.

ANSWER: I think looking at a rating solution to a system problem is a major example of that. In some situations you may have a problem in administration and you don't solve that by changing the benefits or that kind of thing. Most states have been in the process of reforming their system for several years. Minnesota is a good example of that. In 1983 they made changes and changed to a competitive rate system. They still have problems. Louisiana is an example of that. Changes have been made and the rating system has changed in Louisiana. Louisiana has changed it's systems many times, both in benefits and rating but there are still problems.

N. Is that what you see this Commission doing? That there are Workers' Comp problems but we're looking at rates?

ANSWER: I don't think it's a bad exercise to look at the rating law. I think it needs to be done within a context of California and perhaps using the examples of some of the problems.

14.8.6 WRITTEN MATERIAL PRESENTED

Written materials were submitted to the Commission by this witness.

14.9 SUMMARY OF TESTIMONY

STATE COMPENSATION INSURANCE FUND

14.9.1 SUMMARY OVERVIEW

Testimony was received from Jack Webb, Geri Madden, J. Michael Kavanagh and James Neary, who are representatives of State Compensation Insurance Fund (hereinafter SCIF or State Fund).

SCIF emphasized its unique role in the California Workers' Compensation system and asks that the Commission give special consideration to the impact of any rate-making change on the Fund.

SCIF recommended that the minimum rate law be preserved and asserted that a change to a different pricing mechanism would be disruptive. SCIF suggests the California rates are high because of the costs that drive those rates, not because of the rate-making formula or the expense ratios for carriers.

If this Commission recommends a change, there would need to be a residual market mechanism established, separation of the voluntary/involuntary risks would need to take place, the result will be higher rates for almost all small and medium sized employers.

Lastly, SCIF does not support an exclusive state fund, believing that employers are better served with the present system which allows for a competitive market and freedom of choice for employers.

14.9.2 REQUESTS MADE TO THE COMMISSION

State Fund was created by the California legislature and it cannot "sit on the sidelines" while the market adjusts / reacts to a change in pricing mechanism. State Fund asks the Commission to give special consideration to the impact any changes in the current system would have on the State Fund.

State Fund believes the effect of a change in the rate-making system on small and medium employers is the most important public policy question that the Commission will address and urges their attention to this.

SCIF suggests looking at the size of residual markets as a measure for rate adequacy and comparing California's residual market to them. SCIF does not distinguish between voluntary and involuntary markets, and that will create a problem if an alternate rate-making system were established.

14.9.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	2
Equitable Distribution of Costs of System	2
Equity/Small Business Employers	3
Loss Control	2
Availability of Insurance	1

Continued

ITEM	WEIGHT ASSIGNED
Minimum Rate Law	3
Prospective vs. Retrospective Rating	3
Rate Stability	2
Safety Incentives	2
Solvency	1
Appropriate/Expeditious Claims Handling	1
Broker's Role (Commissions/Marketing)	1
Cost Factors/Drivers	3
Dividends	3
Exclusive State Fund: Advantages/ Disadvantages	3
Alternate Rate-making Systems	3
Voluntary/Involuntary Market (Residual Market Analysis)	3

14.9.4 SUMMARY OF TESTIMONY

State Fund representatives presented a written report to the Commission and summarized that report's key points. SCIF stressed the following regarding the unique interaction between the State Fund, the Minimum Rate Law and the workers' compensation system.

State Fund wants the Commission to consider:

A. That the State Fund is an integral and major part of California's Workers' Compensation System;

B. The State Fund's impact and influence in the marketplace;

C. The interplay between the State Fund and the minimum rate law and how it serves California;

D. The impact that alternate rate-making systems would have on the State Fund; and

E. SCIF's recommendations concerning the maintenance of the minimum rate law and the advisability of an exclusive State Fund.

Testimony is summarized under the five key points identified by State Fund.

A. SCIF IS AN INTEGRAL AND MAJOR PART OF CALIFORNIA'S WORKERS' COMPENSATION SYSTEM

SCIF was created by the Legislature to be a nonprofit agency and to offer a low cost, high quality of service product for private and public agencies.

B. SCIF'S IMPACT AND INFLUENCE IN THE MARKETPLACE:

SCIF is the largest Workers' Compensation carrier in California, and the second largest Workers' Compensation carrier in the nation with direct premiums written in 1990 equaling $1.8

billion dollars.

1. The voluntary vs. involuntary market:

   SCIF serves both a voluntary and an involuntary market. As defined by SCIF, a voluntary market s an "account" which could choose where they place their Workers' Compensation Insurance and could have any carrier write their insurance coverage.

   An involuntary market are those "accounts" that may find it difficult/impossible to find another carrier to write coverage for them. This often includes new businesses, small businesses, or large employers who become bankrupt and cannot find a carrier willing to accept the credit risks.

   SCIF points out that they do not distinguish between the voluntary and the involuntary accounts, but provide coverage to all. Absent a residual market mechanism in California, SCIF states it would be impossible to define their involuntary market. For rate-making purposes SCIF assumes 50%. However, even if only 25% of SCIF's premium were voluntary, the State Fund would still be the largest voluntary workers' comp carrier in California.

   State Fund is able to accommodate the involuntary market without subsidization from the voluntary market, as long as the overall rate level is adequate to cover real economic costs.

   Approximately 2% of State Fund's accounts are surcharged and most other business is written at the published WCIRB minimum rates, thus meaning that the involuntary market does not suffer discrimination in pricing and can move freely into and out of the involuntary market.

   All carriers try to solicit business from the voluntary market.

2. Dividends:

   State Fund points out it is the industries' dividend leader and private carriers try to meet the standard that State Fund has established. Given its mixed book of business, including the high loss ratios of the involuntary market, State Fund believes their dividends arise from two key factors:

   a. Higher than average investment income and;

   b. Lower than average expense ratio.

      These two things offset the higher-than-average loss ratio. The low expense ratio is a function of being a direct line writer, eliminating broker's fees and commissions. Additionally, the State Fund is a state agency and its employees are civil servants. Most contract services are provided with in-house legal and rehabilitation services.

3. THE INTERPLAY BETWEEN THE SCIF AND THE MINIMUM RATE LAW AND HOW IT SERVES CALIFORNIA

   State Fund believes that a unique aspect of the current minimum rate system is that it provides an incentive for loss control. State Fund points out that this is especially evident with the larger premium accounts where the impact of strong safety programs are felt by

most employees.

SCIF believes that the interplay between it and the minimum rate law have served California well. SCIF has exercised its right to membership on the governing committee and the classification rating committees of the WCIRB. SCIF's influence has resulted in materially lower rates for employers, and it provided examples.

SCIF's report was designed to give a description of the elements that go into the rate-making process.

State Fund's perspective is with an emphasis on the impact of the rate-making system on medium and small sized employers. Various charts and graphs that have been submitted to support this. As the size of the account increases these employers tend to enter the voluntary market and private carriers vie for their business.

4. THE IMPACT THAT ALTERNATE RATE-MAKING SYSTEMS WOULD HAVE ON THE STATE FUND

State Fund was created by the California legislature and it cannot "sit on the sidelines" while the market adjusts / reacts to a change in pricing mechanism. State Fund asks the Commission to give special consideration to the impact any changes in the current system would have on the State Fund.

SCIF advised that its research on alternate rate-making systems and their impact on SCIF led to the following conclusions:

a. "Administered pricing with rate deviation" would require the Fund to issue two or more sets of rates and the involuntary market would have to be clearly identified and would be subject to higher rates or surcharges;

b. "Competitive pricing with advisory rates" could result in a California environment subject to sizeable fluctuations; and

c. "Competitive pricing with pure premium" (also known as loss cost pricing) would virtually eliminate the dividend system to the detriment of the good risks, whose better experience translates to a lower net cost under the current system. It would eliminate the benefit of a highly visible incentive to provide a safe working environment.

   State Fund believes that any pricing system other than the current one would require an identification of the involuntary from the voluntary risk market. They also feel that the result would equal higher rates for almost all small and medium sized employers.

5. MAINTENANCE OF THE MINIMUM RATE LAW/ADVISABILITY OF AN EXCLUSIVE STATE FUND

SCIF also voiced its concern over the maintenance of the minimum rate law and the feasibility of an exclusive state fund.

State Fund believes the minimum rate law should be preserved because its formula allows SCIF to fill its two primary roles: providing an assured market for workers' compensation to all employers and to be fairly competitive with other insurers. SCIF knows of no other pricing mechanism that would do the job as well as the minimum rate law.

However, SCIF does not believe that California would be best served by an exclusive state fund. A competitive state fund allows employers freedom of choice for their coverage needs and ensures availability for new, small and medium-sized employers.

State Fund believes that California's rates are high, but they are high because of the costs that drive those rates, not because of the rate-making formula or the expense ratios for carriers.

This summarized the testimony of the State Compensation Insurance Fund.

14.9.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following State Fund's testimony:

A. Is there data differentiating the proportion of voluntary and involuntary business?

ANSWER: There is no data. We think somewhere in the range of 30-35 percent.

B. Please explain the impact on the incentive for workplace safety of a more competitive rate-making environment.

ANSWER: For a large employer, there is a dividend system in place. If losses exceed premium, there is no dividend so the dividend system acts as a large differential pricing mechanism that forces the employer to participate directly in their loss experience. If you eliminate the dividend system in favor of an average front-end discount on pricing, then that large differential pricing mechanism goes out the window and a significant incentive for loss control is lost.

C. There ought to be a way to install an incentive for workplace safety even in a more competitive environment. It benefits everyone--

ANSWER: Such a mechanism is the experience rating system. The dividend system constitutes a separate mechanism which is compiled on top of the experience modification system. If employers have worse experience than the experience of their industry, a surcharge of 150% - 175% could be applied. If you eliminate the dividend system we think a significant incentive for employee safety would be lost.

D. What percentage, not of volume, but of total "accounts" participate in a dividend reduction.

ANSWER: SCIF does not pay a dividend to accounts under $2,000 in premium. As premium size went up and loss ratio went down the dividends improved on an aggregate market basis to employers.

E. Is your dividend structure any different from other companies, other private carriers?

ANSWER: No. Most companies use a retention system for paying their dividends which quotes an amount which is retained by the carrier to cover expenses and an "insurance charge" to cover those employers whose losses will exceed 100%. Everybody participates on a dollar-for-dollar retention dividend plan.

F. Is this related to their safety record?

ANSWER: It is directly related to losses incurred on that policy. The dividend is calculated by taking the employer's total premium, deducting from that an amount for retention, usually 23%, at the $100,000 level and then, depending on the employer's losses, a loss conversion factor (1.15%) is multiplied and deducted from the premium also (intended to cover cost related to the claims).

G. Incentivewise, what level of premium would it take before an employer would have a safety incentive? $10,000, $100,000?

ANSWER: $2,000 is the minimum level. Above $4,000 the incentive would come into play.

H. $10,000 is a threshold where serious incentives start to come into play.

ANSWER: Yes

I. California has a minimum rate law and pays dividends, meaning California has incentives for safety; does this mean that other states do not?

ANSWER: There are incentives in other states. Here there are additional tiers of incentives. The experience rating plan looks at several years of experience and the dividend attempts to give an immediate incentive for the policy year and secondly attempts to reinforce that by typing the actual loss experience of the account.

J. If we could change to a different system other than the minimum rate law would that match with what other states provide incentives for? In other words, some employers in California receive an incentive for safety, but other states don't have that incentive?

ANSWER: The combination of incentives is less than would exist in California.

K. So other states do have incentives?

ANSWER: There are incentives.

L. You feel this gives more incentives than other systems?

ANSWER: Yes, we do, for small employers who may have limited incentives in terms of safety, or for other employers that may have a number of losses. For employers who qualify for experience rating and for dividends, they're looking at an expected value. In the case of the experience rating plan, they're seeing the impact on several years. In the case of a dividend, they're seeing the impact on one policy year.

Even though dividends cannot be promised, employers do build up an expectation.

M. You stated that because of the current rate structure there are no subsidies, but you meant that the dividend system was what accounted for your theory that there were no subsidies. That if the system were changed there would be higher rates?

ANSWER: The State Fund takes the position that in order to be a competitive state fund, there cannot be a net wealth transfer from any class of policyholders to another class of policyholders. We can't be subsidizing on a routine basis some undesirable business at the expense of our competitive market customers. But looked at in the aggregate, we think the subsidization is rather small as compared to some states where the involuntary market mechanism is adding 12 percent to the cost of insurance for employers at all levels of the marketplace.

N. Given that your cost structure is lower than other companies, why would anyone move away?

ANSWER: There are a lot of reasons. Primarily, people get upset over claims handling. Also, there are private carriers that offer national coverage for those employers that operate in more than one state, and State Fund is limited to California.

O. Please elaborate on why you do not favor an exclusive state fund.

ANSWER: There is an enormous market. We advocate a competitive system because we believe in competition and it has worked well for 75 years. The political process would ultimately intrude on the pricing mechanism of a monopolistic fund, making it, in effect, a taxing authority of the state -- you lose the concept of an "insurance mechanism".

There are state funds that are monopolistic that are frequently pointed at as financial disasters.

Additionally, the personnel problems that would be created in providing claims operations throughout the state would create a bureaucracy because of the volume of business in California.

P. Is State Fund's process of declaring a dividend any different from the private carrier?

ANSWER: It is exactly the same, the Board of Directors declares a dividend at the end of the policy year.

Q. Would an employer expect a greater possibility of a dividend with you than with a private company? Is there more volatility in private companies as to whether they declare a dividend?

ANSWER: There is more volatility in our dividend plan, but State Fund has declared a dividend every year since 1911. The dividends have deviated radically from 8% to 40%. Private carriers, on a long-term basis, have averaged around 11%.

R. Is that true across all premium size classes?

ANSWER: Well, that is in aggregate terms.

S. Do employers with losses greater than the premium they paid pay anything extra after the year is over?

ANSWER: No

T. But the employers that get a dividend generally have losses that are less than the premium they paid?

ANSWER: Right.

U. There is a subsidy then from the other group that has incurred a loss?

ANSWER: Part of the retention figure covers expenses but also to cover the insurance charge for those employers with losses that exceed 100%.

V. If you have a large involuntary market that the private carriers don't want, part of the reason they don't want it is that they would have to include in the overall rate enough to cover people that won't get a dividend but are going to incur losses greater than the premium?

ANSWER: Right.

W. There may be more of this small level of subsidization in the residual insurer, correct? Assuming State Fund is California's residual insurer even though you don't know which part of the market is involuntary.

ANSWER: Clearly, and State Fund's low expense ratio explains why we can pay better dividends than other carriers can – we work cheap. It allows us to pay a competitive dividend.

X. You do have a larger share of the poor risks?

ANSWER: We don't deny that.

Y. If there were a monopoly state fund and you were able to bring in all the business being written by other companies either the premiums would be lower or the dividends higher based on your mode of operation?

ANSWER: We have "leakage" in the system, and employers do have the option to self-insurer. If you consider an exclusive state fund that is an issue you'd have to consider.

Z. If you were to do what you're doing now, either prices would go down or dividends would go up, is that fair?

ANSWER: Yes, for the short term because the issue is not the price but the cost.

AA. What is the major competitive edge that a private competitor could offer to get somebody away from State Fund?

ANSWER: Service. Agents and brokers would know the best answer to that.

[State Fund indicated that brokers will tell customers that private carriers have a smaller book of business, deal directly with the policyholder and can offer better service than SCIF. They may not offer the same dividend but they make up for it in service.]

AB. Does the service they offer include a willingness to pay claims or non-willingness to pay claims?

ANSWER: The agent and broker has no influence over the adjustment of claims. That is done by the insurance carrier.

AC. As there some kind of pre-selection that brokers/agents do according to certain rate classifications, etc. Couldn't the agent or broker say "go to the State Fund"?

ANSWER: The private market is in business to make a profit and to do that they have to beat the State Fund which is the low cost producer in the marketplace. One way to do that is through underwriting selection. Underwriting selectivity is an important service that an insurance carrier or broker provides.

AD. If we were to ask an agent or broker what the involuntary market looks like would they be able to tell us there are certain industries that involve a large segment of the risk?

ANSWER: Every company has an underwriting policy which specifies the kind of risks they're willing to accept. Different companies have different underwriting philosophies.

AE. Is it difficult to identify what is the involuntary market?

ANSWER: Yes. To elaborate, the involuntary market includes small employers who pay a very small premium and which most private sector carriers would not write premium for.

AF. Could you elaborate on why you think California is a high cost state as compared to other states?

ANSWER: State Fund referenced the study done by Mark Gerlach with the California Applicant Attorney's Association who suggested there are more people compensated in California for injuries than in other states -- even though the benefit structure is not as generous, there are more people being compensated.

Also, certain types of injuries or class types that would not be covered in other states are covered in California. Also there is an aggressive applicant's bar and there are a lot more people participating in the system than in other states.

AG. Any other things that contribute to this, e.g. medical costs?

ANSWER: The applicant's bar does a lot of advertising and there is significant utilization of the system in California. Also medical inflation is a factor.

AH. Are there safety incentives for small companies below which dividends are paid?

ANSWER: No.

AI. Why can't you provide any financial incentives to that group?

ANSWER: If rates were higher we could build in a dividend system for small employers that would give them a greater incentive. There is a problem with this approach from an actuarial perspective. This conflicts with "credibility" (how much individual risk experience is within their control) because small employers do not have very much direct control over their actual loss experience.

State Fund added that there was an additional way in which a safety incentive would apply to smaller accounts and that would be through group insurance efforts. These allow small employers to share in a bonus that the group, as a whole, receives by virtue of its overall good safety practice. State Fund is the largest and by far the most aggressive in the marketplace in selling group insurance policies to associations in California.

AJ. If I am a small employer how do I get into the group?

ANSWER: How you come to be in association is defined by the Insurance Commissioner through the rating bureau filings. You'd have to look at whether you are in a "like nature of business".

There are two types of associations, there are like groups and there are associations that are actual, existing trade associations and there are also safety groups that have been formed by carriers for the purpose of accomplishing the same thing.

AK. Why wouldn't you want to keep track of the involuntary market and know which were good risks even though they are small and which ones were not?

ANSWER: We do try to do that. We go through every classification and the data that is published and released by the Rating Bureau. It has a lot to do with our underwriting and how we choose to surcharge an account. Some classes have higher profitability than other classes and some classes have a higher penetration. We are aware of what may be the involuntary market. We think of it as a "residual market" although there is no residual market mechanism to really tell.

14.9.6 WRITTEN MATERIALS SUBMITTED

Written materials were submitted to the Commission by these witnesses.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESSES WHO AGREE THAT THIS IS A FAIR REPRESENTATION OF THEIR TESTIMONY.

14.10 SUMMARY OF TESTIMONY

CENTER FOR LABOR RESEARCH & EDUCATION
TESTIMONY OF: BRUCE POYER

14.10.1 SUMMARY OVERVIEW

Testimony was received from Bruce Poyer, an Economist with the Center for Labor Research and Education at U.C. Berkeley.

Mr. Poyer believes that as between California and the exclusive fund states, California allows too much money to be used by too many people for far too little policy rationale in this state, and that is one reason we are so high in costs and so low in benefits.

The second point Mr. Poyer makes has to do with data used for rate-making. He believes it should be used better than it is currently used. He explains that we have two data collection systems which do not match: the State Department of Industrial Relations report based on Doctor's First Reports of Work Injury and the insurance industry's system covering 440 job classifications.

Mr. Poyer also voiced concerns with the rationale behind having 440 job classifications on which experience rating is based.

Mr. Poyer believes that the lack of appropriate and expeditious claims handling is our most serious problem in California and it is a problem which leads all others including the rate-setting problem.

14.10.2 REQUESTS MADE TO THE COMMISSION

Several specific requests were made by Mr. Poyer, including:

A. The Rate Commission ought to look at what is the proper number of categories, job classification categories.

B. Can these job classification categories be based on incidents/seriousness of illness and less on cost; and

C. Can these categories begin to build in some "community rating" which is desperately needed in this system.

Mr. Poyer urges the Commission to look at the "Injured Worker's Bill of Rights" which was circulated in California as an initiative several years ago and which petition campaign failed.

14.10.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Appropriate/Expeditious Claims Handling	3

Continued

ITEM	WEIGHT ASSIGNED
Data: Availability / Impartiality	2
Dividends	2
Exclusive State Fund: Advantages/ Disadvantages	3
Injured Workers' Bill of Rights	3
Job Classification/Classification Rating	3
Alternate Rate-making Systems	2
Political Manipulation of Rates	3

14.10.4 ANALYSIS OF TESTIMONY

Mr. Poyer is an economist and coordinator of labor education programs. He works primarily with adults and has seen many injured workers in the courses that he teaches. He is involved in many areas of health, welfare and employee benefit programs as well as legislated programs (social security, unemployment insurance, disability insurance, and workers' compensation).

Mr. Poyer stated his concern about the decline in these programs due to three factors:

A. Social insurance programs fail to keep up with the expanding responsibilities of these programs;

B. We enter cost cutting periods like now and chop the programs into pieces; and

C. These programs all develop large funds. When you have large funds people are interested in using that money and exploiting the funds.

Mr. Poyer prepared and provided the Commission with a study comparing costs associated with the six "exclusive state fund" states as compared with California's system including administrative costs. He worked out a system for comparing administrative costs in this state with the six state funds combined.

Mr. Poyer explained the manner in which he gave weight to the administrative cost factors and developed ratios, weighted averages, etc.

A. EXCLUSIVE STATE FUND COMPARISON

Exclusive fund states administer the programs for 9.3% compared with 36.1% in California. That latter percentage for California was the percentage agreed upon by the Legislature in the 1989 hearings. Mr. Poyer's study attempts to neutralize dividends out of the comparison.

Mr. Poyer's study also looked at the difference in financing these systems in exclusive fund states compared with California.

Exclusive fund states rely essentially on two methods for minimizing the risks they assume. One is experience rating which is similar to that done in California. Secondly, they allocate in their rate-making process an amount to return on surplus the same way it is done here, which becomes their second hedge against unanticipated risk.

There is also a difference in the final handling of return on surplus in the exclusive fund states

compared with California. In the exclusive fund states the return on surplus adheres to the state and can be used to lower the premium rates to improve benefits/or the administrative process. In California that doesn't happen and the return on surplus reverts to some 300 private contractors in the system for profits/retained earnings.

Mr. Poyer relied on Rating Bureau data for California which gives an average return on surplus and dividends. The average return on surplus over the past 15 years (1973 to 1988) was 10.6% and the average dividend rate over those 15 years was 11.8%. If you add up the earned premiums and apply these average rates we are allocated $4.1 billion dollars over the 15 years to return on surplus which reverts to the private contractors, and also allocating $4.6 billion dollars in dividends during that same period. This equals $8.7 billion dollars of allocations through earned premium which Poyer believes is too high and too little accounted for in this State. There is too little rationale as to why private carriers should be allowed to use that kind of money.

Mr. Poyer does not believe we get a good accounting from the Rating Bureau on how the dividends are distributed.

Mr. Poyer believes that between California and the exclusive fund states that California allows too much money to be used by too many people for far too little policy rationale in this state, and that is one reason we are so high in costs and so low in benefit.

B. DATA USED IN RATE-MAKING

The second point Mr. Poyer makes has to do with data used for rate-making. He believes it should be used better than it is currently used. He explains that we have two data collection systems which do not match.

The first system involves the reports from the State Department of Industrial Relations based upon Doctor's First Reports of Injury, but has nothing to do with information about the seriousness of the injury.

The second data collection system is handled in the 440 job classifications set up by the insurance industry. There is no way of applying this data to the whole State Industrial Relations reporting system.

Mr. Poyer suggests that we need numbers from the job classification system to be applied to determine what is serious, how much it costs, for how ever much time it takes to get this straightened out. If we can integrate these two systems in some way, then we could look at prevention and what the industry is doing in the area of prevention through its rate or rating policies.

C. JOB CLASSIFICATIONS

The third point also concerns job classifications. Mr. Poyer discusses the difference between experience rating versus community rating. Community rating is generally found in social security or health care systems. Poyer has concerns with the rationale behind having 440 job classifications on which experience rating is based. Why not more?

Mr. Poyer believes that then we would be moving further away from an "insurance system" and back towards individual employer liability.

Why not fewer than 440 job classifications? Mr. Poyer believes that with more workers included in any broader job classification, some employers who hired workers in that job classification

would begin to complain that they were paying for the higher costs of other employers who hired workers in that same job classification. Mr. Poyer feels that the employers would believe there were differences between themselves -- in incidence and seriousness of worker injuries -- for workers within this job classification.

Mr. Poyer believes the job classification system should relate primarily to incidence/seriousness of injury/illness in far fewer than the present 440 job classifications. He suggested that based on more adequate data than we now have about incidence/seriousness, we could assume only 200 classifications. In this scenario, an employer who pays a higher rate to insure workers (e.g. in job classification 130) could reach the lower rate of job classification 120 by improving health and safety on the job, thereby reducing the incidence / seriousness of worker injuries.

Mr. Poyer indicates that if we were to handle classifications in this way, we would reduce "experience rating" in the compensation system and would be increasing "community rating", because we would have a better understanding as to what is actually happening to workers on the job. We could also begin to develop real employer incentives for improving health and safety on the job.

D. CLAIMS HANDLING

The final point has to do with "appropriate and expeditious claims handling". There is insufficient data on this subject. Mr. Poyer's experience in teaching over the past years have resulted in hearing angry words from injured workers and bitter complaints about the way in which their claims were handled. California does not have appropriate and expeditious claims handling--just the opposite.

Mr. Poyer believes this is our most serious problem in California and it is a problem which leads all others including the rate setting problem.

Mr. Poyer urges the Commission to look at the "Injured Worker's Bill of Rights" which was circulated in California as an initiative several years ago and which petition campaign failed.

Administrative delays are devastating to workers whose primary source of income is cut off because of a job injury. This results in the Workers' Compensation Appeals Board prodding the parties into settlement whenever possible rather than being an adjudicative body.

Mr. Poyer is doing an independent study using input from injured workers to better understand the extent and seriousness of this administrative delay problem.

With respect to the question of financial pressures in exclusive fund states, Mr. Poyer references a study entitled "The Best Alternative", issued by the American Association of State Comp Insurance Funds which finds that for legitimate public policy reasons, a rate-making body can safely choose, in an exclusive state, where there is no danger of individual company insolvency, to hold down rates in the near term. Eventually rates will have to become sufficient to cover both current and past liabilities, but the new higher rates will be charged to the same employers who had the economic advantage of the older insufficient rates. As rates rise, even if employers are dissatisfied, there is equity.

Mr. Poyer indicates that this approach is observable when there are political pressures to tap into pension funds. This ends Bruce Poyer's presentation.

14.10.5 ISSUES DISCUSSED FOLLOWING PRESENTATION

What follows is a summarization of questions and answers raised by the Commission following Mr. Poyer's testimony.

[Note: Mr. Poyer and Mr. Kevin McCarthy provided a joint presentation. Questions directed to Mr. McCarthy are to be found under his summarized narrative.]

A. Please explain "community rating".

ANSWER: In social security the community is the nation and we assess the same amount of contribution from all employers and from all covered employees and benefits are uniform. We depart from these principals with the theory of experience rating in both unemployment insurance and workers' compensation. What we do in California, where the private carrier's "experience rate", is to pick the best risks and leave the bad risks in the uninsured pool (residual market).

B. Commissioner Schaefer indicated that she saw three issues with respect to an exclusive state fund: (a) If there is political pressure, not just rates, but principle itself can be vulnerable to political issues; (b) the bureaucratic behemoth issue and can it be controlled; and (c) if we were to recommend a change we would want to insure that the change did something to improve prevention.

How do you believe an exclusive state fund could address these issues?

ANSWER: With regard to political pressure, we must continue to monitor what is done by the legislature. There is nothing to protect employees covered by private sector pension plans from the reversion of surplus asset funds to the employer. We have to have special legislation to get equity on these issues. Regarding bureaucracy, I would like to see an end to the minimum rate law so that we could have better competition on rates. I also would like to see an injured workers bill of rights because we need a constitutional basis to give people protection from insurance carriers.

C. Give me your opinion on rating law changes if we had them, minimum rating law changes even with modification, etc. Would that really do any significant difference to the system if you don't touch the cost factors?

ANSWER: I don't believe we have adequate data coming in to get at prevention issues. It is not all handled with experience rating or dividends. We need an exchange of data between the state and the job classification system (W.C.I.R.B.) so we can focus on preventable injuries and which prevention efforts are most worthwhile.

D. Please summarize succinctly why you think that the State Fund's significant growth and its market share would not continue to keep growing? Why hasn't the State Fund captured even more of the market and what are the barriers or limits to this occurring that exist presently?

ANSWER: I think the trend will continue, but if you want to accelerate it, drop the minimum rate law and allow the State Fund to compete on rates.

E. I'd like to understand the difference in administrative cost, 36% versus 9%, what is being included, what states are you looking at? Are we comparing oranges with oranges?

ANSWER: Yes, I am comparing sweet oranges with sour ones. The states are Ohio, Washington, Nevada, West Virginia, North Dakota and Wyoming. The 36.1% rate is what the legislature agreed, in 1989, was the administrative cost ratio for California in 1988. The 9.3% is the ratio which is given in my study which is simply total administrative costs compared to total income, including earned premium and investment income, in each individual state.

I combined all the states together to get something that was comparable to California, but there is a lower administrative cost ratio in all of these states, the highest was 10.2 or 10.3 in Ohio.

There is one shortcoming to my study in that it does not cover the benefit structure. I would be interested to see the extent to which some benefits may be broader and more comprehensive in California; administrative costs associated with such benefits would be greater.

F. Concerning the comparability of the numbers, I am still not seeing oranges with oranges in that the exclusive state funds in other states don't declare dividends.

ANSWER: Correct.

G. Do they pay taxes?

ANSWER: No.

H. Is the equivalent expense a purely administrative expense?

ANSWER: Yes.

I. If I wanted to look at purely adjustment expense as it exists in those other states, would the comparison be 23.5% versus 10% or would it be some combination of these?

ANSWER: It might be in that neighborhood. But the way the study is presented, you'd have to look at the appendix data for each individual state and then total that up and compare it to California.

J. There is an apple orange problem.

ANSWER: I'm just talking about if you want to compare all of those costs of commissions and adjustment costs of individual states--the six states compared to California--you would have to dig that out.

K. Do you think there is evidence that points to an exclusive state fund being better able to serve clients--not economic questions but service questions?

ANSWER: I don't have data from my study to add to Mr. McCarthy's opinion, but I would urge you to call representatives from Ohio and Washington and ask them. The general benefit structures in those states are better than California in a lot of respects.

L. Is there any alternative to getting an attorney to get through the system?

[Mr. McCarthy indicated there was not.]

ANSWER: Labor organizations agree. They help people handle the case as long as the company is handling everything okay and as soon as you feel you're entitled to something that you don't get, go get a lawyer.

14.10.6 WRITTEN MATERIALS PRESENTED

Written materials were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.11 SUMMARY OF TESTIMONY

TESTIMONY OF: KEVIN McCARTHY, ATTORNEY AT LAW

14.11.1 SUMMARY OVERVIEW

This testimony was given by Kevin McCarthy, an Attorney in Sonoma County who has represented injured workers in workers' compensation proceedings.

Mr. McCarthy wanted to provide the Commission with an overview of the system and share his experiences with it as an attorney representing injured workers.

Mr. McCarthy advocates an exclusive state fund. He believes it would be more cost effective and administratively efficient.

He points out that the costs of the workers' compensation system are high and there are many "middle men" (insurance carriers, attorneys, doctors) who benefit while the injured workers suffer with low benefits.

Mr. McCarthy fears we may be moving into a period of economic instability which may result in insolvency, which also contributes to the costs of the system.

14.11.2 REQUESTS MADE TO THE COMMISSION

Mr. McCarthy urges the Commission to take a close look at dividend structure. He believes there is a real bias for larger employers. Small employers argue that there is even subsidization from that dividending structure that is to the detriment of the small employer. As an alternative to dividends, Mr. McCarthy suggests extending the actual experience modification programs in lieu of dividends.

Mr. McCarthy believes that insurance agent and broker commissions are a "fat hog" and finds it hard to understand such a high commission in a mandatory system. He urges the Commission to take a close look at the overall premium dollar and the commission rates that come out of it.

Mr. McCarthy asks the Commission to look at group self-insurance. Group self-insurance was not available in California years ago. Private carriers do not want group self-insurance in California, but that is another way that premium costs can be cut especially for small business.

He asks that the Commission study the National Association of Insurance Commissioners' proposal for a minimum rate law on loss data, which would leave each carrier to set its own expense factor. This might be a good strong step toward competition in the marketplace.

Mr. McCarthy asks the Commission to look at the restrictions placed on State Fund and to create an environment where it can expand its market share, particularly if we are moving into a time of instability and potential insolvency.

The Commission was asked to consider certain things including a book entitled The Invisible Bankers by Anthony Tobias, which is an excellent background on the political power and influence of insurance companies in the United States.

14.11.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Equity/Small Business Employers	2
Loss Control	1
Availability of Insurance	2
Minimum Rate Law	2
Safety Incentives	2
Solvency	3
Appropriate/Expeditious Claims Handling	2
Broker's Role (Commissions/Marketing)	3
Cost Factors/Drivers	1
Dividends	3
Exclusive State Fund: Advantages/ Disadvantages	3
Injured Workers' Bill of Rights	3
Need for Workers' Compensation Reform	3
Political Manipulation of rates	2

14.11.4 ANALYSIS OF TESTIMONY

A. AN EXCLUSIVE STATE FUND APPROACH

Mr. McCarthy is an advocate of the exclusive state fund approach. He has had experience working in Nevada and experiencing that system and compares it to his experience in California (mixed market approach). He is firmly convinced that California is taking the wrong direction, to the detriment of the small business community and most especially to the injured worker.

He believes there is greater efficiency in an exclusive state fund approach rather than allowing 300 private carriers to administer this system in a "hodge podge" approach.

He believes there is a "God awful" environment for injured workers who rely on workers' compensation benefits for survival after an industrial injury.

Mr. McCarthy indicates he got out of this type of litigation years ago because he could not psychologically continue to handle these types of problems. He indicated he has had clients who have committed suicide or died of heart attacks, were evicted from their homes and who underwent every from of human suffering because of the inadequacies of the system.

He has worked with Mr. Poyer, and injured workers' groups to seek political reform.

The purpose of his testimony today is to provide the Commission with an overview of the system. He believes the Commission is in a unique position to make recommendations that can have a long term beneficial impact on the California system.

Mr. McCarthy provides information indicating that in 1987 employers paid $6.15 billion dollars in premium while workers received only 3.25 billion dollars in benefits. The rest of the money went to "middle men" administration, lawyer's fees, profits for insurance carriers, and evaluating doctors.

Politically, these middle men wheel much clout at the State Capitol. As the groups breakdown at the State Capitol, lawyers and doctors blame insurers for taking too big a cut in premium. Insurers, sometimes joined by employers and sometimes by organized labor, blamed the lawyers and doctors for driving up costs.

The costs of the system are onerous, especially to small businesses, and because of the inadequacies, they are very destructive to the injured worker.

By way of example, Mr. McCarthy points to the Byzantine permanent disability schedule which helps insurance companies identify their loss, but does not deal with the injured worker in a humanistic way.

An exclusive state fund could use doctors who are state employees, not profit making evaluators (hired guns) which is a major problem in California.

Instituting these major changes would increase benefits to workers, provide a more humanistically protective environment during recuperation, and would do it at a lower cost to employers with a resultant greater social utility to the general society.

Mr. McCarthy feels there are some real systemic weaknesses in the workers' compensation system as well as the insurance mechanisms.

There has been a general trend over the last 70 years which has eliminated the exclusive state funds in the United States and replaced them with the type of administration that California has. This evolution has taken place primarily because of the influence of private carriers and professionals (attorneys) who have made the system better for them even though there has been a cost to the business community and the employee community.

B. SOLVENCY

Mr. McCarthy is concerned that there are many indicators showing that we are moving into a period of high economic instability and possible insolvency of insurance companies.

These potential insolvencies also contribute to the high costs of the system. The reserving aspects of the California system including loss adjustments, expenses, reserves and other mechanism anticipate carrier insolvencies. These would be eliminated with an exclusive state fund.

In response to State Compensation Insurance Fund's argument against a monopolistic state fund, Mr. McCarthy thinks that it is common for most state fund representatives throughout the United States to take this position. He believes they are very sympathetic and open to private carrier involvement.

C. POLITICAL MANIPULATION OF RATES

With respect to the argument that rates set in a monopolistic fund state would be subject to political manipulation, Mr. McCarthy counters by stating that political manipulation can occur in a mixed administration state also. He believes that we would set controls that would limit political involvement by having rate setting for the exclusive state fund conducted by an independent body, such as the W.C.I.R.B. He suggests having a board of directors of the state fund be truly representative of both the employer and labor communities.

Mr. McCarthy thinks that one of the State Fund's arguments that struck him is the fact that even though State Fund has a large residual high risk market, they still have lower expenses and return higher dividends. He concludes that based on their experience they can administer the market at a lower cost.

This concludes Kevin McCarthy's testimony.

14.11.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. McCarthy's testimony:

[NOTE: Kevin McCarthy and Mr. Bruce Poyer provided a joint presentation. Questions directed to Mr. Poyer are to be found under his summarized narrative.]

A. Commissioner Schaefer indicated that she saw three issues:

1. If there is political pressure, not just rates, but principle itself can be vulnerable to political issues
2. The bureaucratic behemoth issue and can it be controlled
3. If we were to recommend a change we would want to insure that the change did something to improve prevention

How do you believe an exclusive state fund could address these issues?

ANSWER: Regarding loss prevention, with an exclusive state fund, right now there is no effective enforcement of safety programs because the employer can change his book of business and go someplace else. With an exclusive state fund you have a locked in market and the carrier could surcharge for refusal to institute safety programs. The loss prevention issue could be quickly and easily addressed with an exclusive state fund.

B. Give me your opinion on rating law changes if we had them, minimum rating law changes even with modification, etc. Would that really do any significant difference to the system if you don't touch the cost factors?

ANSWER: With the current 35% there might be pressure for greater efficiency although structural problems build in a lot of overhead. The more efficient carriers would survive and the weaker ones would drop off. I couldn't say if there would be cost savings or not which is why I prefer an exclusive state fund even though it may be a political impossibility.

If you removed a non-competitive premium structure that covered expenses and you had real competition on the expense side, you would see carrier pressure on the commission structure of agents and brokers. You would see more efficiency in litigation, probably more "house counsel" and faster resolution of cases to cut down expenses.

C. Please summarize succinctly why you think that the State Fund's significant growth and its market share would not continue to keep growing? Why hasn't the State Fund captured even more of the market and what are the barriers or limits to this occurring presently?

ANSWER: There is probably a "gentlemen's policy" to only have a certain amount of the market share.

D. About the shifting from carrier to State Fund, etc., if you don't have a claim, perhaps you just go along until some trigger forces you to look more closely at it. Why has this movement not occurred faster?

ANSWER: In terms of present structure, agents and brokers are not going to talk up the State

Fund unless their clients fall into the residual market and can't get on with private carriers. Most employers I know have no knowledge of the State Fund as an entity. Most people rely on their insurance brokers and if the brokers don't bring up the subject the average business person is not going to deal with it unless there is no private market mechanism for them.

E. I'd like to understand the difference in administrative cost -- 36% versus 9%, what is being included, what states are you looking at? Are we comparing oranges with oranges?

ANSWER: One entity administering the entire market rather than a large number of entities is going to give you instantaneous savings. Also, quoting from Richard Cantrell (past president of the California Applicant Attorney's Association) about "friction costs", he stated that if all employers were covered by State Fund, it would put an end to disputes as to credits and apportionment between carriers. It would end disputes concerning continuous traumas and the carrier liability and there would be a massive reduction in attorneys fees.

F. Please comment on whether you think service would be better provided under a pure monopoly.

ANSWER: Right now we are in such a serious situation in California we have to look at doing something. Perhaps an exclusive state fund is the way. Over the decades they can stay lean and mean, yet still do their job.

G. I'm interested in comments you made on how well / poorly clients are served. Were applicants better served by State Fund than by private carriers?

ANSWER: You have gradations among the various carriers. State Fund and some of the other carriers have house counsel programs rather than hired attorneys which makes a difference. As you move down the scale you run into companies that litigate, deny, or cut-off benefits as a matter of policy.

H. You're saying State Fund does better.

ANSWER: I think so. There are other carriers that maintain decent claims attitudes. But the problem is that in California the system gives free reign to any company to make internal decisions about paying or not paying benefits. The injured workers' bill of rights would require a pre-termination hearing in the event of a dispute between the applicant receiving benefits and the carrier who feels they should be terminated.

I. To what extent are clients served by attorneys, representative of all clients served? Are they more dissatisfied than other clients?

ANSWER: A high proportion of injured workers who are represented by attorneys are unhappy with the system including their attorney. It is a volume business for applicant attorneys.

J. Do you have an idea of what proportion of applicants are served by attorneys?

ANSWER: 75% of lost time cases end up being litigated, but from my own personal experience it ends up that way because of the complexity of the system.

K. Do you think there is evidence that points to an exclusive state fund being better able to serve clients -- not economic questions but service questions.

ANSWER: Yes. If you have uniform administrator you cut out a lot of the litigation between carriers (friction costs). In addition you have uniformity of philosophy so in my mind an exclusive

state fund would improve administration from a workers' perspective.

L. Is the State Fund the best, the middle, the worst as far as handling claims?

ANSWER: I'd say it is in the top third, probably the top quarter.

M. Is there something wrong with the state bureaucracy in facilitating the claims process?

ANSWER: If you mean the Division of Industrial Accidents, their overburdened and lacking in staff. I don't think the recent 1989 legislation have helped at all. There is an exceptionally high level of litigation.

N. Is there any alternative but getting an attorney to get through the system?

ANSWER: I don't think so. Not realistically.

O. What makes you believe that there are economies of scale in the provision of insurance and if there are, how can you have so many firms at very small sizes which would tend to be too small in terms of cost efficiency?

ANSWER: When I use the phrase "economy of scale" I was talking in terms of the cost of administration of an exclusive state fund with branch offices throughout the state in lieu of a large number of companies.

P. The Department of Insurance does take complaints about insurance companies in general?

ANSWER: They do now.

Q. Is there something compiled to substantiate what you have eluded to concerning workers' compensation carriers?

ANSWER: All injured workers' complaints go to the Division of Industrial Accidents.

R. A person could not get data as to the number of complaints against a certain company?

ANSWER: There are audit functions within the Divisions so you could get information from the Division, but you won't get much from the Insurance Department.

14.11.6 SUMMARY

No written material was submitted to supplement Mr. McCarthy's testimony.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.12 SUMMARY OF TESTIMONY

SUMMARY OF TESTIMONY: TOM RANKIN CALIFORNIA LABOR FEDERATION, AFL-CIO

14.12.1 SUMMARY OVERVIEW

This testimony was received from Tom Rankin, a representative of the California Federation of Labor.

Mr. Rankin began by discussing the background of the insurance industry and stated that they are tremendously protective of the Minimum Rate Law and the rate setting mechanism.

He warned the Commission that the materials and data that the Commission will need to review will be filtered through insurance companies or the Rating Bureau. Mr. Rankin contends that the Rating Bureau is their institution and the California Workers' Compensation Institute (C.W.C.I.) is their institution.

He urged the Commission to gather information from other sources, including consumer advocacy groups and to visit other states and observe, first hand, what changes have occurred. He urged this approach rather than relying on what insurance companies will tell the Commission has happened to rate setting mechanisms in other states.

Mr. Rankin felt that the Commission would have to obtain impartial data in order to provide a credible report to the legislature.

Mr. Rankin reviewed each of the Commissions' goals and stated his position concerning them. His complete testimony is summarized in section 14.12.4 below.

14.12.2 REQUESTS MADE TO THE COMMISSION

Mr. Rankin was very concerned that the Commission come up with findings and a proposal that are as objective as possible. He warned that Insurance Companies control most of the data the Commission will be dealing with and urged the Commission to look at what is happening in other states by actually visiting them.

He also urged the Commission to try to get information from independent sources. He stated that if the Commission can conduct an independent study and get a director who is "clean" in terms of connections with the insurance industry, the Commission will be able to give the legislature a report that has credibility.

14.12.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	1
Cost of Actual Operation	3
Equitable Distribution of Costs of System	3
Loss Control	3

Continued

ITEM	WEIGHT ASSIGNED
Availability of Insurance	1
Minimum Rate Law	3
Safety Incentives	3
Solvency	1
Appropriate/Expeditious Claims Handling	3
Data: Availability/Impartiality	3
Exclusive State Fund: Advantages/ Disadvantages	3
Need for Workers' Compensation Reform	3
Alternate Rate-Making Systems	3
Political Manipulation of Rates	3
Rating Bureau Functions	3

14.12.4 SUMMARY OF TESTIMONY

A. BACKGROUND

Mr. Rankin began by indicating that it was important to review the background of the insurance industry in California: they are tremendously protective of the present minimum rate law and the rate setting mechanism. They have fought off calls for an exclusive state fund in the 1930's and have fought off a recent call for a competitive pricing system. They are opposed to all measures to introduce competition within the administered pricing system we have. They have agreed to some changes that are quite minor and agreed to add public members onto the Rating Bureau.

Mr. Rankin pointed out that the Rating Bureau is funded by the insurance industry which is the basic body that proposes the rates to the insurance commissioner. Originally insurance companies agreed to put two public members on the Rating Bureau's Board of Directors, one from labor and one from business and since then, two more have been added with the 1989 Reform Act.

Mr. Rankin feels that one of the effects of this has been that rates are lower than they would have been without public members. The State Fund experience is considered differently by the Rating Bureau when they are setting rates which keeps rates down.

With regard to the Reform Act Mr. Rankin indicated that insurance companies agreed to lower their expenses loading provision from 35% to 34% then 33% and next year to 32.8%. They agreed to set up this Commission. This Commission is a substitute for the legislature dealing with the hard issues of insurance reform and workers' compensation. In 1989 the legislature set up a more highly administered state system to police employer/insurance industries in terms of making payments on time. The hope was to reduce delays and litigation, but they left the rate making issue up to the Commission for various political reasons.

Mr. Rankin believes we need rate suppression in California, and that rates have been too high. As an example, he stated that after a bill passed in 1982 which increased benefits, the rates in this state went up dramatically. That caused a great deal of concern among employers and labor with what was happening in the insurance industry. High rates are used to keep benefits down, despite the increases with the 1989 Reform Act we still have some of the lowest benefits in the country.

B. DATA AVAILABILITY / IMPARTIALITY

Mr. Rankin urged the Commission to get their information from independent sources. He recommended the Commission: talk to insurance commissioners in other states, talk to labor in other states, etc. Don't rely on the insurance industry to tell you how they operate. Also talk to people in the consumer advocacy business. By conducting an independent study and getting a director who is "clean" in terms of connections with the industry you will be able to give the legislature a report that has credibility.

Mr. Rankin pointed out that the insurance industry has had contradictory positions on things in the past. They want the minimum rate system in California, however, they are dead set against rate regulation being introduced into the health insurance arena. They also don't like regulation in auto insurance. Mr. Rankin believes that the reason for this is that it's workers' compensation has been profitable, they think it works, and that's why they like it.

C. COMMENTS ON THE COMMISSION'S GOALS

In closing, Mr. Rankin also commented on the list of goals this Commission was given by A.B. 276. He stated each goal and summarized his position following that goal as follows:

1. Expeditious claims services to injured employees

   California has historically failed here which was partly the reason behind passing the law in 1989 and for adding penalties for failure to pay claims on time. We don't have data as to how that has worked yet.

2. Security of payment of benefits to injured workers

   We have not had a problem with insurance company insolvency in California. There was a problem with Mission Insurance Company which did go bankrupt. You may want to look at those problems.

3. Provide financial incentives to injured employers to maintain safe operations

   Mr. Rankin thinks this bears looking into as the present system does not do this. We should look at whether or not we should look at the old laws which allowed the schedule rating system to give breaks to employers who had health and safety plans in place. When OSHA went into effect this was dumped in the early 1970's and we should ask whether or not it should be restored. Employers need a lot of help in this area.

4. Provide the lowest cost to insured employers consistent with protection and services provided and the losses/expenses incurred

   This is the major question you're dealing with and I won't discuss it.

5. Provide fair and equitable distribution of the cost of the system to injured employers, reflecting sound principles of insurance with the actual loss and expense of individual employers (see page 157)

   Mr. Rankin and the CLF advocate what has been implemented in one state, Washington, a system of premiums based on hours worked, for employers in industries where there is a great discrepancy between wages. For example, in the construction industry unionized wages can be $25.00 to $35.00 an hour, but the non-unionized sector has wages of $6.00 to $7.00 an hour

for the same work.

Since compensation rates are based on payroll you have a situation where employers who pay high wages are paying tremendous workers' compensation premiums that are in no way consistent with the accident experience, and actually accident experience in the union sector is lower.

Washington State solved this problem by basing premiums on hours worked. This is something that the Rating Bureau is doing a study on, but I think it is important that you look at it also.

6. The availability of insurance

   Mr. Rankin believes that because we have a State Fund that is not a problem in California.

7. A reasonable rate of return to insurers

   Mr. Rankin felt that it was too hard to define "reasonable rate" here.

This concludes Mr. Rankin's testimony.

14.12.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

A. Was the Washington provision for "premiums calculated on the basis of hours" worked for all rate classifications?

   ANSWER: Yes, not just construction.

B. Why doesn't retrospective rating (where the dividend payment process accounts for your example) make it equitable?

   ANSWER: We don't believe in the whole dividend system. Why should the insurance company be using the employer's money for a year? The more you do this on the front end the more fair it is.

C. You use this example of the construction industry with highly varying wages. Doesn't retrospective rating and dividends which are given to that specific employer -- such as an employer that has union labor and therefore these high wages and is paying more than they should in some sense based on accident history -- equalize the situation.

   ANSWER: I don't think it equalizes it.

D. Regarding the relationship of the Rating Bureau to the insurance companies, my impression is that the Department of Insurance either doesn't have that capacity or isn't allowed to do that or some combination of those two.

   ANSWER: The Rating Bureau provides the Insurance Commissioner with a filing as to what they think the rate should be the next year or the next half year. The Insurance Commissioner holds a hearing and takes evidence from the Rating Bureau and anyone else who wants to testify, but the Insurance Commissioner doesn't have the staff that the Public Utilities Commission has. The other problem is that the rating bureau asks for the data and if they don't ask for a certain segment of the data they don't have it. They control things in terms of "data" by the questions

they ask the insurers.

E. Regarding your list of cautions to the Commission, the prices have gone up and the benefits to workers have gone down, could you amplify this?

ANSWER: Benefits have gone up, relatively up. Before the law was passed in 1989 we were 45th in maximum temporary disability benefits in the country despite the fact that we had very high premium rates in California. Most states have indexed benefits, California does not.

F. You're saying that benefits have gone up but they haven't gone up commensurate with costs?

ANSWER: Benefits haven't kept up with the cost of living.

G. With the cost of insurance itself?

ANSWER: The cost of insurance goes up whether benefits go up or not.

H. The gap is widening and it's effected by administrative costs, is that your suggestion?

ANSWER: If we lowered administrative costs there would be a lot of money for temporary disability benefits. The current premium in California is about nine billion dollars. One percent of ninety million dollars, would go a long way in increasing benefits.

The dilemma we face in the legislature is that they are constantly told we can't have benefits because the system is so costly. There are a lot of elements in terms of the system where expenses could be reduced so that benefits could be increased. The system was meant to provide injured workers' with enough money to live while they recovered from the injury which it does not do. If you are a high paid employee you are not going to get too far with a mortgage and everything else on $336.00 a week. Two years ago it was $224.00 a week.

I. Do you advocate extension of experience rating to smaller employers as an incentive to health and safety?

ANSWER: No. I was talking about something called "schedule rating" not "experience rating". Schedule rating is where an employer gets a discount on the front end for having in place a health and safety program approved by the insurance company. It's not experience rating.

J. You've given us a caveat as far as collecting data goes. What are the alternatives, apart from speaking to people, as you see them, which would provide, at best, anecdotal evidence and hearsay -- Where can we go to get systematically formulated data?

ANSWER: Don't discredit speaking to people. You need a pragmatic approach. You can't just listen to the insurance industry telling you an exclusive state fund in Ohio doesn't work. Go to Ohio and find out if it works or not. You have to accept data from insurance companies to some extent, but you have to get practical experience from other states, not just insurance companies. You need to step back and make judgements about how the data is manipulated.

K. When you say data is manipulated, what evidence do you have for that assertion?

ANSWER: The Rating Bureau basically provides the insurance commissioner with a justification every year for increasing rates. When there is enough political pressure on the Rating Bureau from employers they find ways of changing the formula so the increase isn't as much.

L. It would be helpful to me to get a write-up of where the data fails to be adequate or where it fails to lead to the right kind of conclusions where it is misleading.

ANSWER: It is not necessarily the data, it is the theory they apply to it.

M. Whatever critique that you have, rather than talk about it in general terms, if you feel the data is misleading then I would like---

ANSWER: Basically, I don't have the time to do this. Insurance is not my job. I am just warning you to be careful about it and use your judgement.

N. It would seem that safety or loss prevention is an area in which employers and employees have a very strong common interest. In your view, would you be willing to suggest what the characteristics of a system would be that would have the strongest incentive for safety?

ANSWER: The notion of schedule rating provides a good incentive, especially in light of recent legislation in California that was passed mandating that employers have safety programs in place and train their employees. Employers need help and if they are willing to work to develop these safety programs insurers should give them a discount for it.

O. We have heard from several people during these hearings, that if an injured workers' case is complicated or contested, you need a lawyer to get through the system. Do you have any suggestions on how state agencies could improve that irrespective of the rate-making system?

ANSWER: Well, that question is a whole lot different from what you're really looking at, but I'd be happy to answer it.

P. It does have to do with payment of claims, expeditious payment of claims.

ANSWER: It does. But you have to realized that insurance companies could pay people on time. Prior to the 1989 Reform Act the average time for first payment of benefits was something like 27 days, when it was supposed to be paid within 4 days after the injury. Insurance companies don't need a law to tell them to do this. They can do it, but they don't. They don't need to contest claims. They don't need a law to put in mediation and other mechanisms to make it easier. They can pay the claims without a lot of hassle. We have to make the law more stringent because they haven't done it. The reason we are making the law more stringent is because they haven't done it. Whole claims departments are overloaded. Claims adjustors have way too many cases and can't deal with them all.

Q. I would like a political perspective with dealing with the insurance companies and also experience. Could you share your political experience working with insurance companies having all of these multi-interests and the multi-perspectives? I don't think you can characterize the insurance industry as one whole with one agenda.

ANSWER: They have different agendas but they are good at putting together a common front in the political arena.

R. I'm getting at the concept of "competition", because even though I have the groups that will come in and speak as a voice they really go have different interests and compete. Has that been your experience at all?

ANSWER: They compete, but the question should be: "To what extent does the minimum rate law allow room for competition in a way that is going to reduce cost to the employers?"

14.12.6 WRITTEN MATERIALS PRESENTED

There were no additional materials submitted by Mr. Rankin at this time.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.13 SUMMARY OF TESTIMONY

ALLIANCE OF AMERICAN INSURERS

14.13.1 SUMMARY OVERVIEW

The Alliance has summarized their position on key issues as follows:

A. The rating system is only the vehicle for distributing the burden of the system's underlying costs, and relief from the pressure of escalating rates can be achieved only when the underlying FORCES DRIVING COSTS are addressed.

B. Whether a rating law encourages back-end or front-end price competition, it is imperative that it be administered so that ECONOMIC FACTORS, NOT POLITICAL DECISIONS, determine the market price.

C. While a priori, a strong case on efficiency grounds can be made for systems that promote pricing freedom and flexibility for insurers, the available data do not indicate that one type of rating system outperforms another. One of the problems in doing such an analysis is that it is difficult to separate out the effect of the rating laws from the effect of the way in which the rating law and the workers' compensation laws are administered in each state.

D. The imposition of a MONOPOLISTIC FUND would not save employers money in the long run, would not produce the same level of service for employers and employees, and would likely produce a severe financial burden on the citizens of the state as the result of short-sighted, politicized decision making.

E. The California workers' compensation market is workably COMPETITIVE, although on the surface it bears only a vague resemblance to the theoretical paradigm of perfect competition. If the Commission determines that change is necessary, modest changes in the existing rate-making system could improve the efficiency of the pricing system while preserving system attributes which accommodate the public policy goal of regulatory oversight of the rate-making process by the Department of Insurance and pricing freedom for insurers.

F. The SAFETY INCENTIVE provided by the workers' compensation system are important but remain only one of a number of forces that influence the employer's safety decision. Moreover, resources available for the provision of insurer loss control services are limited and are allocated to their highest valued use.

14.13.2 REQUESTS MADE TO THE COMMISSION

The Alliance requests that the underlying cost of the system should be examined. The Alliance believes that relief from the underlying costs and escalating rates can only be achieved when the underlying forces are addressed.

The Alliance hopes the Commission will emphasize the true policy problem in California is finding solutions to the cost drivers.

The Alliance would also hope that the Commission addresses the issue of the administration of the rating law and find that those systems that are punitive (defined as "confined freedom and flexibility of market participants") end up, in the long run, injuring both the employer and the worker. Administration of that law is critical.

The Commission should examine the issue of the experience rating program in California which prohibits an insurer from combining an employer's California and non-California experience for the purpose of the experience rating plan. This frustrates the desire of a multistate employer/insurer to rate the enterprise on the entire experience as a unit. Also, the fixed percentage expense loading ignores economies of scale. It does not appear in other states except the monopolistic state fund states.

The Alliance requests that this Commission's recommendations not include a recommendation that a monopolistic state fund be created in California.

14.13.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	3
Loss Control	3
Minimum Rate Law	2
Safety Incentives	3
Solvency	3
Cost Drivers/Factors	3
Alternate Rate-Making Systems (Effect and Analysis)	2
Exclusive State Fund: Advantages/ Disadvantages	3
Political Manipulation of Rates	3
Rate Adequacy	2
Need for Worker's Compensation Reform	3

14.13.4 SUMMARY OF TESTIMONY PRESENTED

Testimony was received from Alliance Senior Vice President Rodger Lawson, Keith Bateman, an Associate Vice President of the Alliance, and Barry Hoschek, who is also the Division Manager for Loss Prevention at Liberty Mutual Insurance Company.

TESTIMONY OF RODGER LAWSON

Mr. Lawson began the presentation by explaining that the focus of this testimony are the issues of rate regulation and monopolistic state funds. Mr. Lawson indicated that Mr. Hoschek from Liberty Mutual will focus on loss prevention, loss control services, incentives for safety concerning the rate law, and Keith Bateman will focus on the costs of the system. Mr. Lawson indicated that the Alliance believes the Commission's charge is unduly restrictive because it requires the Commission to abstract the mechanics of the process from the environment in which it operates. It places too much emphasis on the "grinder" and not enough on the meat and spices that go into making the rate "sausage".

With regard to regulation of the system, there are two elements that should be distinguished:

A. The process of developing the rate level

B. The administrative procedure by which the actuarial estimates are turned into market rates

Mr. Lawson stated that as far as developing the rate level in California, this has been described by other witnesses and will not be reviewed by the Alliance in this presentation. This is similar to the actuarial procedures conducted in other states and California does not really differ from the rest of the country.

Concerning the administrative procedure, Mr. Lawson stated there is wide variation across the country. Some state are characterized as being "open competition states/competitive rating states" and are supposed to operate with minimal regulatory interference in the rate-making process--most often carriers simply file their rates with the insurance department.

Mr. Lawson continued that at the other end of the spectrum are "strict prior approval environments" which are characterized by a more intrusive and bureaucratic procedure for determining rate level and the rules that apply these rules to the marketplace. Mr. Lawson indicated there is a strong efficiency argument that can be made for systems that promote pricing freedom/flexibility for insurers.

The Alliance has classified nine states by whether they are open competition, prior approval with no deviation, or prior approval with deviations. That is submitted to you for review. The results suggest that differences in the form of the rating law alone cannot be the reason for the differences. In our viewpoint it is very difficult to pull out the impact of the form of the rating law from the results that exist in the marketplace. It is very important that the underlying cost of the system be examined and that in your report to the Legislature you do not avoid the issue.

TESTIMONY OF KEITH BATEMAN

Mr. Bateman indicated that he would try to put the California costs in a natural context, which is not an easy task. The California system is characterized as an expensive system which too broadly and imprecisely defines entry, wastes resources, generates "friction costs", provides relatively low replacement rates and inequitably distributes benefits.

A. High costs versus low benefits:

Mr. Bateman reviewed the work of Professor John Burton at Rutgers, who has compared average adjusted rates for the last 30 years. As of July, 1988, California ranked second in the average costs of adjusted manual rate. Concerning net costs (a function of the adjusted manual rate and the average weekly wage of a given state) California ranks third.

Mr. Bateman referred to a handout provided to the Commission. The gap between California and the national average is increasing. In terms of benefits (weekly maximums) California is at the low end (35th). As far as permanent partial disability it ranks 44th. If you look at the average cost per case, then California clusters around the middle of the states for permanent cases, but concerning "fatals" and temporary total, it's still relatively low.

B. Frequency of claims:

Mr. Bateman indicated that California stands out in terms of the frequency of claims per 100,000 workers. The data reviewed covers 45 states and does not include the exclusive state fund states.

California is 42% above the national average in frequency of temporary total. Regarding the frequency of permanent partial claims, California ranks second -- twice the national average.

Mr. Bateman indicated that he cannot yet tell the effects of the 1989 Reform. Early indications based on the C.W.C.I. is that claim frequency is continuing to increase in California - up 8%.

C. Litigation

Regarding the issue of litigation, Mr. Bateman summarized that for lost time cases, 44% of those involved applications. Mr. Bateman advised that it is very difficult to make comparisons among the states in the litigation area because of definitional differences and also differences in the meaning of a particular form and how it is treated. Another way of looking at this is in terms of attorney involvement. Nationally 17.1% of cases involve an attorney. In California it's 39.6% based on Mr. Bateman's estimation.

Mr. Bateman stated that the cost of litigation is difficult to compute because there are few statistics. Regarding medical/legal costs, California costs are considerably higher than what he could find from other parts of the country.

D. Medical Benefits

Concerning the rate of increase in medical benefits, California is 45.5% higher than the national average and ranks fourth highest, both in average and average rate of growth.

E. Vocational Rehabilitation

Mr. Bateman stated that a specific California problem is vocational rehabilitation. These costs are not replicated anywhere else. Vocational rehabilitation involves 11.5% of the indemnity claims, but represents 19.9% of the dollars.

F. Mental Stress Claims

Mr. Bateman stated that mental stress claims involve an area in which California is very high. Mr. Bateman suggests changes in the figures which were in the written testimony specifically referring to C.W.C.I.'s 1988 study concluding that the Division's figures may understate a true frequency of mental claims by a factor of ten. Mr. Bateman said that a subsequent study indicated four times rather than ten and the costs of mental stress claims in California is probably in the range of 100 to 383 million.

In conclusion, California's costs tend to be higher than the national average.

TESTIMONY OF RODGER LAWSON

Mr. Lawson continued by giving testimony concerning the monopolistic state funds. He indicated that the Alliance of American Insurers had been following the economic fortunes of the monopolistic state funds for several years and their findings support the belief that the world is moving away from state run enterprises.

Mr. Lawson indicated that a major issue to be considered is whether monopolistic state funds would have the same incentives for efficiency as insurance companies in the private sector. Without competition is there less incentive to reduce expenses and a tendency for public enterprise to become an expensive bureaucracy?

Mr. Lawson stated that monopolistic funds have reduced interest in controlling loss costs of their customers which unnecessarily endangers workers. Two monopolistic state funds (West Virginia and Wyoming) provide no loss control services whatsoever. In this type of state, there are no alternative outlets with the possible exception of self-insurance. The potential is increased for rates and operating practices to be influenced by political rather than actuarial principals.

Underwriting losses have been experienced in all monopolistic state funds over the last five years and in some cases income from investments were insufficient for that underwriting loss. Operating losses have occurred in the five years from 1984 through 1989 for North Dakota and Wyoming. They have occurred in four of the last five years for West Virginia and have occurred in three of the last five years for Nevada and Ohio, two of the last five years for Washington.

Concerning political interference, Mr. Lawson also stated that this has led to disastrous financial conditions in several of the funds. Mr. Lawson discussed the West Virginia situation, the Ohio fund, and the Wyoming statutory restrictions (pages 126 and 127 of the transcript).

Based on evidence available, four of the six monopolistic funds are financially insolvent by private market standards. (The liabilities of these funds are comprised mostly of benefits owed to injured workers exceeding the assets the funds possessed).

Mr. Lawson indicated that this situation exists in Ohio, West Virginia and, to a smaller extent, North Dakota and Wyoming. These are not true insurance operations, but "pay as you go" schemes with snowballing liabilities.

Mr. Lawson concluded that under most monopolistic state funds, premiums currently collected are little more than an additional tax to pay for claims. As liabilities increase, taxes must increase to compensate the ever increasing pool of injured workers. This cost shifting, although politically expedient today, hurts workers and employers and jeopardizes safety.

[Mr. Lawson offered to provide more technical literature to the Commission concerning the issue of what occurs when you don't fully fund a social security system.]

TESTIMONY OF BARRY HOSCHEK

Mr. Hoschek testified concerning what loss control does for an insurance company, as far as what works for the benefit of employers in this state as well as employees.

Mr. Hoschek is with Liberty Mutual. The loss control department tries to help prevent work related injuries by providing a consulting service in an advisory capacity. They identify loss trends to pinpoint specific problems. Insurance premiums are high but there are other costs which are equally important and can be more expensive. We help to direct activities in that regard.

Mr. Hoschek stated that the additional areas in which he works involve making suggestions concerning employer work safety programs. Since the passage of SB 198 which became law on July 1st, employers are required to have a written safety program or injury/illness prevention program.

Mr. Hoschek stated he would like to summarize the loss prevention section of this presentation with three key points:

1. It is a valuable service to Liberty's policyholders, it is provided based on need and it is not impacted by the minimum rate law;

2. Customers use our services and seek financial rewards and lower premiums with larger dividends; and

3. Liberty's services help in numerous ways beyond the rating benefits. We help establish effective illness and injury prevention programs, train and educate supervisors and management, conduct research and develop solutions to problems in specific areas (cumulative trauma) and help customers meet the legal responsibilities in the state.

TESTIMONY BY RODGER LAWSON

Mr. Lawson resumed testifying and summarized by adding several brief recommendations:

A. The minimum rate law has many positive attributes as an administrative process and we favor its retention. The public policy interest in overseeing the rate-setting process is well served. The process allows for considerable pricing freedom for insurers and that benefits the insureds who want service options. This process has not become overly politicized, and in our view no change in the system is really necessary.

Mr. Lawson added that if this Commission feels compelled to make some marginal changes, then we recommend and urge you bear in mind that systems involving more centralized direction of the pricing process / less freedom for insurers to act independently will be destructive to the mutual interest of business, labor and the insurance industry. Maine, Texas and Louisiana have experienced this problem already.

B. The true policy problem in California is finding solutions to the cost drivers and we hope the Commission will emphasize that in their final report. Recognition of these problems from the Commission will go a long way and carry much weight with the legislature.

C. You should examine the issue of the experience rating program in California which prohibits an insurer from combining an employer's California and non-California experience for the purpose of the experience rating plan. Only New Jersey has this similar prohibition. This frustrates the desire of a multistate employer/insurer to rate the enterprise on the entire experience as a unit. Also, as a second point, the fixed percentage expense loading ignores economies of scale. It does not appear in other states except the monopolistic state fund states.

It is our recommendation you examine that, look at the systems that are used in other states which have a graduated expense loading in recognition of the fact that the costs are not the same for small and large risks to write business.

14.13.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following the Alliance's presentation and testimony:

A. One of our witnesses generated what he called the "Liberty Mutual Test" with respect to the minimum rate system and it was indicated that you have a very low administrative cost. Why wouldn't you prefer to compete on the basis of something other than the minimum rate law if you are one of the more efficient producers?

LAWSON: I think the issue is how competitive is this market at point of sale today? Can a minimum rate law allow this system to be working in a competitive sense-price competitive sense?

[Mr. Lawson continued to discuss dividends, compensating insureds and comparing actuarial prices of life insurance.]

HOSCHEK: My responsibility is loss control. I can't address Liberty Mutual's position, but we compete in general with the marketplace on the basis of dividends/quality of our service.

B. Your recommendation includes moving from a mandated uniform expense loading to a modified graduated schedule. Would it include going to actual expenses? (You set the experience rating and then add on the actual administrative costs company by company)--this looks more like a competitive market to me.

LAWSON: This is really a public policy trade off. We don't think you need to go that far, but the Commission should investigate and make that determination for itself.

C. What public policy benefit would be lost by that?

ANSWER: I think to the degree an insurance department wants to examine expenses/expense loading in terms of the rate determination process, there is that opportunity to do that under the current system, but might be lost under an alternative system.

D. Please remind me of the difference between AAI and AIE.

ANSWER: The AAI is an association headquartered in Chicago. We have 170 members which write 13% of the market in California in workers' compensation. The AIE is headquartered in Washington but are basically large eastern stock companies also heavily involved in the provision of workers' compensation insurance in California.

E. Is one primarily "mutuals" and one primarily "stocks"?

ANSWER: Early in our history that is absolutely correct, but those distinctions have evaporated over time.

F. Were the underwriting losses that were experienced in monopolistic state funds offset by investment income? You did not refer back to investment income.

ANSWER: Operating loses have occurred in four of the last five years and that would take into account investment income.

G. Not the underwriting--I wanted to make sure I clarified the difference there. Most of your comparison is not compared primarily to Oregon, is that correct?

ANSWER: Oregon is not a monopolistic state fund, it is a competitive state fund.

H. Could you make some observations about the solvency issue compared with the relative competitiveness of more front-load pricing differentials versus back-loading. would it be desirable to get more front end competition which is now back ended?

ANSWER: In some of the earlier materials you have been provided, Orin Kramer made the observation that the minimum rate law didn't have much to do with solvency. My sense is that the current system does provide or may have some benefit, in terms of allowing companies to assess what their dividends ought to be, and would marginally improve the likelihood that companies are not going to be insolvent.

Having said that I must address the Mission Insurance insolvency which was a large workers' compensation writer in California. In terms of front-end price competition I think the markets are generally competitive. If you look at overall insolvency concerning the property casualty insurance industry, the long term history of this industry is that there have not been many insolvencies. It is nothing like what we have found with the savings and loan industry. I would not expect that a front-end price competition type system would drive us into a huge number of insolvencies.

I. Why do you think State Fund's share of the market has been increasing?

ANSWER: I think the State Fund has some distinct advantages that they are able to use--their dividends are a powerful marketing force. There are also tax advantages that they share from an expense standpoint. That's all I can tell you.

J. The advantages they have, they have had for many years?

ANSWER: Correct

K. Why do you suppose they have been doing better in recent years proportionately?

ANSWER: My personal opinion is, in general, the loss ratios for a lot of companies in California are increasing. There is more underwriting selectively on the part of insurers.

L. So the involuntary market is growing?

ANSWER: If you want to put it in those terms, yes.

M. What is unique about California's law or administration that makes the frequency and rate of increase in litigation higher than in other states?

ANSWER: The sorts of cases that are allowed into the system and how those cases are treated. If you have cases that are compensable in this state and not others there are going to be more, such as mental stress claims. Some states allow them but you also have cultural and other factors that have led to the fact that you probably have twice as many of those claims as any other state. Michigan has had the law the same as California, but there are different attitudes toward emotional health, and employer responsibility in the two states and you get more claims coming into the system in California.

If benefits are low people are going to try harder to get everything they can, but if you raise benefits will people drop out of the system? Once the culture of entitlement is there, then if you enrich the system, it is unlikely the claims volume or expectations will change so you end up with an even more expensive system.

14.13.6 WRITTEN MATERIAL PROVIDED

Written materials were submitted to the Commission by these witnesses.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESSES WHO AGREE THAT THIS IS A FAIR REPRESENTATION OF THEIR TESTIMONY.

14.14 SUMMARY OF TESTIMONY

ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES TESTIMONY OF: BARRY CARMODY, DON YOUNG AND KEN FUJINO

14.14.1 SUMMARY OVERVIEW

A joint presentation was made and testimony was received from Barry Carmody, Association of California Insurance Companies, Don Young, President and Chief Executive Officer of the Citation Insurance Company and Ken Fujino, President and Chief Operating Officer of Transamerica Workers' Compensation Insurance.

The focus of Mr. Young's testimony was the importance of the Minimum Rate Law and why it has been important to the stability of the California Worker's Compensation marketplace.

Both Mr. Young & Mr. Fujino stated that the minimum rate law has worked to keep rates stable and prevent insolvency. Insurance companies compete by offering specialized services such as loss control or claims handling. Mr. Fujino believes that the major issues that need to be addressed are the cost drivers and excessive use of litigation. Mr. Young also believes the minimum rate law guards against insolvency and allows insurance companies to offer incentives to promote safety. Mr. Young believes the minimum rate law has served California well.

14.14.2 REQUESTS MADE TO THE COMMISSION

Mr. Fujino suggested the Commission look at the forces driving up the costs and where the rating law issue place in important to the overall hierarchy of issues.

14.14.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Political Manipulation of Rates	1
Competition between Insurers	3
Loss Control	2
Minimum Rate Law	3
Profitability	3
Rate Stability	3
Solvency	3
Appropriate/Expeditious Claims Service	3
Cost Factors/Drivers	3
Safety Incentives	2
Need for Workers' Comp Reform/Benefit Increases	1

14.14.4 SUMMARY OF TESTIMONY

Mr. Carmody introduced Don Young and Ken Fujino as representing two of A.C.I.C.'s member companies.

TESTIMONY OF DON YOUNG

A. BACKGROUND

Don Young introduced himself and explained he was President and C.E.O. of Citation Insurance Group and Citation Insurance Company. He explained they began business in 1982 and have specialized in providing workers' compensation coverage in California.

The focus of his testimony was to explain to this Commission why the minimum rate law has been important to the stability and consistency of the workers' compensation marketplace in California. He also focused on some of the practical problems and opportunities associated with being a small California Insurance Company.

Mr. Young began by giving a personal background about himself, which included the fact he was immediate past Chairman of the governing committee of the W.C.I.R.B. and currently serves as President of the C.W.C.I., the insurance industry's research and education organization. Mr. Young previously worked for Industrial Indemnity prior to developing his own insurance company.

B. STARTING UP CITATION INSURANCE GROUP

Mr. Young went on to explain how he worked with the Department of Insurance during Citations first year to become authorized to write workers' compensation insurance. From the beginning they decide to focus on selected types of larger businesses with a focus on offering loss control and claims management services. Mr. Young explained their focus with potential customers was that they viewed themselves as "long-term" players and developed their business carefully and profitably over time. Mr. Young's ultimate goal was to become publicly held when the time presented itself.

Mr. Young stated that it was essential the company be able to produce a competitive return on the money people invested in them. The existence of the minimum rate law was critically important to his capitalization efforts. Mr. Young indicated that investors are impressed with the stability of the marketplace in California and also with the steady returns on investments that they receive over time.

Mr. Young went on to explain they began writing their business in 1982 and have always maintained their focus on larger businesses. He explained that once they obtained an initial rating of "A-minus excellent" from the A.M. organization, they had access to large businesses and brokers began taking notice of them. Mr. Young explained they currently provide workers' compensation coverage to approximately 700 California businesses who pay an average annual cost of $85,000 in premium. There are 125 Citation employees in a network of five offices located throughout the state that service these customers.

C. THE MINIMUM RATE LAW

Mr. Young indicated that he and other specialty carriers have been able to successfully compete over the years because of the minimum rate law, which he believes was designed, in part, to keep insurance companies solvent. This is so, because no company can issue a policy for less

than the minimum rate law established by law. Carriers compete primarily on the quality of services they provide. These companies that focus on providing service to businesses, are viewed by brokers and agents as better able to help the client control workers' compensation costs. Mr. Young stated that to the best of his knowledge, California is the only state in the nation where so many carriers provide only workers' compensation coverage. He believes it is because there is ease of entry to the insurance business. It is a highly fragmented market with hundreds of companies authorized to write workers' compensation, and it is intensely competitive. He does not believe, with the exception of State Fund, that there is a dominant company.

Mr. Young went on to state that rates have been adequate to cover loss costs and benefit increases which he believes is another benefit of the minimum rate law. He indicated that unlike other states, there is no residual or assigned risk market which must be funded by policyholders or tax payers. He pointed out that the State Fund is the residual marketplace and he believes it is every bit as important as the minimum rate law in making the California workers' compensation marketplace consistency stable.

Mr. Young stated that profitability in California workers' compensation is never a certainty. He believes profitability is more easily obtained in the absence of irresponsible price cutting and instability in the marketplace.

Mr. Young went on to state that price competition in California occurs only in the form of insurance companies returning a portion of previously paid is known as policyholder dividends. He indicated that these dividends are not issued until after the policy term has ended and the costs become known. These dividend can only be declared from accumulated policyholder surplus, also protecting against insolvency. Mr. Young stated that because of this insurers only disclose the factors that they have used to calculate dividends for similarly-sized policyholders on a historical basis.

Mr. Young went on to state that his company focuses on larger businesses. When the ex mod factor is applied to minimum rates set for each employment class (approximately 450), depending on whether the experience is good or bad, these businesses will pay more or less than the minimum rate. Mr. Young stated it is the minimum rate law, working with the experience rating plan which provides economic incentives for business to maintain a safe workplace.

Mr. Young indicated that Citation's job is to work with those selected businesses to whom they sell workers' compensation insurance to help reduce their costs. He believes their loss control people are critically important and have a dual function: (1) helping in the underwriting selection process (2) working with the customer to create a safe environment.

Mr. Young indicated that Citation offers its loss control expertise to help their clients set up safety management. He added that Citation actively manages the claim function by frequent communication with the injured workers and trying to return people to work as soon as possible. These two factors reduce the cost of workers' compensation insurance.

Mr. Young went on to discuss the practical problems associate with running his company. He believes that because of their small size they are dependent on the adequacy of the minimum rates. He cited the example of 1983 when there was a rate increase in the industry to fund a benefit increase which turned out to be grossly insufficient. He stated that they came to the line in 1987 having to add to their loss reserves of the earlier years of business which caused an operating loss for their shareholders. Mr. Young indicated that his competitors for Citation's clients tend to be specialty carriers rather than the national multiline companies. He believes Citation has developed a reputation for providing excellent service.

Mr. Young summarized by stating that based on what he knows of the minimum rate law, it has worked well for employers who are concerned about work place safety and has worked well for the insurance industry. He believes it has worked well for California as well. Although it may not be perfect, it's the best approach that he has ever seen. Mr. Young believes that the problems with the workers' compensation system stem from the cost factors that feed off the system. The Workers' Compensation Reform Act did not accomplish any reform and we are still waiting to see reform. He believes that although it increased benefits it also increased the administrative burden on both employers and insurance companies.

This concludes the testimony of Mr. Young.

TESTIMONY OF KEN FUJINO

Mr. Young's testimony was followed by the testimony of Ken Fujino, the President and Chief Operation Officer of Transamerica Workers' Compensation. He has been in that position for four years and previously spent 23 years with Fireman's Fund. Transamerica is the sixth largest writer of workers' compensation in California and in 1990 they wrote $450 million in premiums nationally, and $310 million in California.

Mr. Fujino's presentation was from the position of a businessman who has to make the system work, and he gave the Commission an "operational perspective".

Mr. Fujino pointed out three trends in the recent past worth noting because they have a bearing on what this Commission is studying.

The first involves changes in the 80's toward increased productivity and efficiency, a period of major restructuring. Many businesses downsized or relocated, and workers' compensation had to respond to those changes.

The second trend is the significance of a growing health and safety consciousness of the American public. Mr. Fujino pointed out that people are more aware of the hazards they're exposed to every day and are more aware of medical and health conditions that we wouldn't have known about 10 years ago. He believes the work force is more sophisticated about safety and health.

The third trend is the cost of workers' compensation insurance. Mr. Fujino pointed out that premiums are high and employers view them as growing at an alarming rate. He believes that although the real world must manage these increased rates, the insurance industry is targeted as being the "heavy" or the bad guy, but the industry cannot live with inadequate prices. He pointed out that inadequate prices are becoming the norm in many states.

Mr. Fujino went on to state that average premium levels increases in many states of some 10% over the past five years, workers' compensation insurers have fallen short of profitability because rate approvals missed actuarial indication by 1/3 to 50 percent. He believes part of this is the result of political influences. Mr. Fujino indicated that adequate rates are necessary to generate appropriate revenue, which enables carriers to provide a variety of services, including loss control. Mr. Fujino is concerned over inadequate pricing and Transamerica is changing from being a nationwide workers' compensation generalists to a specialist insurer with staff handling workers' compensation exclusively. Due to rate inadequacy in many states, his company is focusing it's growth in 13 states.

Mr. Fujino indicated that California's rating law has served employers and organized labor well, fostering an environment which allowed insurers to compete based on services that carriers provide.

Mr. Fujino indicated that this has influenced Transamerica because they provide a broad market for small, intermediate and large policyholders. 26% of their premium and 86% of their policy count come from policies of less than $10,000 in estimated annual premium. He also indicated that they actively write safety groups and they have 29 they provide coverage for.

As to solvency, Mr. Fujino pointed out that this has not been an issue in California in the recent past, but pointed out that it could happen. Workers' compensation is no longer a simple line of insurance and there are complex issues facing it. Secondly, in California there are a number of specialty comp carriers with large premium writing. Third, insolvency has happened outside of California and Mr. Fujino cited the Texas Employers Insurance Company which was declared insolvent and recently went into receivership. Fourth, Mr. Fujino pointed out a recent audit of the Colorado State Fund which showed their surplus was minus $200 million dollars.

Mr. Fujino then discussed a study done by Tillinghast, an international organization of actuaries / consultants. They sent a questionnaire to executives in charge of workers' compensation programs trying to gauge the effect of the workers' compensation crisis on employers. 576 organizations responded and more than 8 of the 10 cited health costs and perceived abuse of the system by health care providers as a major problem. Following that, the issues cited most often was a widening definition of work-related injuries, including for example, repetitive motion and stress related disorders. 62% of those responding indicated attorney involvement was a major problem. The issue of inequity in the insurance rating process was listed by 22% of the respondence. Mr. Fujino indicated that in a Chicago Tribune article concerning organized labor, a study on employee goals found that organized labor's number one goal for employees interviewed was not a pay raise but a safe working environment.

Mr. Fujino went on to discuss a study done in Michigan focusing on safety, which compared the highest 15% of employers in term of frequency of losses as compared with the lowest 15%. Those companies who have put a great deal of emphasis on safety were in the low frequency group. Mr. Fujino said that his own experience demonstrates that the relationship between the worker and the employer before the injury, and the way the worker is treated after his injury, makes a difference. No change in the rating law will accomplish as much. Mr. Fujino said that, given this research and the findings, it is obvious that safety and health issues are the rising priority for the American worker and insurance companies must address that. Mr. Fujino indicated that Transamerica focuses on safety in the workplace but that requires the commitment of cooperation of employees and employers, not just lip service.
At this time Mr. Fujino shared a video which demonstrated how Transamerica works with employers towards loss prevention. As the projection continued he discussed the employer, Hughes' Market which had a large experience mod (200) they began working with them. They helped reduce the mod to 120.

He concluded by indicating that the rating law allows carriers to compete through competitive pricing as well as through the services that they provide. He believes the major issues that need to be addressed are the cost drivers that force workers' compensation premiums to keep climbing, including medical costs and excessive use of litigation. He further stated that the minimum rate law has guarded against insolvency and has allowed insurance companies to offer meaningful incentives to promote safety.

This concluded Mr. Fujino's presentation.

14.14.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

The following is a summarization of the questions and answers raised by the Commission following the presentations of Mr. Young and Mr. Fujino:

A. Please give me a scenario of starting a similar company in a state that does not have a minimum rate law. What would be the difference and how would that effect what you would have to do

to capitalize?

YOUNG: The key to starting any business if you need capitol from outside sources is to return some portion to the investor. The minimum rate law has a history of stability in this state and that was an important part of our being able to attract capitol in the first place. I doubt whether Citation Insurance Company could have pulled off a similar capitalization effort in other states where there is more volatility and no investor is going show much interest in investing.

B. Are there proportionally more new carriers entering the California market than the market in other states that don't have the minimum rate law?

YOUNG: There's no question about that. There's no other state where there is such a preponderance of compensation specialists. There was in Texas before it's volatility and it became an uncooperative place to write workers' compensation. As Mr. Fujino indicated, five companies have recently entered the state.

C. In your opinion, is it a function of the minimum rate law or the size of the market?

YOUNG: I think it is a function of both, certainly the latter without the former would make California a less attractive place to write workers' compensation. The marketplace is vast and gives opportunity to a number of us to provide our services to customers when we seek business. But if the States workers' compensation system was as volatile as in other states, such as Texas, I doubt there would be that much interest in pursuing workers' compensation as an attractive line of business, as it is now.

D. You mentioned the process by which your company encourages injured workers to return to work, please describe them?

YOUNG: It's a team effort involving our claims examiner working with the injured employee, the employer, and the medical provider. If an employee is injured in a place where they enjoy working, they are anxious to get back to work and the employer wants them back. Our emphasis is to return them to that workplace as quick as possible even if they are not able to do the same job in which they were injured, to bring them back in some other form of employment. This requires ongoing communication with the injured employee, employer and medical provider.

E. How do you deal with the employee who is reluctant to return to work?

YOUNG: There is no magic answer.

F. What are some ways you deal with such an employee, give some examples?

YOUNG: It gets back to ongoing communication. If the employee is reluctant because he didn't like the place where he worked, then we're going to have a difficult time. Our effort then is aimed at getting the employee to a point where he is fully recovered from the injury and back into some comparable form of employment, either through vocational rehabilitation or through an informal means. If the employee is reluctant to go back because they don't think they can do the job, than that presents a different set of challenges, but those are more easily worked out between the employer and the employee if we can gradually move the employee into the workplace and have them perform other duties leading up to the job they had at the time of injury.

G. You talked about a medical cost containment program. Were you referring to a safety program or to a program to contain costs once the injury has occurred.

FUJINO: We're talking about programs that will contain costs once an injury has occurred, as an example, managed care programs. This involves communicating with the attending physician as to what the workplace environment is and the job specifications are. The physician must understand what the job is that the individual can go back to and we find that when we work closely with the physicians the communication assists the injured worker as well. We also have medical bill review programs and preferred provider organizations.

H. I suspect that you are correct in saying the minimum rate law does provide stability that encourages the ease of entry into the insurance marketplace. In terms of the premiums you write, you referred to your company choosing to operate in the area of larger premiums. How many real competitors do you feel you have that are after this?

YOUNG: From a practical standpoint, we find ourselves competing against other compensation specialty carriers. To come up with a number, I'd say half a dozen or dozen although sometimes we compete with larger multiline companies.

I. Could you give an idea of the proportion of your potential customers who consider self-insurance as another option?

YOUNG: Over the years we have provided coverage for some businesses that have ultimately moved into self-insurance and we have provided coverage for businesses that have moved out of self-insurance. The businesses we deal with may have that option.

J. Do you have a mental cut-off in terms of the smallest premium your firm is willing to write?

YOUNG: Not really. It's not quite that cut and dry. While the average premium is quite large, we do have offices throughout the state and in some locations there aren't large businesses we are able to write for. We will attempt to write a broader cross-section of book, which means we are going to have to take some of their smaller business.

L. How many people are in your organization and how many insurance companies are in A.C.I.C.?

CARMODY: Almost 30 property and casualty insurers in the state. We have auto and workers' compensation.

M. Do you know how many of those have workers' compensation?

CARMODY: About 17.

N. Are there any of those -- would you say all of them have either an industry specialization or size of premium specialization?

CARMODY: Not to my knowledge. That raises the issue of what is insurance? Everyone is in business and we have a collection of independent businesses that are part of our Association. We are not familiar with the policies of how they conduct their business.

FUJINO: From our standpoint, we write a lot of small businesses and we do operate with the strategy for each sector of the marketplace.

O. So next week if I decide I'm going to start a catering business with four employees I wouldn't call Mr. Young but I might call you?

FUJINO: Right.

P. Concerning safety groups, you have mentioned that this is an active part of your business. How do I get into a safety group (with my catering business)?

FUJINO: We look at safety groups as a association of risks with similar exposures who have a commitment -- safety programs that are established and that have been filed with the Bureau. You'd have to find out whether there is a group for caterers and I couldn't tell you that. But I could tell you how to go about getting a number of them to establish safety programs.

Q. If I came to you with a group, such as gardeners, what you do offer safety groups services to, would you direct me to one of these groups?

FUJINO: We would work through an independent insurance system. As a result we have both closed groups and open groups. Closed groups are handled exclusively through a particular agent and that agent has expertise and an ability to coordinate the safety and insurance activities of that association. The other one is called an open group which is available to all insurance agents within the state of California and they can place business actively into that group.

R. You have indicated a good deal of service that you are willing to provide to companies with respect to their safety programs. To what extent do you insist upon this?

FUJINO: We can not insist. There may be accounts in which we will underwrite and determine from a risk standpoint if it is a controllable one. Without loss control we would be unable to make a profit. As a result we would decline your business and advise that you would have to make a commitment to safety.

14.14.6 WRITTEN MATERIAL PRESENTED

Written materials were submitted to the Commission by the witnesses.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESSES WHO AGREE THAT THIS IS A FAIR REPRESENTATION OF THEIR TESTIMONY.

14.15 SUMMARY OF TESTIMONY

AMERICAN INSURANCE ASSOCIATION
TESTIMONY OF: MARK WEBB AND TOM BROWN

14.15.1 SUMMARY OVERVIEW

Mr. Brown focused on several key issues: (1) incentives for safety (dividends and loss control); (2) the increasing impact of the cost factors/drivers of the system and (3) the growth of residual markets.

Mr. Brown believes that workers' compensation is a unique animal and doesn't fit into a normal economic analysis. He also believes that rate-making can't be divorced from the workers' compensation system in general. He argues that retrospective pricing is better for the seller and more equitable for the buyer. Dividends are a direct way to influence loss prevention.

Mr. Brown fears that if the pricing system is changed, there will be more risks, instability, more volatile pricing and less of an incentive to promote safety.

14.15.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to the Commission.

14.15.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	1
Loss Control	3
Minimum Rate Law	3
Profitability	1
Prospective vs. Retrospective Rating	1
Rate Stability	3
Safety Incentives	3
Solvency	2
Cost Factors/Drivers	3
Dividends	3
Alternate Rate Making Systems	1
Need for Work. Comp. Reform/ Benefit Increases	3
Rate Adequacy	3
Voluntary/Involuntary Market	3

14.15.4 SUMMARY OF TESTIMONY

Testimony was received by Mark Webb who is the Western Region Counsel for A.I.A. and formerly the Deputy Director and Chief Deputy Receiver of the Arizona Department of Insurance. He explained that the A.I.A was a national property and casualty trade association with over 230 member companies writing approximately 30% of the private share of the workers' compensation market in California. He explained that policy issues on workers' compensation are established in the A.I.A through committee. Mr.Webb then introduced Tom Brown, who is the chairman of workers' compensation committee. Mr. Brown is also the Vice President for commercial lines and workers' compensation for Fireman's Fund Insurance Company.

TESTIMONY OF TOM BROWN

A. BACKGROUND AND FOCUS ON ISSUES TO BE DISCUSSED

Tom W. Brown is Vice President of workers' compensation for Fireman's Fund. He gave a background of Fireman's Fund including the fact they are the countries 20th largest property and casualty insurer and in 1989 they wrote approximately $2.6 billion in premiums nationwide, of which $560 million was in workers' compensation. He indicated that more than one third of that was in the state of California.

Mr. Brown went on to indicate that the focus of his testimony today would include several issues. The first was the financial incentive for safety in California's pricing system; to share some information about the national workers' compensation picture and increasing costs and the growth of residual markets (the direct result of inadequate rates) and how his insurance company looks at and responds to these developments. Lastly, Mr. Brown indicated he wanted to comment on the remarks made last month made by Mark Gerlach on behalf of the California Applicants Attorneys Association.

B. THE "UNIQUENESS" OF WORKERS' COMPENSATION

Mr. Brown began by indicating that his main point is that workers' compensation is a unique product and different from other lines of insurance. He feels you can't divorce the rating law from the system. He does not think you can evaluate workers' compensation rate making and the workers' compensation market using traditional economic theories because it is unique. It is different because it is a form of social insurance whose beneficiaries do not purchase the product. It also has a long tail because losses develop over a long period of time. Mr. Brown stated that there's also a high frequency of losses in this line of insurance.

He believes that both of these factors argue for after-the-fact pricing of workers' compensation. He believes workers' compensation insurance is sensitive to efforts to control losses and there is a great opportunity to control them. Dividends, together with experience rating, are the most direct way and the only way for a rating system to influence loss prevention during the course of the policy.

Mr. Brown went on to state that if pricing is given up-front (whether an administered pricing environment or "file and use" environment, "use and file"), there's not a direct and clear connection between loss prevention behavior and the net cost to the buyer. The dividend system was created in California, and Mr. Brown pointed out that other states which later adopted that have made tremendous mistakes by switching to an up-front pricing method.

C. DIVIDENDS

Mr. Brown went on to state that this Commission has heard other testimony concerning the dividend system and how dividends improve on the equitable distribution of costs to employers who generate them. This Commission has also been told that dividends are a financial incentive to reduce losses by maintaining a safe work environment and Mr. Brown believes this is all true.

Mr. Brown believes that a rating law can compliment and support safety and health laws and reduce the cost of injuries. He went on to state that the safety incentive is not theoretical and that Fireman's Fund Loss Control Department has many experts providing the full range of services to policyholders, regardless of size. They can design site-specific programs and he went on to give an example of their special software program.

He went on to ask the question of whether anyone can prove that incentives really work? He answered the question by stating a simple comparison of workplace injury rates across states would not help with any useful conclusions because injury rates will vary with significant differences in the distribution of occupations among the states.

Mr. Brown referenced a study entitled "Workers Compensation and Workplace Safety: the Nature of Employer Financial Incentives", which was published in 1982 by the Institute for Civil Justice of the Rand Corporation and written by Dr. Richard Victor who is currently the Executive Director of the Workers' compensation Research Institute in Cambridge, Massachusetts. This study focused primarily on experience rating and retrospective rating but does contain a brief discussion on dividends. Mr. Brown summarized some of the reports findings. Those findings included a statement that the minimum rate law enhanced prevention incentives.

D. INCREASED COST OF WORKERS' COMPENSATION

Mr. Brown went on to discuss workers' compensation and prices and markets in general. He believes that the cost of workers' compensation insurance has risen sharply over the last decade in California as well as throughout the country. He believes the reason is fairly obvious: medical care, rehabilitation and indemnity benefits cost more every year. He pointed out that the average claim cost rose from $6,000 in 1981 to $9,000 in 1989 and the average medical cost per claim rose from $1,800 to more than $3,400. He also indicated that coverage has been broadened so it's not just a cost increase. Mr. Brown went on to state that in some states, including California, there is a higher proportion of claims that are litigated. He also indicated that premiums have also risen but not enough by actuarial standards.

E. OTHER STATE COMPARISONS

Mr. Brown discussed several states including Maine, Florida, Texas, Rhode Island and Louisiana where rates have gone up dramatically. He stated that prior to the passage of the 1989 Reform Act, the comp system was 24% above the national average. He added that this state is one of a handful that provide compensation for mental stress claims. There is also an ever increasing number of vocational rehabilitation claims being filed. Mr. Brown said there was a fundamental difference between California and other states in that rates have kept pace with system costs in California up until now. Mr. Brown addressed the fact that some critics of the insurance industry believe insurance companies simply pass through the costs, doing little to hold them down, but Mr. Brown believes the facts he has pointed to show a different picture. He believes that A.I.A. member companies are actively engaged in efforts to strengthen administration and reduce frictional costs. He believes insurers have used all available tools to control the cost of medical care including using preferred provider networks and bill audits. Mr. Brown then cited Fireman's Fund Physicians Bill Audit Program which has saved money for their clients.

F. COST DRIVERS

Mr. Brown went on to state that even with the implementation of cost containment programs, medical benefits account for an increasing proportion of the claims dollar; almost 40% nation wide and in California. One of the reasons workers' compensation is so high is that workers' compensation provides dollar one coverage, unlimited medical coverage by law. He pointed out that some techniques used in other health care networks are not available in workers' compensation, and cited claimant co-payments and deductibles.

G. RESIDUAL MARKETS

Mr. Brown then discussed residual markets. He pointed out that residual markets in other states are rising to almost one fourth of the premium. He feels there's a lot of political pressure to dampen rate increases. Mr. Brown went on to state that his responsibility is to try to manage his book of business as best he can, to make a reasonable rate of return over time. They analyze a number of factors in determining what kind of capacity they have on a state by state basis. A stable environment where results don't fluctuate wildly is very important to make a capacity allocation determination. He asked the Commission to keep in mind the different nature of workers' compensation from other types of insurance programs. He also felt the pricing utilized should enhance to the maximum extent possible, safety incentives, rather than discouraging them. He believes that if we change the pricing system in California there will be risks, instability, more volatile pricing and perhaps, less of an incentive to promote safety.

Mr. Brown concluded by again pointing out that workers' compensation is a different line of insurance. He felt that after-the-fact pricing is better for the seller and is more equitable to the employer as well as being better for the beneficiary of the comp system because it promotes safety.

This concludes the testimony of Tom Brown

14.15.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. Brown's testimony.

A. You indicated your association has 230 member organizations -- how many write workers' compensation in California?

WEBB: I know the share of companies that write is approximately 30% of the private marketplace but I don't know how many companies are writing workers' compensation.

B. You indicated you company does a third of it's workers' compensation business in California. How many other states do you offer it in?

BROWN: We operate in 43 out of 45 possible jurisdiction, but write very little in most of these states.

C. You spoke of high frequency of loss and I want to make sure I understand the comparison you're making. Are you saying if I have auto insurance, I make a claim every three years or so, but with workers' compensation a typical company would have lots of claims during a single year?

BROWN: That is basically the idea. Smaller employers do not typically have claims during the year. But the vast bulk of companies which cover the great majority of workers would be expected to have claims each and every year. Not exactly sure of the number here but I would imagine that employers of 20 or more employees would represent close to 80% or more of the employees employed in the state. Those employers typically do have some sort of claim just about every year.

D. Does your company specialize in certain size of premium or certain segments of the marketplace?

BROWN: We write very. very small risks all the way to very jumbo national accounts.

E. We hear about "frictional costs" and you have raised that issue in the context of a company of your size that has experience in this. By this do you mean, as an example, a person who has worked for two different employers covered by two different firms and there is an issue of where the injury should be assigned?

BROWN; What I meant by that generic term is basically unnecessary expenses spent on resolving disputes over compensability such as when there are a number of lawyers on both sides.

F. How would you differentiate between this and the claim adjustment process that you have of figuring out how the person ought to be compensated? Are you saying anything that goes beyond your normal process is a frictional cost?

BROWN: There will always be a number of claims that can't be resolved through any administrative process, but they should be kept to a minimum to make the system run efficiently. When the first notice of an injury is submitted by an attorney, that's not how it's supposed to work. If attorneys get involved unnecessarily, those are costs that are over and above what was originally contemplated.

G. When making a claim, what are the unusual conduits by which a claim is made? Are you saying there is an increasing percentage in people starting with attorneys?

BROWN: For a number of years they have in California.

H. But is a typical claim processed through the employer?

BROWN: Yes.

I. With respect to your business how much originates with an attorney as opposed to being disputed?

BROWN: I can't really tell you.

J. You ask us not to change the rate making device based on your belief that it is operating efficiently and that it is the underlying cost drivers that are forcing up the costs. Are there any market mechanisms that will make things come into balance or can we only look at cost drivers, the underlying cost structure?

BROWN: No. There are a number of things that are being done to reform the law. There are repeated attempts in other states such as Texas to reform the laws. We know we can't keep asking for more and more money, but people have to understand that we can't sell a product

at a loss. To resolve these forces the only answer is reform.

K. Do you see any discipline coming? You seem to imply medical costs, attorneys costs -- do you see any forces other than legislative bringing an abatement to this price escalation?

BROWN: There are a lot of things the companies have done in the area of cost containment. We are doing as much as the law allows and the statutes allow so that is helping. But there has to be statutory changes as well.

L. If we accept the benefits and incentives of the dividend system, are there any ways these can be extended to the smaller or even smallest of employers that you could suggest?

BROWN: Yes. Safety group dividends is the way to do that. By the way, that practice is more prevalent in California than anywhere else.

M. Is this possibility widely known and understood by small employers? If not, what can be done to make the utilization of safety groups easier for employers?

BROWN: It's fairly widely known. There are a number of very large groups. Perhaps some of the other trade associations could answer that question. But I would guess that it is a fairly significant percentage.

N. You said that is "the" way. Would there be a possibility of statistically grouping employers without requiring them to join such a group? In other words, to place them in a group rate so they could receive the benefits of dividends?

BROWN: The whole rate-making system, the classification rate-making system, essentially does that up-front.

O. I suppose just the size of the employer, the number of employees, makes it statistically difficult to deal at the other end.

BROWN: My personal belief is that a lot of small employers don't like it when we can't determine the price ahead of time. But in fact we don't know. We have an estimate represented by the manual rate which is the average for the class. But this gets into an actuarial kind of argument.

P. It's statistically impossible?

BROWN: It's statistically impossible to determine ahead of time what the right price for that is.

14.15.6 WRITTEN MATERIALS PROVIDED

Written materials were submitted to the Commission by the witnesses.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESSES WHO AGREE THAT THIS IS A FAIR REPRESENTATION OF THEIR TESTIMONY.

14.16 SUMMARY OF TESTIMONY

CALIFORNIA SELF-INSURERS' ASSOCIATION
TESTIMONY OF: JOE MARKEY AND JOAN SPIEGEL

14.16.1 SUMMARY OVERVIEW

Mr. Markey's presentation provided the Commission with information about self-insurance in California, the size of the marketplace, the qualifications for being self-insured, etc.

Ms. Spiegel gave her perspective as a risk manager for Lucky Stores, a large retailer in California which is self-insured.

Ms. Spiegel also discussed aggregate excess insurance and her inability to purchase it in California. She followed legislation, specifically SB 2650, which directed this Commission to examine the phenomenon, but the bill eventually limited this Commission's scope to public entities. Ms. Spiegel asked the Commission to also consider the needs of private self-insurers to purchase the coverage.

Ms. Spiegel discussed the industry "fears" that having aggregate excess insurance would result in a company no longer maintaining safety programs or monitoring their costs. Ms. Spiegel pointed out that this is not the case because the self-insured employer still pays every dollar that goes out the door. Aggregate Excess Insurance exists in other states and is a risk management tool that self-insurers should have available.

14.16.2 REQUESTS MADE TO THE COMMISSION

Ms. Spiegel requested that aggregate excess insurance be reviewed for the private sector as well as the public sector.

14.16.3 MATRIX ITEMS DISCUSSED

ITEMS	WEIGHT ASSIGNED
Aggregate Excess Insurance	3
Self-Insurance/Pools	3
Cost Factors/Drivers of System	3

14.16.4 SUMMARY OF TESTIMONY

Testimony was received from Joe Markey, President of the California Self-Insurers Association. He and Joan Spiegel with Lucky Stores gave a combined presentation.

TESTIMONY BY MS. SPIEGEL

Ms. Spiegel works for Lucky Stores as a Corporate Risk Manager. She indicated that self-insurance is an option that many large employers in California have chosen. Lucky Stores has been self-insured since 1976. Ms. Spiegel indicated this gives them the ability to better manage their program which is one of the largest ones in California.

She indicated that the Commission will learn through its study, that retailers tend to be fairly large workers' comp risks and tend to have very high frequency losses with less severity. Ms. Spiegel indicated that most retailers, the grocery chains especially, are self-insured in California. She indicated that as the Risk Manager of Lucky, she must generate a rate for individual locations which is very difficult on a prospective basis. She indicated they believe very strongly that management can reduce the frequency of claims and she believes they have been successful with that. Self-Insurance gives them better control and they do get the cash flow benefit. She also indicated that they have the ability to select their own people to handle claims and to have greater control of claims management.

Before turning the microphone back over to Mr. Markey, Ms. Spiegel indicated she did want to discuss aggregate excess insurance. She indicated that specific excess insurance is currently available which allows them to cap their ultimate liability for any given loss on a specific incident. Ms. Spiegel indicated that Lucky does purchase specific excess insurance.

Ms. Spiegel went on to state that aggregate excess is designed to allow an employer to cap the ultimate costs during any given year for their self-insured losses. It is not available in California and Ms. Spiegel indicated that her broker can't sell it to her. She indicated that theoretically you could go out-of state to buy it which is cumbersome. She said it had been her experience that some people do that. If you were a nationwide company, you may have a different view of it.

Ms. Spiegel went on to state that Senate bill 2650 from Senator Davis initially indicated he would like the issue to be changed. Ms. Spiegel indicated that she followed the bill through the year and it was ultimately resolved that this would be one of this Commission's charges to study aggregate excess for public employers. Ms. Spiegel indicated she wanted to make a pitch from the private sector. She believes it is a tool self-insurers could have to try to cap their ultimate costs. Ms. Spiegel went on to state that even though it is difficult to forecast costs, if there are any changes in the nature of the business, if you acquire or divest any of your operations, it is more difficult to forecast their impact. It's difficult to say how many more claims there would be and what they would cost.

Ms. Spiegel believes aggregate excess would at least give her company the option of saying it might be worth it to have this coverage to protect against reserve shortfalls. She indicated that this has happened to Lucky in the past. She indicated that Lucky had difficulty forecasting the changes that came in as a result of the benefit increases in 1982. She indicated that they were aware of them and tried to factor it in but they were wrong.

On a personal level Ms. Spiegel has wondered why this product is not here. She thinks some of the arguments concern the insurance industry's view that employers would no longer be interested in safety or try to manage their costs. Ms. Spiegel's understanding of how aggregate excess is priced and calculated in states other than California, is that you would be buying fairly catastrophic protection. You would have to be off on your forecast pretty significantly and, still every single dollar is still coming out of our coffers. The incentives to maintain a safety program is there regardless. It impacts our bottom line too much not to be doing everything we can to reduce the losses. Ms. Spiegel indicated that this product is available in other states and that nationwide firms would be able to use pricing data that is collected from other states. This concludes Ms. Spiegel presentation.

TESTIMONY OF JOSEPH MARKEY

Mr. Markey gave testimony on behalf of the California Self-Insurers Association and the focus of his testimony concerned self-insurance as a part of the workers' compensation system in California and how it relates to this Commissions' study.

Mr. Markey pointed that self-insurers are subject to the same forces and drivers that the insurance industry is involved with and has the same cost problems they have. Self-insurance is a self-assumption by an employer of the risks of workers' compensation with claims administration of one of the various types. To give this Commission a general idea, there are 700 master self-insurers. There are a number of subsidiary certificates that are held by those masters. A classic would be a restaurant chain which has 143 certificates. But if we look at the masters we are talking about 700 in the private sector. There are 2,050 in the public sector which include cities, counties, school districts, etc. Mr. Markey pointed out that 1,713 of these public agencies are members of Joint Powers Authorities which leaves 337 public entities that are self administered or administrated by third party administrators. In the private sector, Mr. Markey pointed out the payroll is $50 billion. The benefits paid in 1989 were $713 million; so it's not a small operation. The Division of Workers' Compensation views self-insurance to be roughly 35% of the market with insurance being 65%.

How does one become self-insured? Mr. Markey explained that for a private sector applicant, an application must be made with a certified independent accounting record to show the ability to assume ones liabilities. It is also a discretionary program. The assets to liabilities ratio should be in the vicinity of 1.5 to 1. Ownership equity in excess of $2 to $3 million Profit over the last five years. Good cash flow and a safety program need to be in place. Now it's required that a prospective self-insurer have an independent analysis of their safety program. There must be a competent administrator. If you don't have your own program, you have to hire a third party administrator. In addition there is a deposit. The first year in self-insurance would be three time the claims expense for the last calendar year in which the employee was injured. Subsequently it would 135% of the estimated future liability which would be put on deposit with the treasurer of the state of California in the form of a security.

Mr. Markey went on to state that every self-insured employer in the private sector is a member of the security fund which could be assessed in the event someone goes into insolvency. These shortfalls are diminishing but the potential is still there to be under-reserved.

Mr. Markey went on to state that in the public sector the requirements are not as stringent in terms of finances. They don't have to make a profit or have an asset-to-liability ratio. They are monitored but not quite as strictly as the private sector. Mr. Markey concluded that he had presented an overview of self-insurance and he would be happy to answer any questions.

14.16.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

The following is a summarization of the questions and answers raised by the Commission following Ms. Spiegel's and Mr. Markey's testimony.

A. Concerning aggregate excess insurance, it's not available? This is a market phenomenon that nobody wants to write? Or is it some other type of restriction that is causing the insurance companies not to want to insure you?

SPIEGEL: It's in the rules of the Insurance Commissioner.

B. From your perspective, why does that exist?

SPIEGEL: My understanding is that there is a concern in the industry that the ability to cap our

losses would provide additional incentives for employers to move from insurance to self-insurance. One of the advantage of an insured program is that you can cap your losses at some point. There is a maximum and you will not be charged any additional retrospective premium. You may lose all your dividends but at some point you know what your cost is going to be.

C. I am curious as to when a worker makes a claim against you, and you're his or her employer as well, is there a tendency -- does that worker get less benefits? Is there a protection to that worker? How does it work from your perspective?

SPIEGEL: We hire a claims administrator who pays the same benefits that an insurance company has to pay in terms of medical benefits, temporary disability and permanent disability.

D. What about some less tangible injuries like mental stress, do they seem to be escalating?

SPIEGEL: We can get more involved in the investigation and we offer employee assistance plans. We don't administer our own claims.

We are charged by Self-Insurance Plans to follow the letter of the law and the people administering these claims have the same requirements to investigate and to determine whether the claim is compensable or not. The methodology is the same. As a self-insurer we may have a better ability to investigate the claim, but it is still within hands of the W.C.A.B. whether a claim is compensable or not.

E. What if a company goes to self-insurance, goes through a leveraged buy-out, and essentially runs down it's plant and equipment so it is not only less efficient but also less safe, and then effectively goes out of business. What protection is there to the worker, to safety records, things of that sort. Is there any mechanisms that guards against that phenomenon?

SPIEGEL: Yes, there is. In order to be self-insured you have to get a certificate from Self-Insurance Plans which is part of the Department of Workers' Compensation for Industrial Relations. They have requirements that you document a safety program and they make periodical audits of the claims files to make sure the reserves are appropriate. Every year we are required to file a report with Self-Insurance Plans documenting what we paid and what the outstanding reserves are. We have to post security in the amount of 135% of that reported figure in either the form of a surety bond or in a letter of credit. The Office of Self-Insurance Plans makes sure there is sufficient funds available. There are several situations where employers have gone bankrupt and those claims are now administered by the security fund (Self-Insurers Security Fund) who contract with another administrator to handle the claims.

F. I'm interested in the underlying basis for making the decision to self-insure. Is the severity of the claims the driving force in making that decision or are there other factors?

SPIEGEL: I would say that severity is definitely a concern. It is more likely that one will self-insure if you have a good history and good predictability of your losses. Our industry tends to be high frequency, low severity.

The decision to self-insure: I would say generally, you have to be of a certain size, there are some minimum administrative costs that go along with it. A common rule of thumb is that if you are generating close to a million in premium you should probably at least look at it. There are administrative costs involved although I don't believe they're as significant as the expenses of an insurance premium. If you are a firm that only has a few locations in one state, it might

not be worth it to self-insure in that state. I'd say probably the reason to consider self-insurance, or one of the reasons I have, is to get better control over how the claims are paid, how they are investigated, to be sure that you can manage your money as effectively as possible. The claims administrators are required to follow the labor code.

G. What kinds of changes would occur in the workers' compensation system that would provide incentives for a self-insured to reenter the insurance market? I mean in the rate structure mechanisms, administration.

SPIEGEL: Increasing the loss sensitivity. Increasing the ability to be able to make sure that you only pay for your losses and to be able to minimize the expenses. Perhaps unbundling some of the services that are currently included. When you're dealing with self-insurers, you tend to be dealing with a somewhat larger company that may have additional resources available or safety people of their own. I'd say greater sensitivity to your own loss patterns -- I believe there are now some limits on what was called paid loss retro, retrospective plans which used to be available in California where you reimburse the insurer on a pay-as-you-go basis rather than on an incurred-as-you-go basis. Those plans have a lot of incentive for a large company, and several years ago we had those kinds of plans outside of California.

H. You mentioned the cash flow benefit. It seems most large employers would prefer to have their dividend up-front rather than wait for the dividend -- that is, have a lower price. When you talk about cash flow benefit, what are saying? When you speak of the other benefit to you of better control, and you hire a claims handling firm, how does this differ from working through an insurance company? Are you saying you have a closer relationship with the claims handling firm, than you would with a claims person at an insurance company?

SPIEGEL: Yes. Most third party administrators (TPAs), claims handling is their only business and it is in their best interest to make sure they're doing the best administration possible for the price. We can set the parameters with the claims administrator. We can tell them we want to be notified of a claim, we want to receive a copy of correspondence, etc. I think this gives us a better ability to insure that employees are dealt with in a fair way. There is much more of a view that you're spending the companies' money rather than the insured's money. A self-insurer may have a particular claim they want aggressively pursued that economically, in the insurance companies' view may not be in their best interest to do so. But we have the right to do that. Conversely, we may wish to bend over backwards and try to help somebody if we think there is a particular problem. Its more of a direct relationship.

I. I believe you said at the time of Lucky's decision to go self-insured there was a $10 million premium?

SPIEGEL: I wasn't there.

J. If you currently use a claims processing firm, is there another step there where it becomes economical beneficial to start it yourself, start doing it yourself, or is that more of a philosophical decision?

SPIEGEL: I believe it's a philosophical decision. You need claims staff, you have to have a very specific information system, claims administration system to handle the claims and you need to have management that cannot be shared as overhead with other administrators.

K. Do most companies that could self-insure do so?

MARKEY: It's very difficult to answer but I would have to say probably no, for a variety of

reasons.

L. Is your organization voluntary?

MARKEY: C.S.I.A. is a voluntary organization of both public and private self-insured employers. I also manage the self-insured security fund (S.I.S.F.) and that is not voluntary.

M. What is the gap? Are most people members of the association and not just the fund or ...

MARKEY: Everyone that is in the private sector is a member of the fund. A small percentage of those that are eligible belong to the association directly or vicariously through their third party administrators or through other organizations.

N. What is your feelings on the spread between those organizations that use claims handling firms and those that do their own?

MARKEY: If we take the private sector, 80% are third party administered and 20% would be self administered. Generally, the very large tend to be self administered.

O. Are there a dozen administration firms or how many?

MARKEY: Between 75 and 85 administration firms ranging from a one person operation to a large insurance company that has subsidiaries.

P. How much movement is there in and out? Do people go from purchasing insurance to self-insurance and stay, or do they move back out?

MARKEY: There's very little movement. Once in, unless they make a unique purchase to sell off liabilities or losses, they tend to stay in. There are some situations where there are multistate operations and they drop out because of leverage buyouts, or merge with a company that is insured. So you have a full range with very little movement.

Q. Can you speculate for a multistate company. Do they tend if they're self-insured to be self-insured every place they can be?

MARKEY: There are some who are self-insured in other states but when they look at California, its not the most friendly climate to be self-insured, or insured, for that matter. Its the cost drivers where its not necessarily the method of coverage. Generally, when there is a philosophical commitment to self-insure, its followed through in those areas where the action is adequate enough to support self-insurance.

On the financial end it might take a while to decide if your going to be self-insured and it may be a very significant decision. Once there is a commitment by top management to self-insure then they get into the philosophy of controlling their costs. One of the things Ms. Spiegel was pointing out, is that self-insurance gives you an option to call the shots rather than be there and let the carrier call the shot as to compensability or method of claims handling.

R. From your perspective, how does the price equilibration mechanism work between self-insured and insured? What type of discipline? Do you bring a discipline to the marketplace and if so, how does it work?

MARKEY: I really don't know -- I think that is more of a broker point of view. I deal with self-insurance and we don't sell it. I will explain it to anybody who is interested but we want only

those who are committed for the right reasons to become self-insured.

S. So you have no observations with respect to the discipline of people selecting to be self-insured assuming they're the right size?

MARKEY: No I don't. I suspect that when Ms. Spiegel was pointing out the importance of your study of aggregate excess she mentioned that one of the reasons that this was prohibited in the early development of workers' compensation was to avoid mechanisms of competition and so they prohibited the rights of agents and brokers etc. to talk about aggregate excess. I don't think it has any bearing on the cost in the insurance community at all. I don't think its a good product personally, based on my own years of experience. From my point of view I would like see an option that can be rejected if there is a desire.

T. I gather you're suggesting we have two trains in the night passing each other.

MARKEY: Pretty much. We are heading in the same direction in the sense that we are faced with the same cost mechanisms and we have concern about the utilization of benefits. But these apply to both self-insurers and insurers. The difference is only in the pricing mechanism.

U. Is there any private sector equivalent to a joint power agreement in the public sector?

MARKEY: No. Not in the self-insurance community. There is group insurance for like organizations of like industry but not in self-insurance. There is in other states.

V. Could there be or should there be?

MARKEY: It's an option I would like to see. It would be very tightly controlled as far as who could participate. As a representative of the Self-insurers' Security Fund, I wouldn't want to do it unless there was the option of aggregate excess insurance, but with perhaps a base potential retention level. The base retention on specific excess is any claim exceeding $120,000. If you went aggregate excess, it would have to be considerably higher then that to make it feasible.

But group self-insurance in the private sector, without aggregate excess, would be rather dangerous.

W. Mention was made this morning of the Security Fund. Is that a recent development and how did it come into being?

MARKEY: In 1983 and '84, Cal Canners went bankrupt. There were 300 employees who had been receiving benefits, including medical treatment. There was a deposit of $2.129 million and there was a question as to who this money could be paid to. Self-insurance was getting some bad press and so the Self-Insurer's Association developed a bill, had it passed through the legislature, to stand in the shoes of the bankrupt self-insured employer. The Fund received the deposit and we provided the benefits. In 1984 it became effective, and since that time there have been 29 companies in their history that were self-insured, that we are now administering claims for. Some of them, I think one is a cab company that went bankrupt, still has 2 claims. There is specific excess insurance that is still paying off on that one and there is still residual left in the surety bond, but there is no coordinating force, so the State has asked us to assume the liability.

There are others where recently a letter of credit was denied by the bank and in order to make sure that no employee was going to be deprived of benefits, the State assigned the liability to the Security Fund. The Fund started flowing benefits within 30 days, and so employees are

getting all the benefits to which they are entitled. The self-insurer community set it up to insure that the integrity of the right to self insure was kept in tact.

X. You're satisfied with this system the way it is now, or do you see it as having the potential of being overburdened?

MARKEY: As to a system, no. I am overburdened, but I always have been. I have six third party administrators doing the work under our direction, which includes a board of seven people. The potential is there. We are going to have to issue another assessment -- the 4th in six years. Its affordable and it's a far better option than letting employees go without benefits.

Y. As a self-insurer, what proportion of my payroll might I project into the future I might pay the Security Fund?

MARKEY: The maximum in any one year is 1.5% of the claims costs, or the benefits paid in the prior calendar year. It need not be an annual event as far as the assessments go. We have an assessment when we are actuarially directed to or by the Board, and we make our determinations based upon input on the status of the cash available to us at the time, and the payout potential.

Z. There is a safety incentive because my tax to the Security Fund is based on the benefits that I paid last year?

MARKEY: Correct.

AA. You said that your organization also includes public agencies -- do they tend to self administer?

MARKEY: I would say that probably more than half are handled by third party administrators. Just the very large and very early ones are self-administered.

AB. You indicated that the requirements on the part of a public agency are not as stringent as on a private agency. Does this lead me, as a public employee, to be concerned about the ability of my agency to meet its potential obligations?

MARKEY: I would not be at all concerned about your agency since the State is supervising. They send out questionnaires, develop data, to more effectively manage the public agency programs. The difference between a corporation and a public agency is the taxing potential and the sources of money a public agency has at its disposal. Some investigation has gone on to find out the level of funding and what percentage of the funds might be "raidable", but I am not aware of any grave concern at this point. The big difference is that the private sector has to make a profit and stay in business, whereas the public agencies don't worry about going out of existence.

AC. It seems unlikely that there is anything in the rate mechanism itself, outside of the rates going to zero, that would change the decision of self-insurers to self-insure. Rather, it is a commitment based on size, control, cash flow, philosophy, etc., and minor changes in the rate structure would not move large numbers of self-insurers back into the insurance market.

MARKEY: I can't envision a mass exodus from self-insurance towards an insurance mechanism -- short of some very dramatic findings of this Commission and the adoption through an extensive process of legislation.

14.16.6 WRITTEN MATERIALS PROVIDED

No written materials were submitted by these witnesses.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESSES WHO AGREE THAT THIS IS A FAIR REPRESENTATION OF THEIR TESTIMONY.

14.17 SUMMARY OF TESTIMONY

INDEPENDENT INSURANCE AGENTS AND BROKERS OF CALIFORNIA TESTIMONY OF: ROBERT LEVERING

14.17.1 SUMMARY OVERVIEW

Mr. Levering testified as a representative and member of the Independent Insurance Agents and Brokers of America (I.I.A.B.C.) and shared his unique perspective as a broker.

His testimony focused on the service provided by the broker to employers looking to place their workers' compensation insurance. He believes the focus has shifted away from dividends and is now on the services a carrier provides, such as loss control or better claims service.

He cited areas where a broker can impact experience rating to include: (1) explaining how the formula works; (2) monitoring claims handling; (3) loss prevention; (4) experience modification recomputation; (5) verifying proper classifications; (6) special claims reviews prior to the unit statistical report; (7) final audit reviews; and (8) dividend claim reviews.

His association supports the minimum rate law and is opposed to a monopolistic state fund which he fears would bring more harm than help.

14.17.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to the Commission.

14.17.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	3
Loss Control	2
Availability of Insurance (Market Availability)	3
Minimum Rate Law	2
Safety Incentives	2
Appropriate/Expeditious Claims Service	2
Broker's Role: Commissions/ Marketing	3
Dividends	3
Exclusive State Fund: Advantages/ Disadvantages	3
Job Classification/Classification Rating	2
Political Manipulation of Rates	1
Rating Bureau Functions	3

14.17.4 SUMMARY OF TESTIMONY

Testimony was received from Robert Levering who is an independent insurance agent from Sacramento, California. He is also the workers' compensation chairman for the Independent Insurance Agents and Brokers of California. The I.I.A.B.C. is a California based trade association which represents approximately 12,000 agents in California. Effective January 1st, 1990, the Workers' Compensation Reform Act was passed. Mr. Levering indicated the cost-cutting mechanisms of that bill didn't come into place until January 1st, 1991, and many employers will tell you that they are not in place at all at this point (April 9,1991). Many of the administrative mechanisms to achieve cost cutting are not yet in place.

Mr. Levering indicated that from his standpoint as an independent agent the best thing they have seen from the Reform Act is a platform wherein all participants of the system are talking about what needs to be done in the future to reform it.

A. ROLE OF THE INDEPENDENT AGENT.

Mr. Levering indicated that his focus today is on the role of the independent agent in the placement of workers' compensation insurance in California. Mr. Levering said he thinks there have been some real changes in the last few years and many independent agents now sell workers' compensation insurance based on the strengths of the American Independent Agents insuring company's strengths.

In the past, the sale of workers' compensation was based on dividend projections. That was shortsighted and he thinks many employers are recognizing that a dividend is not the most important element in the workers' compensation system. Mr. Levering thinks it is important to know that workers' compensation dividends are not guaranteed and when an employer receives a piece of paper which indicates what the insurer thinks they might be able to return, that is not guaranteed. Mr. Levering thinks the real price of workers' compensation is not comparing one insurer's projections of what they might return to the employer versus than others.

Mr. Levering thinks the key issue that many insurance agents talk about today is the "net cost" of the workers' compensation product to an employer. The key issue is what they receive from their broker or independent agent. Mr. Levering feels that the American Agency companies are uniquely qualified to assist employers in placing their insurance.

B. STEPS TO HELP EMPLOYERS WHEN PLACING INSURANCE.

Mr. Levering indicated that there are key elements that are involved in assisting the employer to select the appropriate carrier based on the services that carrier can provide. As an example Mr. Levering cited better claims service via low case loads for examiners, faster response by examiners which reduces litigation, returning the worker to work more promptly, etc. Mr. Levering indicated the second area is in terms of providing loss control services. Mr. Levering discussed SB 198 which will require employers to be more diligent in terms of their loss prevention efforts and they could go to jail if they don't. Mr. Levering stated he feels that the agency companies may be more expensive but that shouldn't be where the emphasis is placed.

Mr. Levering went on to explain that when he talks about net costs to the employer he is talking first about what is paid at the front-end. He believes that the experience rating process is dealt with between agents/brokers and the insured on a much more regular basis than in the past. Mr. Levering indicated that an independent agent can impact experience rating by explaining to employers how the process works, to explain the mechanism and formula.

The second area where the broker can assist is in monitoring the claims handling that the carrier provides.

The third area is loss prevention and what is being done to assist the employer in that area.

Another area is experience modification recomputation. If there is a subrogation recovery there is reason to recompute the experience rating. Other reasons could be "take nothing awards" or clerical errors.

Mr. Levering indicated that proper classification is another area that agents become involved with to assure that the employees are being reported in the lowest possible rating classification appropriate to the business.

Another way of assisting the employer involves special claims reviews at the time a unit statistical report is going to be made to the Rating Bureau. What gets reported to the Bureau is the reserve on the claim, not what has actually been paid, and that goes into the experience rating computation which affects the mod for three years.

Mr. Levering stated that dividend claim reviews are also important. Another area involves final audit reviews.

Mr. Levering indicated that they have clout with the insurance companies by being able to say "if you're not doing the job, we will get somebody that can do it".

C. THE STATE OF THE INSURANCE INDUSTRY AND SELF-INSURANCE

Mr. Levering went on to discuss The State of the insurance industry in California. He stated that there are 300 private writers of workers' compensation in California. 41 of them write approximately 80% of the premium. Another unique aspect of California is that 12 of those 41 companies are workers' compensation specialty companies. In 1989 State Fund controlled 23% of the total premium of the 77% of the remaining market, 90% of that is with American Agency companies and 10% are with direct writers.

Mr. Levering also discussed self-insurance and indicated that there are some 2,000 public self-insureds and around 461 private self-insureds.

D. EXCLUSIVE STATE FUND: ADVANTAGES / DISADVANTAGES

Mr. Levering went on to touch on the concept of California as a monopolistic state. Mr. Levering indicated that the independent agents do not think that would be a cure but could make the situation worse. He went on to cite the 13 competitive state funds in the U.S. and 6 monopolistic state funds. He indicated in the past, Pennsylvania, Arizona, Oregon, New York and West Virginia have all raided their state funds of surplus to supplement their general funds. In 1987 the Ohio state fund had a $2.7 billion deficit and Montana had a equal problem.

The I.I.A.B.C. did a study on monopolistic state funds called "The Future One Report". One of those conclusions indicated that few state funds have the personnel to provide high quality safety and loss prevention services to a large number of insurers or to provide the claims administration services that are crucial to serious workers' compensation cases. Mr. Levering believes that has been his experience in California and on behalf of the I.I.A.B.C. would strongly oppose a monopolistic state compensation insurance fund.

Mr. Levering went on to discuss the situation in Oregon which five years ago passed a "file and

use" rating system. Most of the private writers in Oregon withdrew from the state and there are so few private insurers in Oregon now that there is really little or no competition in workers' compensation in that state.

E. DIVIDENDS

Concerning dividends, Mr. Levering stated that they are in the decline in California. Pure loss ratios are on the rise. State Funds' 1989 pure loss ratio was 82%. Mr. Levering believes that is due in part to the history of the rate request versus the rates that were granted. He pointed out that not all rates requested were approved in their entirety for a number of years. The I.I.A.B.C. is in favor of the decreased emphasis on dividends.

F. THE RATING BUREAU

Mr. Levering stated that workers' compensation is social insurance, is state mandated and the benefits are mandated. The I.I.A.B.C. supports the minimum rate law in the state. The last point Mr. Levering made concerned the Workers' Compensation Insurance Rating Bureau the I.I.A.B.C. strongly supports the W.C.I.R.B. in California believing they are accurate and efficient and respond to problems concerning class codes efficiently. The I.I.A.B.C. does not think they should be replaced with a government agency.

This concludes the testimony of Robert Levering.

14.17.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of the questions and answers raised by the Commission following Mr. Levering's presentation:

A. I gather you're happy with the present system?

ANSWER: There are inefficiencies, but most of them have to do with those people that serve the system, attorneys, doctors etc.

B. When you place insurance with a particular company, what goes into your determination -- how do you select an insurance company -- what factors influence you?

ANSWER: It depends on the need of the employer. If an employer has claims problems or loss control problems he would need a carrier with more to offer on the service side. Also some companies wouldn't write that particular insured at all. It really depends on who you're talking to and what their needs are and what the company can provide.

C. It's dictated primarily by service, not by price?

ANSWER: Price is only an after-the-fact type of situation. You have to wait 10 months to a year and a half after the policy expires in order to receive a dividend. The trend in California is towards more service.

D. You seem to imply that you would prefer not to have so much of the total premium rebated in dividend, you would like price up-front. Is that the case?

ANSWER: We favor the minimum rate law but we do favor squeezing whatever redundancies there might be in the rate. The minimum rate law has made it possible for there to be 300

private carriers to write comp in the state. Some say that this minimum rate law guarantees a profit to insurance companies. If you look at the nine month results in 1990 of the major writers in California that disputes the fact they are guaranteed a profit under a minimum rate law. Some carriers select their risks carefully and select their market segment carefully. Some carriers like to do a rehab job -- they find an employer and train them how to operate better and reduce their losses. Then the insurer who has helped drop the mod does not want that account anymore and the broker must move it to a carrier who is less service- intensive.

E. You really don't think State Fund should be satisfied with 23% do you?

ANSWER: I think that is a perfect number for them unless it was 15.

F. We have heard from at least four or five people giving testimony that a principal danger of an exclusive state fund is it's susceptibility to raids by the Legislature. Why is an exclusive state fund more susceptible than a state fund in competition?

ANSWER: I'm not sure I'm qualified to answer that question. I think either of them could be susceptible to raids by the Legislature. I think our own state fund in the 70's was in poor shape and workers' compensation rates were raised. One of the reasons State Fund is in good shape now is that when rates were raised there was a redundance in the rate and it reaped the benefits of that. When rates were the highest the fund was paying low dividends. If you look at the State Funds' historical performance over the last few years you'll find in their statutory filings that they paid their dividends out of investments income.

G. When you say independent what you mean is, not tied to a particular insurance company?

ANSWER: Correct.

H. Yet you also indicated that your company is fortunate in having many to choose from. I guess the suggestion is that a company, a particular broker, is tied to some group of companies in some way?

ANSWER: An independent agent, depending of his volume of workers' compensation can attract more companies than an independent agent who does a small volume. Obviously, the carrier looks for some degree of volume from their producers.

I. A small broker is probably working with two or three companies in placing all or most of my business with one of those companies?

ANSWER: Possibly, yes.

J. Is it typical for a brokerage to specialize – within the business areas as opposed to personal, large business versus small -- specialize on the basis of a particular industry?

ANSWER: Yes, we have three producers in our office that won't write anything but workers' compensation.

K. Does your own firm specialize in some size of client or a particular industry?

ANSWER: We try to look for larger employers.

L. Back to my hypothetical catering company, if I were in Sacramento and decided to start a company with three or more employees and I came to you, would you tell me that your clients

were a little larger than me?

ANSWER: Probably not.

M. It's more likely that you wouldn't come looking for me but that if I walked in the door you'd be nice.

ANSWER: Correct.

N. Of the twelve or so insurance companies you work with, how many of them would listen to you if you tried to take me to them?

ANSWER: I'd probably take your comp to a company along with your other lines of insurance, tie the two together to get as much premium volume and make your business insurance as attractive as possible.

O. Under what circumstances would you tell me to use State Fund?

ANSWER: After trying and failing then we are going to send you to where we know you can get insurance.

P. How much movement is there with an established client from workers' compensation carrier to carrier?

ANSWER: Quite a bit. There is a lot of competition in the workers' compensation marketplace. The bottom line is that the discussion becomes a combination of insurance company's service and broker's service. Our renewals are subject to competition.

Q. We have a lot of testimony regarding the dividend as a safety incentive. Do you see things such as the experience rating as strong a safety incentive as a dividend that you get back at the end of the period?

ANSWER: Very much so. I purchase workers' compensation myself and would rather have a 70% experience rating and get a 30% discount then get 30% back a year and a half after the policy expires. It's more a matter of continuing to educate employers about the dividend concept. Dividends are paid out of surplus and if a surplus isn't there, dividends can't be paid.

R. Do you have any feel for the proportion of your clients that receive dividends?

ANSWER: Some of my clients have received dividends in the last couple years. In the last couple of weeks, some clients, none over $30,000 in premium, received dividends; one received close to a 20% return, others less. So it is still happening, but not to the same degree it used to.

S. Are you yourself or your company involved in safety groups?

ANSWER: Yes, but mostly company safety groups. I dealt with the concept of a group in a previous direct writing situation before I got into agency business. Group programs work best if you do not have a degree of difference between members in their premium size. So if there is a lot of similarity between group members, a group makes good sense. Group programs work well for small employers.

T. If I came to you with my catering company, could you find me a group?

ANSWER: I don't think I could find a catering group.

U. There's no master index anyplace that tells you where to look?

ANSWER: No, there is no master index. You must go through information from the various comp companies and see if there is one in that particular area.

14.17.6 WRITTEN MATERIALS SUBMITTED

Written materials were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEW BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.18 SUMMARY OF TESTIMONY

TESTIMONY OF: DR. DAVID APPEL

14.18.1 SUMMARY OVERVIEW

Dr. Appel returned to the Commission to discuss the results of research which he had proposed earlier when he gave a presentation in conjunction with the Association of California Insurance Companies and Tom Conneely. The focus of this technical presentation was to explain his methodology and findings.

14.18.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to the commission.

14.18.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Dividends	3
Profitability	3

14.18.4 SUMMARY OF TESTIMONY

Dr. Appel gave additional testimony concerning the results of his earlier research. He began by indicating that at the last meeting he spoke as to what types of issues could be addressed using standard research methodology. Dr. Appel took exception to testimony received from Tom Brown which indicated that workers' compensation was unique and standard economic models did not apply. Rather, Dr. Appel believes that economic methods and economic models can be applied to workers' compensation and he indicated that he has spent much of his career trying to do that.

Dr. Appel began by discussing what he had talked to the Commission about at the last meeting and indicated that the Commission's mandate was extremely broad including a number of objectives that relate to the entire workers' compensation system not only to the rate-making. Dr. Appel went on to indicate that to control medical costs says something about incentives to control costs although the rate-making system has little to say about it. However he said there are several things that the rate-making system has a direct bearing on and indicated there are several goals stated in the digest of charges for which rate-making has a lot to say. He believes these have to do with creating financial incentives for safety, providing an equitable distribution of costs and providing for a fair and reasonable rate of return.

Dr. Appel indicated that these things are objective and can be directly effected by the rate-making system. Dr. Appel had previously indicated that he would complete two studies that would address several of these objectives and he has done so. His focus today is to report on the results of those studies as well as the description of the methodology that is contained in the document that he provided to the Commission.

Dr. Appel stated that there were two things he believed they could do: (1) Evaluate the historical profitability of workers' compensation in California, and (2) evaluate the equity aspects of dividend payment

in California.

A. PROFITABILITY ANALYSIS

Dr. Appel indicated that to the extent that rate-making can create an environment which makes workers' compensation insurance available, affordable to employers, it should create an environment where it provides for insurers the opportunity to earn a fair rate of return. He went on to state that rate-making itself should set prices such that the expected returns are fair and reasonable. He compared this to the public utility approach to rate-making (setting a target cost of capital, evaluate the prices, determine a set of prices which yield a return, and expect a return equal to the cost of capital.)

He went on to state that if you want to evaluate how the system has performed in the past you should do a retrospective analysis, and you don't need to do a prospective analysis. He acknowledged that this was a retrospective analysis and explained that it calculated. He referenced Professor Van Horn's text which indicated book returns on book equity might not be the most desirable metric but one can't really observe market returns on market equity because there are so few publicly traded insurers, and the ones that are publicly traded don't write workers' compensation exclusively in California.

Dr. Appel went on to describe how the study was done, the details of the profitability analysis in insurance and then described his conclusions.

Based on the data source he had available which was from the Workers' Compensation Insurance Rating Bureau, the returns on net worth on property casualty insurers who write workers' compensation in California averaged 11.1% over the last decade. If you rely on data compiled by A.M. Best Company you would calculate a 13% return on equity, or net worth, and that is returns on G.A.A.P., estimated equity, not statutory surplus, as calculated on the insurance annual statement. He compared that with the S & P 500 book return of 12.6% and Forbes' all industry return of 13.7%, for comparison purposes.

Dr. Appel explained how he calculated rates of return or profitability. He said you calculate the difference between total revenues and total costs and divide by some metric for equity and you have a rate of return on equity. He explained it was difficult to calculate a rate of return for a single line in a single state because most insurance companies are multiproduct firms who write multiple lines of business in multiple states. He went on to discuss the manner in which the calculation of total revenues and total costs was conducted. He felt the distinction (the way in which income was segregated from three sources) was artificial although there was a history as to how it was done. He indicated that if you wanted to consider the returns from undertaking the risks of insurance you could look at income from underwriting plus the income from the investment of reserves which would give you income from the total insurance operation excluding your own equity. In the alternative you could look at the whole picture or calculate the total return. That is what Dr. Appel has done in his study. Although he indicated he began by segregating the three separate sources of income as had traditionally been done.

Dr. Appel went on to explain the two step process used to convert the underwriting term to a return on net worth and explained the two step process. Dr. Appel indicated that the report describes his steps in that process and referred to the tables for reference purposes. He indicated the first table was based on data from the W.C.I.R.B. and the second was based on non-W.C.I.R.B. sources. He then explained the information to be found under the column entitled "underwriting result." Dr. Appel discussed the second piece, which is investment income from reserves. Dr. Appel also brought attention to Dr. Schaefer's question about the cash flow benefit from insurance underwriting. He indicated that part of this benefit is this portion of

investment income that is earned because you hold premium revenues before you make payments of losses and expenses.

The discussion continued with Dr. Appel discussing the insurance convention blank, the annual statement that is required to be filed by all property casualty insurers with every state insurance department in which that company operates and which prescribes a method for allocation of investment income to lines of insurance. Dr. Appel explained that method. He felt there were a couple of details which were particularly arcane and cited the most meaningful is that the annual statement implicitly assigns different assets to different activities. He felt it was important because when you assign investment income to the lines of insurance you assign only the income that derives from bonds, real estate, and other asset items to the lines of business and you assign all capital gains and all dividend income from stocks to capital and surplus.

His findings reveal that workers' compensation insurance in the aggregate countrywide received $3.7 or $3.8 billion of investment income according to this allocation process. As far as California goes, they estimate that California accounted for 16% of workers' compensation reserves countrywide and so he took 16% of $3.8 billion dollars of investment income and assigned that to California and then divided by California premium in 1989 which amounted to 10.9% of premium. He compared this to workers' compensation investment income per dollar of premium countrywide which is a figure of 13.4%.

He explains the difference. In workers' compensation statutory benefits provisions vary dramatically from state to state so coverage and claims settlement patterns are not the same in different states. He stated that the average holding period in California was about 3 1/3 years where as it is roughly four years countrywide. Dr. Appel indicated you would expect California investment income to be lower than countrywide income because you are holding money for a shorter period of time. He added that California accounted for 16% of countrywide reserves but 19 1/2% of countrywide premium indicating that California has smaller reserves relative to its premium than countrywide. Dr. Appel concluded that California will have a lower income investment per dollar of premium than you would observe countrywide and that explains the difference between the 10.9% and the 13.4% figures.

Dr. Appel went on to discuss the third piece which is investment income from capital and surplus which also requires an allocation. He explained his approach to that allocation. In Dr. Appel's opinion allocating surplus proportional to the liabilities in the line of business as a more sensible basis for allocation and those liabilities include both loss and loss expense reserves and unearned premium reserves. Dr. Appel acknowledged that there has been a lot of dispute about the proper basis for the allocation of surplus. He acknowledged that and explained his approach to this problem. He clarified that they allocated surplus proportional to liabilities. California workers' compensation accounts for 3.07% of all insurance liabilities countrywide, all lines. Consequentially California gets 3.07% of surplus and 3.07% of the investment income on surplus. Dr. Appel then referred to his chart again under Roman numeral III.

Dr. Appel went on to state that as a second matter, moving from returns on premium to the returns on surplus and then on equity, allocating 3% of total countrywide surplus to California and then taking that number and dividing it into premium, suggest that California premium-to-surplus ratio is 1.56. Dr. Appel felt that made sense because California's workers' compensation is producing a higher than proportionate level of reserves. He then directed the Commissions' attention back to the underwriting results. He discussed the early years and the pretax underwriting result for those years. He discussed the tax reform act and the specific provisions of the tax reform act that apply to property casualty insurers (discounting of losses or loss reserves for tax purposes). A specific discussion followed concerning the 1986 tax reform act and what it required property and casualty insurers to do (pate 152 of the transcript).

Dr. Appel then discussed to get a return on net worth, one has to adjust that amount for the premium-to-surplus ratio and then adjust it for the fact that statutory surplus is less than G.A.A.P. net worth. He then explained the steps in the process to do that.

B. STATUTORY VERSUS G.A.A.P

Dr. Appel went on to discuss the difference between statutory and G.A.A.P. accounting. He indicated that statutory accounting is extremely conservative. It means that certain assets are excluded from consideration under SAP that would be included in G.A.A.P., the biggest of which is deferred acquisition costs and non admitted assets, and he defined those two terms.

He went on to state that his firm made conversions based on industry-wide aggregate data for all those factors. The result was that G.A.A.P. net worth (equity) is roughly 20% greater than statutory surplus.

Dr. Appel then indicated that the return of 9.32% on surplus (which he referenced in his step by step process of calculating premium-to-surplus ratio) amounts to a 7.8% return on net worth and he indicated this is the process that they used in each year for both data sets in tables 1 and 2. He then explained the last line in the total post tax return on net worth.

He then discussed the data in the second table which included the same calculations but using non-California specific data. Concerning that data he pointed out the difference (the A.M. Best data is almost 2 percentage points higher on an unweighted basis) are explained or two thirds of that difference is explained by loss adjustment expenses in California versus average lost adjustment expenses countrywide. Dr. Appel stated the remainder are difference in reported losses. He thinks that difference in loss adjustment expenses is about 1.6% percentage points of premium. Dr. Appel believes the reason is that California has a system that is more litigation oriented than most states.

Dr. Appel went on to state that to use the A. M. Best countrywide data to represent California is a serious mistake because the data from the rating bureau reflects California specific adjustment expenses and is more precise and germane, and also consistent with at least my priors. He summarized that explains most of the difference. The other differences are on other expense items and a small difference in dividends. Dr. Appel stated that to the extent the rates of return are on average below what public utilities have been allowed in California, one would think that these were not excessive. As to whether they had been fair and reasonable and whether the rate-making system met it's objectives of providing a reasonable rate of return that question he deferred to the Commission. However, he stated that in his opinion they were certainly not excessive. He also indicated that there is an availability of state specific data which is different from the data available in other states and he believes to the extent that the rate-making system provides for a mechanism like the rating bureau to do precise data collection, it does an extremely useful service particularly for evaluating these sorts of issues.

Dr. Appel pointed out one item concerning the profitability study. He referenced table 1 concerning dividends to policyholders. A discussion followed interpreting some of that data (see page 167 of transcript).

14.18.5 ISSUES DISCUSSED FOLLOWING PRESENTATION

The following is a summarization of questions and answers raised by the Commission following Dr. Appel's testimony:

A. On your profitability estimates, have you shared these figures with the industry or have they been shared previously with the industry?

ANSWER: I made copies available to the sponsors of this study.

B Have you got any questions as to bias in your results?

ANSWER: If we want to pick holes at these estimates, the places people go are the premium-to-surplus ratio and the allocation of surplus question itself.

C. Would the results have been different if we had used the standard rule of thumb (two-to-one premium-to-surplus ration, or three-to-one) which some people allege is an appropriate value?

ANSWER: Yes, because these years, on average, have earned positive returns and the results would be better. They would be higher if you had a higher premium-to-surplus. Other people would go at the statutory to G.A.A.P. net worth conversion and some might allege (I disagree adamantly) that statutory surplus is the best metric for owners' equity in insurance. I think that is an erroneous argument. There would be a line of argument which would say these expenses are excessive and insurers had no reason to incur these excessive expenses in the first place, a prop 103 voters revolt allegation. I believe insurers have every incentive to minimum expenses regardless of what the rate-making system is because they maximize profits when they minimum expense but I don't address the propriety of these expense loadings at all.

D. Property and casualty companies are subject to notorious cycles in profitability due to excessive underpricing and overpricing. Is this any different than a typical cycle?

ANSWER: The average property casualty cycle has been roughly six years historically, but the last one was much longer, about nine or ten years. This covers most of the last cycle. The workers' compensation cycle has been out of phase with the property casualty cycle as well, but this covers a period of time over most of the cycle.

E. Where would you say are the peaks and troughs in the last 20 years of cycles in workers' compensation?

ANSWER: The peak, as far as profitability, would have been 1980 or 1981. The workers' compensation industry countrywide has been in the trough for the last six years without any evidence of coming out of it.

F. When was the previous trough in the 70's?

ANSWER: Probably the mid 70's. (Dr. Appel went on to make a comment concerning the reasons why you find almost no jurisdictions in which domestic workers' compensation writers are willing to capitalize such as is done in California.)

G. There seems to be somewhat of an inverse relationship between profitability and the performance of the general economy. Is that just a coincidental observation or is there something to it?

ANSWER: If you just look at the real medical and indemnity costs, there is a connection between economic events and those costs but it not an obvious connection necessarily. (Dr. Appel gives an example related to unemployment rates increasing.)

Additional testimony by Dr. Appel continued on his dividend study.

Dr. Appel pointed out one item concerning the profitability study. He referenced table 1 concerning dividends to policyholders. A discussion followed interpreting some of that data (see page 167 of transcript). Dr. Appel concluded that the single variable model--dividends as a function of lag loss ratio explains 70--has a an R-squared of 73%, explains 73% of the variation. The coefficient is negative and statistically significant with a T of four and a half or so.

H. Two year lag?

ANSWER: One year lag.

I. Are dividends typically paid that soon?

ANSWER: No. Usually within 18 months but there are other members of the audience who know a lot more about this than I. I just ran LAG 1. I think LAG 2 would yield the same results but I didn't try it. The answer with an explanation about the dividend and historical loss experience related to them. (page 169 of transcript). Dr. Appel indicated that no other state compiles this sort of data. The aspect of safety incentives is one he infers from logic. He thinks empirical tests of that proposition are more complicated than the logical inference that one draws from this type of analysis. He believes this study suggests that dividends do promote equity in rating but only by logic does it suggest it creates incentives for safety. A discussion ensued concerning the manual rate established by the Rating Bureau, the plans that are in place in most jurisdictions and retrospective rating. Concerning retrospective rating Dr. Appel defined that term and then defined deviation and schedule rating plans. He indicated that those were the two traditional plans that are available in many jurisdictions, and in almost all jurisdictions there is a premium discount plan although California does not have one.

He went on to state there are other ways to adjust the economic price of insurance such as a waiver of deposit premium, etc. He indicated those plans are subject to rules and regulations by the insurance department. The other plans Dr. Appel mentioned, e.g., experience rating, premium discounts, etc., reduce the price before loss experience has materialized. He indicated there are two characteristics of individual insureds which are reflected in those plans. One is size of risks and the other is expected loss experience and as size increases because of the economies of scales and fixed costs in production process, there is reason to reduce the price for size alone. He indicated there is another reason why size would have significance and that is because the experience of larger risks is more credible.

Dividend Study

Dr. Appel then explained that in this part of the study they set out to study these hypotheses. Are dividends related to size? Are they related to expected loss experience? Is there any interaction between size and loss experience? (A general discussion followed concerning Dr. Appel's making available to the Commission the data sets and providing computer disks for their use. Dr. Appel referred the Commissioners back to table 1 under the 1983 California dividend. Dr. Appel continued his discussion. He explained how they tested that dividend model (page 179 of the transcript). A discussion followed concerning the models and the figures contained in the columns under models 1 and 2 and model 3. (Page 175-176 of the transcript.) Dr. Appel stated that these models were run on all the data--model 1 is a model which says dividends are a function of loss ratio alone and that is the only variable entered in model 1.

Questions and answers resumed at this point

J. Is that a lag?

ANSWER: No. The nature of the data set is that these were policies issued in 1978 and the dividend experience on those policies was reported. We are matching the loss experience by policy with the dividends paid on that policy. It's grouped, not by individual risk. The groupings can be seen in those data sheets and there is a data appendix which describes a little bit of the detail there. The first model is just run on loss ratio alone, the second on premium, the third on loss and premium both.

(A discussion followed concerning model 4 and the logic of adding the premium squared term to that model page 177.)

Dr. Appel referenced several graphs, which come after the three tables showing predicted dividends on different loss ratio. (Dr. Appel stated the interaction between dividends and loss ratio, between loss ratio and premium, or loss ratio and size is interesting. What is really being identified is whether the responsiveness of dividends to loss ratio, varies by size of risk.

K. Wait a minute--

ANSWER: Responsiveness of dividends to loss ratio varies by size of risks.

(A discussion followed concerning the first model.) Because loss experience is more credible for large than small risks. I would expect that as risk size increases, dividends should be more responsive to the loss experience of those risks. And so as it turns out dividends are more responsive to larger risks. I think that reflects some logic in how dividends are really paid. Dividends are retrospective adjustments based on the actual costs that were incurred under the policy, but they are also ways to retain risks in the company.

L. Your logic is clear. I am thinking about the question of when a company declares a dividend policy, generally talking about a more gross set of categories--.

ANSWER: You'll have to ask the insurance companies as to how their plans work. There is evidence in the data that these work particularly by virtue of the statistical significance of that interaction term which is highly significant. (In the testimony above Dr. Appel indicated the interaction term as identifying that dividends should be more responsive to the loss experience of large risks because large risk experience is more credible than small risk experience.)

Dr. Appel continued by stating that he concluded that these models indicate that the hypotheses

are borne out, that is, dividends are quite responsive to loss ratio. The average size risk and the average loss ratio, a 10% improvement in the loss ratio would give rise to a 7.8% improvement in dividends. Similarly, a 10% increase in size of risk at the average loss ratio would give rise to a 3.2% increase in dividends.

M. Did you say 7.2?

ANSWER: 7.8. That is based on equation 4 and equation 4 is evaluated at the mean size in the sample.

N. That is where you were getting that.

ANSWER: Right. The mean size in the sample is a $25,000 premium but the log of it is roughly 10. (A discussion followed concerning the variables and the data from 1978 policies and 1983 policies and the test as to whether the structural relationships have shifted over time. Dr. Appel also referenced table 2 which estimated the model for 1978 alone and 1983 alone and then estimated it combined. He then referenced table 3 concerning the magnitude of the change. (Pages 181 and 182 of the transcript.)

Dr. Appel stated that dividends have become more responsive to loss experience and to premium size between 1978 and 1983 which is not inconclusive with the increasing competitiveness in the workers' compensation business during that time. As the line becomes less and less profitable, there is more incentive to retain good risks.

O. You have nothing for the late 80's. Your data is limited to '83?

ANSWER: Right. These dividend studies were conducted for the 1978 and 1983 policy years. The graphs you have simply reflect the regression models. The fourth graph shows the market shares of participating companies which are the base for this study.

(A discussion followed concerning the fact the data used in the dividend study is divided by participating and non-participating companies and the participating one are the ones who have participatory dividend plans. The model referenced are run only on the participating companies.) Dr. Appel continued that the last graph shows the market share for the participating company exceeds 80% for all premium size above $10,000. In California you have small companies receiving dividends as well, a situation which is unusual compared to other states.

P. Is your conclusion that dividends then, are a reasonable pricing deice vis-a-vis more pricing up-front?

ANSWER: I think they certainly serve a purpose. Yes,. I would conclude that they work well here. Dividends in California are substantially higher than they are in any other state which is due because of the absence of premium discount in California. I think that these results are quite consistent with that.

14.18.6 WRITTEN MATERIALS SUBMITTED

Written materials were submitted to the Commission by this witness.

THE ABOVE TESTIMONY HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.19 SUMMARY OF TESTIMONY

CALIFORNIA APPLICANTS ATTORNEYS' ASSOCIATION TESTIMONY OF: PATTERSON FROZEN FOODS, INC.

14.19.1 SUMMARY OVERVIEW

Testimony was received from Paul Fanelli, a representative of Patterson Frozen Foods, Inc., a privately owned food processor located in the San Joaquin Valley.

Patterson Frozen Foods, Inc. is very concerned about the high price of doing business in California as a direct result of the Workers' Compensation system. Their projected premium this year will be $2 million to insure the workforce of approximately 850 employees.

Patterson Frozen Foods, Inc. has supplied statistics and graphs which indicate the following:

A. The number of frozen vegetable processors in California has dropped from sixteen (16) to six (6) in the last ten years.

B. The manual rate for their classification (vegetable and fruit processing - frozen) has risen from $8.75 to $18.70 per $100 of payroll - a 115% increase.

C. The cost of doing business in California involves paying from 30 - 350% more for their industry in Workers' Compensation premium than if they were in another state.

Patterson Frozen Foods, Inc. has raised several points concerning the effect of specific cost drivers on the overall rating system. These items are components of the Workers' Compensation claim for which dollars are reserved and, eventually, by which premium rates affected. Therefore, a closer look at the ways in which these items are handled could assist the Commission in its charge.

14.19.2 REQUESTS MADE TO THE COMMISSION

Patterson Frozen Foods, Inc. has asked the Commission to explore beyond the rate-making formulas and to address the cost factors involved in the rate-making system. It asks that the Commission recommend that balanced reform take place which will include benefit increases for the injured worker and resultant assistance in four target areas for employers.

14.19.3 MATRIX ITEMS DISCUSSED

Patterson Frozen Foods, Inc. focused on these key areas:

ITEM	WEIGHT ASSIGNED
Cost of Actual Operation	3
Cost Factors/Drivers	3

(Continued)

ITEM	WEIGHT ASSIGNED
Need for Workers' Compensation Reform	3
Job Classification/Classification Rating	3
Dividends	3

14.19.4 SUMMARY OF TESTIMONY PRESENTED

A. COST OF ACTUAL OPERATION

Patterson Frozen Foods, Inc. submits statistics indicating that its particular industry is leaving California due to the costly impact of Workers' Compensation. Specifically, the Company cites that the industry is impacted by low competition costs from areas outside California. That, coupled with the increase in the manual rate for its classification, results in a corresponding increase in its Workers' Compensation premium.

B. MANUAL RATE FOR CLASSIFICATION

Patterson Frozen Foods, Inc. indicates that the primary classification on which its insurance premium is based has risen 115% from $8.75 to $18.75 per $100 of payroll.

C. NEED FOR WORKERS' COMPENSATION REFORM

Patterson Frozen Foods, Inc. believes that the increase in premium is also directly tied to the cost of handling Workers' Compensation claims and believes that, even with reform legislation, it is "too little, too late".

The primary argument of Patterson Frozen Foods, Inc. is that the "cost drivers" of the system are allowed to continue unchecked and costs are skyrocketing.

D. COST DRIVERS

The majority of the testimony from Patterson Frozen Foods, Inc. centered around the effect of five cost drivers that it has identified. These are built into the Workers' Compensation system and thus factored into the rate-making system. The identified cost drivers include:

1. The unparalleled litigation rate
2. Abuse of the medical/legal evaluation system
3. An ineffective vocational rehabilitation system
4. The excess of mental stress claims
5. The unbridled medical (costs) inflation rate.

Patterson Frozen Foods, Inc. reviews each of these five factors and provides statistics to support its arguments that these five items are "wreaking havoc" with the Workers' Compensation system.

a. Litigation
This "no fault" system has resulted in one of every eight claims being litigated with an

average cost of $5,800 per litigated claim. These costs will only increase in the future. Additionally, once a claim is litigated, it requires a longer time period to return the worker to the job and finalize the claim.

b. Abuse of the medical/legal evaluation system
The role of the forensic medical expert has expanded, but the primary complaint is that the employer must pay for both the applicant and defense medical evaluation. The injured workers does not have to pay for any of these evaluations and there is no incentive to limit the number of evaluations that take place. If the employee does not prevail in his claim, the employer must still pay the cost of these medical/legal evaluations.

Patterson Frozen Foods, Inc. relies on statistics from the C.W.C.I. indicating that an average medical/legal expense of $1,200 per medical/legal evaluation. Although the new 1991 Q.M.E. process (enacted as part of the 1989 Reform Act) may help here, it is too soon to tell whether this will assist overall.

c. Vocational Rehabilitation
Patterson Frozen Foods, Inc. cites the rise of rehabilitation claim costs from three percent (3%) to thirteen percent (13%) of overall costs. Patterson Frozen Foods, Inc. does not believe that the reform legislation will help to modify or to reduce these costs. It does recognize that there is a small incentive for employers to provide modified work, but it is too soon to tell whether this will be effective.

Patterson Frozen Foods, Inc. also believes that the effectiveness of rehabilitation is questionable. According to statistics from C.W.C.I. at least seventeen percent (17%) of those injured workers participating in vocational rehabilitation return to their pre-injury work.

d. Mental Stress Claims
Perhaps one of the most volatile areas of Workers' Compensation, at the present time, involves the mental stress claim which may be the fastest growing injury/illness claim filed in California. Patterson Frozen Foods indicates that these claims account for more than $500 million in claim costs and provided statistical data to support the claim.

The Reform Act (of 1989) still has minimal standards to determine compensability for stress claims and something has to be done about the frequency of this type of injury.

e. Medical (Costs) Inflation
The last item identified by Patterson Frozen Foods, Inc. is the skyrocketing cost of medical care. This a major cost factor in the rate-making process since medical benefits comprise forty-three percent (43%) of the overall Workers' Compensation system benefits. While managed care can result in reduced costs, there is limited focus on reducing the frequency of utilization of these services.

14.19.5 ISSUES DISCUSSED FOLLOWING PRESENTATION

The following is a summarization of the questions and answers raised by the Commission following Mr. Fanelli's testimony:

A. Do you see a change, even a radical change, in the rate structure that might have an impact on these things, absent other kinds of reform?

ANSWER: One change would be less of a reliance on dividends. I believe the experience modification formula in California is a good beginning because it rewards people who focus on safety in the workplace. When our experience mod was 151% we took steps to lower it to 61% -- it took 12 years and it was difficult. Dividends, on the other hand, are really a function of the profitability of the insurance company.

B. I think it is true that claims adjustment costs, for example ought to be related to some of the issues you have brought up.

ANSWER: Certainly.

C. Two of the factors you think we could take a look at directly would be more reliance on up-front costing and/or experience modification and the expense loading?

ANSWER: The expense loading issue was addressed temporarily in the reform act. There is some minor modification to that and I am not here to report that insurance companies don't have the right to make a profit. However, it all should be explored.

D. The experiences that you unfold for us, are these experiences of your settlements under workers' compensation?

ANSWER: Yes.

E. You have had roughly how many in ten years, 40?

ANSWER: The 40 were for workers' compensation vocational rehabilitation. We average 120 to 130 claims per year.

F. Under workers' compensation?

ANSWER: Yes. The 40 were vocational rehabilitation.

G. How many were instigated directly to you vis-a-vis attorneys? Where does the process start?

ANSWER: In 1991, with the Reform Act, the process starts in the nurse's office or the personnel office when we give the employee a claim form. Prior to that, if anybody complained we would begin the paperwork at that time. About 20% of the notifications we got from claims at that point, (prior to the reform) were from attorney's offices and most were cumulative trauma disorders. We know we are guilty for some of the exposure on a cumulative trauma but we have had workers that have worked for us eight days, developed bilateral carpal tunnel syndrome and filed against us.

H. You mentioned that this happened prior to the reform act, have things changed?

ANSWER: Well since 1989 our rate costs have gone up 42%. That is the first thing that is changed. We know that the funding for benefits had to come and that the reform to pay for the benefits will come when some of the claims mature. We also increased our administrative expenses just simply to hand out this claim form and to make sure everything is done properly. We are an insured employer. We have an insurance company who we purchase our coverage through and they perform a lot of the administrative expenses for us, but I'm sure with the additional administrative burdens their costs will go up.

I. What in your view as an employer, does the minimum rate law do to your ability to do business

and provide coverage?

ANSWER: The minimum rate law effects us specifically in that it's a cash flow deterrent to us. Our experience mod is below 100, so because of the minimum rate law we have to pay 100%. We pay that all up-front or over the course of the policy period, and the insurance companies get to utilize that money. The dividend concept -- we'd rather see the rate lower at the front end and not have a dividend, or less of a dividend. The other problem we see with the minimum rate law is that we're in a classification that is shrinking payroll size. As our classification shrinks we come closer to unity in that experience mod.

J. A number of representatives from the insurance providers have stated that the minimum rate law is still highly competitive, including service. Is this your experience? Are insurers actively competing for your business and competing on the basis of offering you a better service.

ANSWER: We've seen a change in the people who approach us, the carriers that approach us. For the first 40 years, our company stayed with one carrier. We had a change a couple years ago based on retention and dividend schedule. Service was adequate but we decided to change because we didn't agree with the philosophy of the company. When we shopped for insurance we looked at the prime decision maker for us -- stability of the company. For our $2 or $3 million dollars we expect a lot and deserve a lot. Because there are other companies out there, we can tell our present carrier that we will leave them and go someplace else if they don't do their part to help us. We have looked at self-insurance because we are large enough to do so and have decided -- , the last time we looked was a year and a half ago, right after the reform act was passed. We decided the waters were too murky for us to take that jump right now.

K. You said other companies are willing -- are these companies coming to you on a regular basis?

ANSWER: Yes.

L. Do they come to you without you having to go out and inquire?

ANSWER: Yes.

M. Since you are apparently large enough or on the verge of being large enough to consider self-insurance what do you think of that as an idea, your ability to enter into a group workers' compensation agreement of some kind?

ANSWER: Our facility is set up that in addition to processing, we do some harvesting. The harvesting end of our operation is small and that group is in the farm bureau program. We found the experience for that isolated portion of our business to be very adequate (it's about 8%) in that particular group. The premium size is rather homogeneous. It's the same kinds of risks. In our particular size and particular kind of business, I don't believe we would be interested in getting into a larger group.

N. Could you cite two or three things that have made the most difference to enable your company to move it's loss experience from 150% to 61%?

ANSWER: The first and foremost was that management wanted it to happen. It became a priority and the money was there for the changes that had to be made. We began to make employees partners in this process and involved our collective bargaining and union in the process. We involved employees through incentive programs. We got loss control and ergonomic specialists in from the carrier to help. We provided employee assistance programs so the employee can deal

with some of the non-work related concerns rather than bringing them to work. We put together a mandatory drug testing program at the plant, a mandatory exercise program during the first ten minutes of the day. We took an aggressive stand with our workers' compensation carrier on quarterly claims reviews and held them accountable for how they set reserves. We decided to take an advocacy roll in proceedings like this because I think you can make a difference. Workers' compensation is our largest controllable cost. It is the one cost that can put us out of business so we have to maintain control.

14.19.6 WRITTEN MATERIALS PRESENTED

Written materials were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.20 SUMMARY OF TESTIMONY

WASHINGTON STATE FUND
TESTIMONY OF: MR. WILLIAM WHITE

14.20.1 SUMMARY OVERVIEW

Mr. White was a guest speaker at the July, 1991, meeting of the Commission. Unlike all other testimony received before this Commission, there was no court reporter present and a verbatim transcript is not available regarding the contents of this testimony. However, Mr. White provided numerous charts and handouts to support his presentation, and those are incorporated in this analysis.

The primary focus of Mr. White's presentation was the exclusive state fund for the State of Washington and a comparison between the rate setting system in Washington and that utilized in California.

14.20.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to the Commission.

14.20.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Exclusive State Fund: Advantages/Disadvantages	3

14.20.4 SUMMARY OF PRESENTATION

Mr. White is a Senior Actuary for the Department of Labor and Industries in the State of Washington. Prior to joining the State of Washington as Senior Actuary, Mr. White had functioned as a workers' compensation actuary in the State of California, thus he was in a position to provide a comprehensive comparative analysis of Washington and California. He provided a summary overview of the Washington program, which operates as an exclusive state fund. He also discussed the rate setting system utilized in Washington and compared that to California's system.

During the early 1980's, rate increases were half of what had been recommended. A new administration came in 1985 which was interested in reform. The fund was almost insolvent.

Several actions were taken. Vocational rehabilitation was changed from a mandatory benefit to a discretionary benefit, based on the Department's analysis of whether it was necessary and likely to benefit the injured worker. The "stress claim" was reclassified an noncompensable. Laws were changed as to the length of time in which a claim could be reopened. There was an extended social security offset on claims. In Washington, State agencies can self-insure.

Additionally, in 1988, benefit increases were enacted which doubled the permanent disability rate and

increased temporary disability dramatically (75% - 100%). Mr. White feels that at this point in time the fund is doing well financially.

As to experience rating, all employers, regardless of size are rated. At first it was thought that you couldn't experience rate small risks. If you have no compensable claims, this is your experience rating. To experience rate small firms, you need rate adequacy. The average experience factor is .908 rather than 1.0. The Rating Bureau is prohibited from having expense gradation. Insurers do rough justice with a dividend system. The experience mod is a motivator--at least politically--they all think they're getting a 10% reduction. There is no expense gradation in Washington. Retrospective rating is a "big deal" in Washington, roughly 24% of premium, the majority of which comes from association group plans in which members in a common industry enroll. These are very much performance oriented. This is not used too much in California, but rather dividends are used.

There is a performance adjustment factor. If you perform, you get money back. If not--you're in "trouble." This is closely tied to loss control and risk management along with work place safety.

There is a retro rating advisory meeting. Loss control is the big important issue. What is gratifying is the extent that this has had in modifying behavior. Legislators say that the State Fund is responsible for developing a rate system in accordance with recognized insurance principles--and it is all done through regulation.

14.20.5 ISSUES DISCUSSED FOLLOWING PRESENTATION

The following is a general synopsis of questions and answers raised by the Commission following Mr. White's presentation. The questions and answers are not verbatim, but are an overview representation of the discussion.

A. You were insolvent in '85. You didn't change rating laws but changed the structure?

   ANSWER: Yes. Mr. White went on to state that stress is not covered, and he felt that the system can't take this type of injury.

B. How happy are workers with the State Fund?

   ANSWER: When I came to the fund we weren't in a position to assist claimants, but now it has gotten better.

C. How about your budget?

   ANSWER: We are handled through the general budget. It is difficult to get an increase in staff. We are a government agency.

D. Under payroll is there an automatic adjustment? You have independence--do you have a political process involved with increasing rates?

   ANSWER: We make recommendations. We don't always get what we should.

E. Are there pressures on state funds in general, and deviations from insurance principles?

   ANSWER: We don't keep track of other states. Four of six have actuarial deficiencies and are showing political pressures. There might be more pressure in a private company.

F. What if you had a surplus. Would there be a "raid?"

ANSWER: I know there are several states where that has happened. When the legislature needed money we were insolvent. Insolvency in a state fund is bad, but not critical. A state fund operates with small surpluses, so insolvencies happen. We can always raise rates.

G. Any advice?

ANSWER: A lot of states are going to loss costs. Oregon did that, and they're still high--relatively. Loss costs may spur some savings but the problems are the benefits. Allowing stress is crazy. There needs to be reform. So much money is being wasted that could go to benefit increases and rate reductions to employers.

H. Papers say our costs are due to litigation over claims. What discussions have you had with employers regarding being tough on claims?

ANSWER: We hear a lot from employers on individual claims. We are not looking at fraud. It is difficult to prove fraud in a system that bends over backwards to make the system work for the injured worker. We litigate less than we should. Fuzzy boundaries get fuzzier all the time. Litigation is an alternative of the system.

I. Maybe the rating system doesn't make a great deal of difference. It may be important from an equity standpoint and/or incentives to employers.

ANSWER: Benefits are the "tidal wave" and the rate system is a "ripple."

J. How much of a factor is litigation?

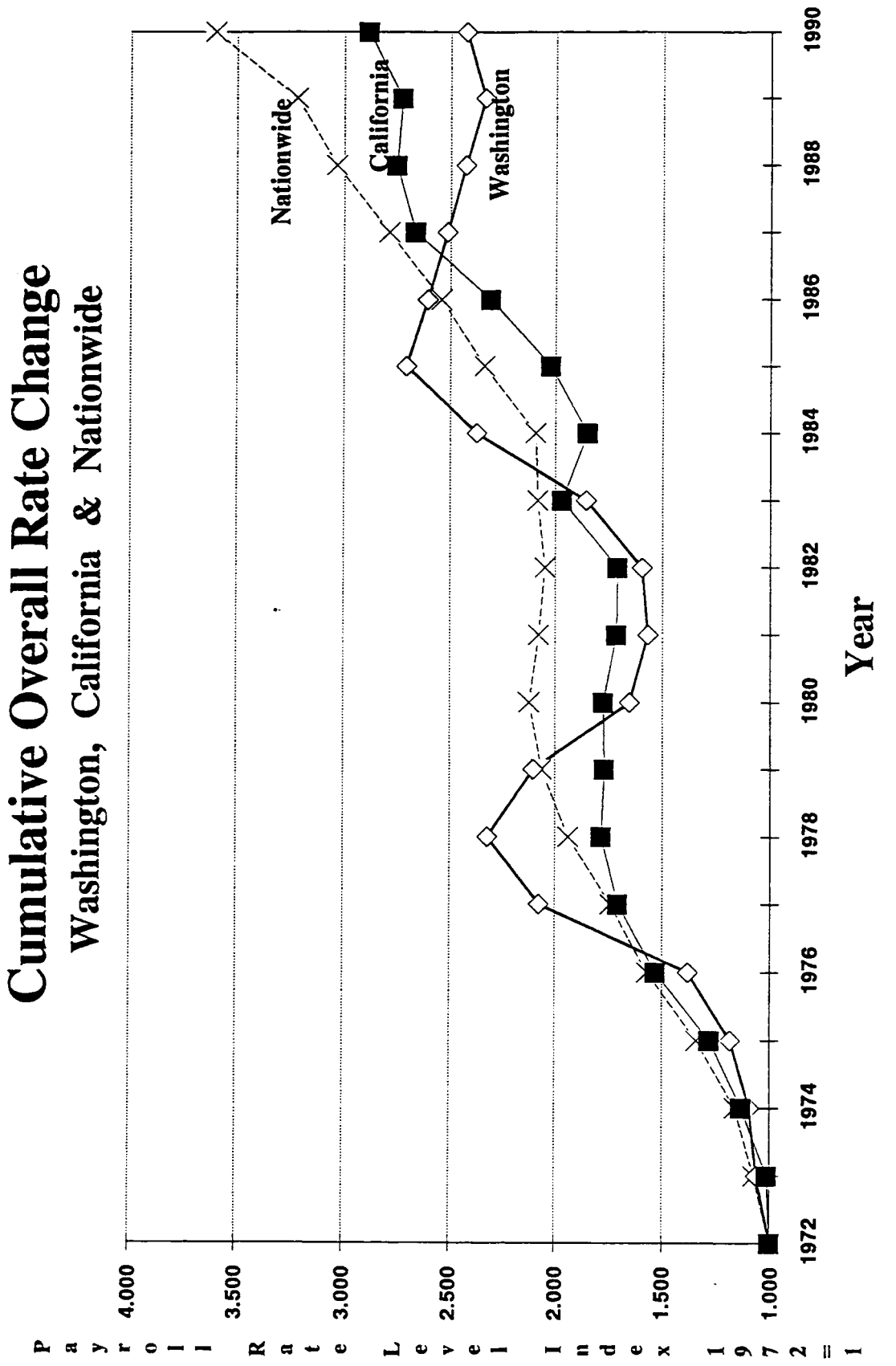
ANSWER: Well under 5%. When we eliminated the problem with vocational rehabilitation there was less friction. When we removed the stress claim there was a better system and we did it without private insurers.

There is a quarterly report that generates premium for medical and indemnity. There is a COLA (cost of living adjustment)--cash funded, and this applies to both self-insureds and to the state fund.

14.20.6 WRITTEN MATERIALS PROVIDED

Handouts and slides were used in the presentation given by Mr. White and were made available to the commission.

Commencing on the following page is a number of different exhibits provided by Mr. White and are considered as representative of his presentation. Please note that the items concerning the State of Oregon were deleted from the report as not representative of the comparison between the States of California and Washington.


Cumulative Overall Rate Change
Washington, California & Nationwide
Nationwide
California
Washington
Payroll Rate Level Index 1972 = 1
4.000
3.500
3.000
2.500
2.000
1.500
1.000
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
Year

WASHINGTON STATE FUND
Standard Premium Earned
in $1,000s

Accident Year	Accident	Medical
1990	440,300	337,400
1989	382,800	297,500
1988	327,900	302,000
1987	307,700	286,200
1986	294,000	268,800
1985	244,096	244,615
1984	213,029	238,590
1983	171,630	151,191
1982	167,258	123,528
1981	184,314	123,177
1980	199,122	113,974
1979	263,092	142,987
1978	255,345	144,327
1977	190,801	103,912
1976	116,586	63,787
1975	94,489	44,254
1974	81,538	39,365
1973	75,345	35,770

WASHINGTON STATE FUND
Rates (per hour worked)

	ACCIDENT FUND		MEDICAL AID FUND	
Date	Rate*	% Chg.	Rate*	% Chg.
7/1/73	0.0369	0.0%	0.0191	0.0%
1/1/74	0.0416	12.8%	0.0216	13.2%
1/1/75	0.0478	14.8%	0.0242	12.1%
1/1/76	0.0598	25.1%	0.0335	38.2%
1/1/77	0.0821	37.3%	0.0460	37.5%
7/1/77	0.1046	27.4%	0.0585	27.3%
1/1/78	0.1231	17.7%	0.0700	19.7%
1/1/79	0.1231	0.0%	0.0700	0.0%
1/1/80	0.1011	-17.9%	0.0614	-12.3%
1/1/81	0.1014	0.3%	0.0679	10.5%
1/1/82	0.1039	2.5%	0.0740	9.0%
1/1/83	0.1039	0.0%	0.0896	21.0%
1/1/84	0.1262	21.5%	0.1376	53.6%
7/1/85	0.1678	33.0%	0.1510	9.7%
1/1/87	0.1671	-0.4%	0.1516	0.4%
1/1/88	0.1668	-0.2%	0.1519	0.2%
1/1/89	0.1815	8.8%	0.1373	-9.6%
1/1/90	0.2015	11.0%	0.1524	11.0%
1/1/91	0.2079	3.2%	0.1737	14.0%

STRUCTURE OF STATE WORKERS' COMPENSATION INSURANCE SYSTEM
(Government organizations in *italics*)

COMPETITIVE INSURANCE SYSTEM	EXCLUSIVE STATE FUND SYSTEM
I. DEFINITION OF BENEFITS	
State Legislature	***State Legislature***
II. INTERPRETATION OF BENEFIT LAWS AND DISPUTE RESOLUTION	
State Appeals System	***State Appeals system***
State Courts	***State Courts***
III. RECIPIENTS OF INSURANCE BENEFITS	
Injured workers	Injured workers
Medical providers	Medical providers
Vocational Rehabilitation Counselors	Voc Rehab Counselors
Attorneys	Attorneys
IV. POLICYHOLDERS (PREMIUM PAYERS)	
Employers	Employers
V. DELIVERY OF INSURANCE BENEFITS	
Private Insurers	
State Fund (in some states)	
VI. BENEFIT DELIVERY OVERSIGHT	
State Industrial Accident Board	
VII. RATEMAKING	***State Fund***
Rating Bureaus (classification system, manual rates, experience rating, retrospective rating, statistical plan)	
Private Insurers (dividends, schedule rating)	
VIII. RATEMAKING OVERSIGHT	
State Insurance Commissioner	

RATING SYSTEM COMPARISON, WASHINGTON & CALIFORNIA

Rating Feature	Major difference, Washington vs California
Exposure base	Worker-hours (vs payroll in California and all other states)
Overall rate level	Higher permissible loss ratio (Larger % of premium devoted to benefits)
Classification Manual rates	Fewer risk classifications, more "subclassifications" (for gathering statistics)
Experience rating	Applies to all employers, regardless of size
Retrospective rating	More "performance" oriented, association group plans permitted
Expense loading	Uniform for all employers (California insurers accomplish non-uniform loading outside of bureau rating system)
Dividends	None

THE PERMISSIBLE LOSS RATIO

Item	Wash.	Calif
	Ratio to losses	
1. Losses (benefits)	$1.00	$1.00
2. Investment Income	($0.37)	($0.20)
3. Loss Adjustment Expense	$0.10	$0.15
4. Other Expense	$0.05	$0.30
5. After tax profit	$0.00	$0.05
6. Federal Income Tax	$0.00	$0.02
7. Subtotal (Required Premium)	$0.77	$1.33
8. Dividends	$0.00	$0.19
9. Grand Total (Required Premium)	$0.77	$1.52
10. Permissible Loss Ratio		
A.No allowance for dividends (1)/(7)	130%	75%
B. Allowing for Dividends (1)/(9)	130%	66%

California expense loadings are taken from the 1990 bureau rate filing (attached). Ratios to premium have been converted to ratios to losses. Where the filing gives a range of values, the midpoint is used.

Comments

Investment Income:
A. Tax free investment income.
B. Larger claim reserves
generate larger invested assets

Real expense savings:
A. Commissions
B. Marketing
C. Policy Writing
D. Profit
E. Underwriting
F. Taxes
G. Regulation

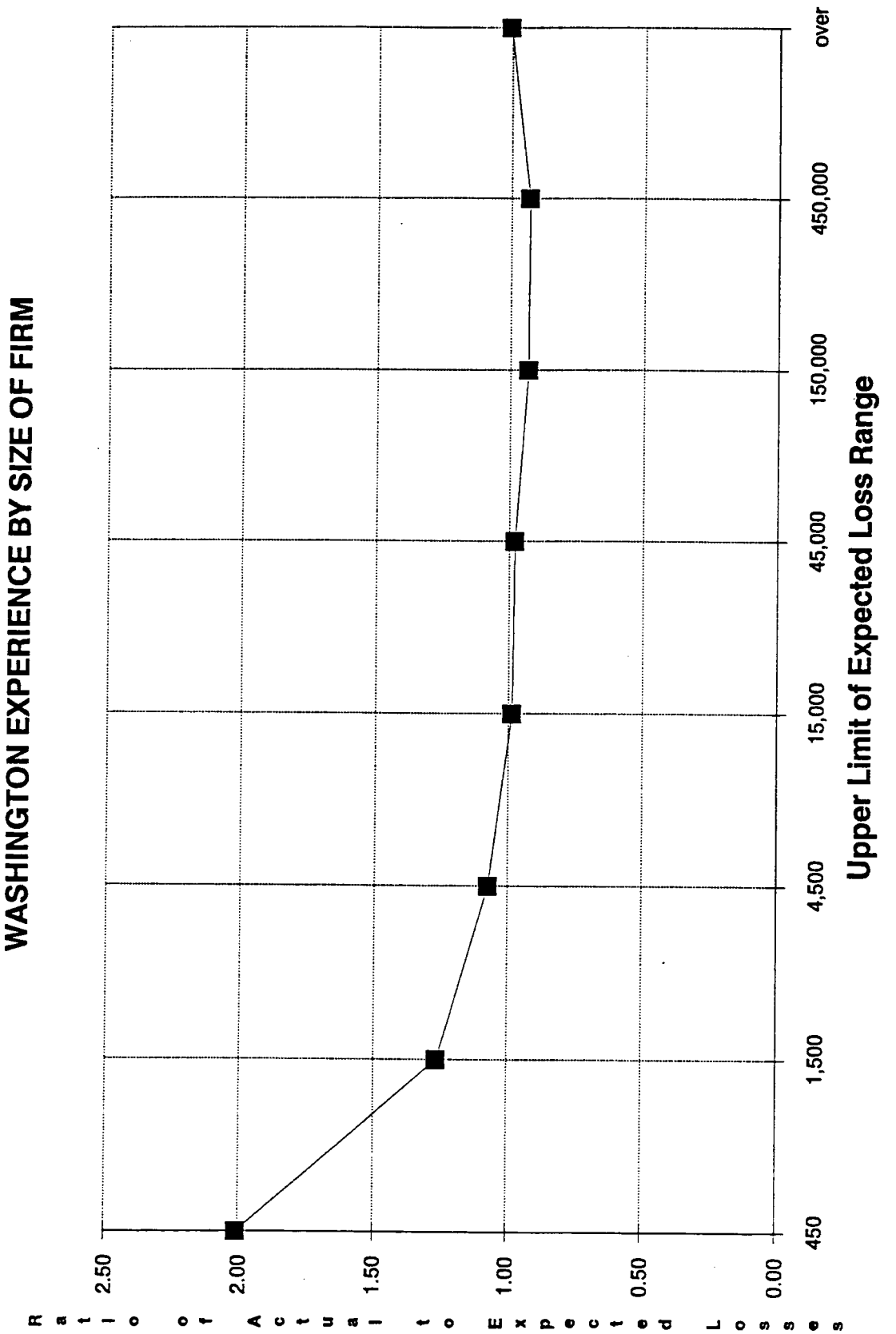
Unreal Expense Savings:
Does the State Fund:
A. Collect all of the premium it should?
B. Not pay any more claims than it should?
C. Provide adequate service to customers?

W. C. I. R. B. - January 1990 Rev.

Exhibit 1

PROJECTED DISTRIBUTION OF INCOME AND DISBURSEMENTS
BASED ON 66% PERMISSIBLE LOSS RATIO

Income		
	Premium	100%
	Investment	12 to 14%
	Total	112 to 114%
Disbursements		
	Losses	66%
	Loss Adjustment Expense	10%
	Other Underwriting Expense	17%
	Dividends	10 to 15%
	State and Other Tax	3%
	Total	106 to 111%
Pre-Tax Profit		1 to 8%
Federal Tax		0 to 3%
Surplus Contribution		1 to 5%


WASHINGTON EXPERIENCE BY SIZE OF FIRM
Ratio of Actual to Expected Losses
2.50
2.00
1.50
1.00
0.50
0.00
Upper Limit of Expected Loss Range
450
1,500
4,500
15,000
45,000
150,000
450,000
over

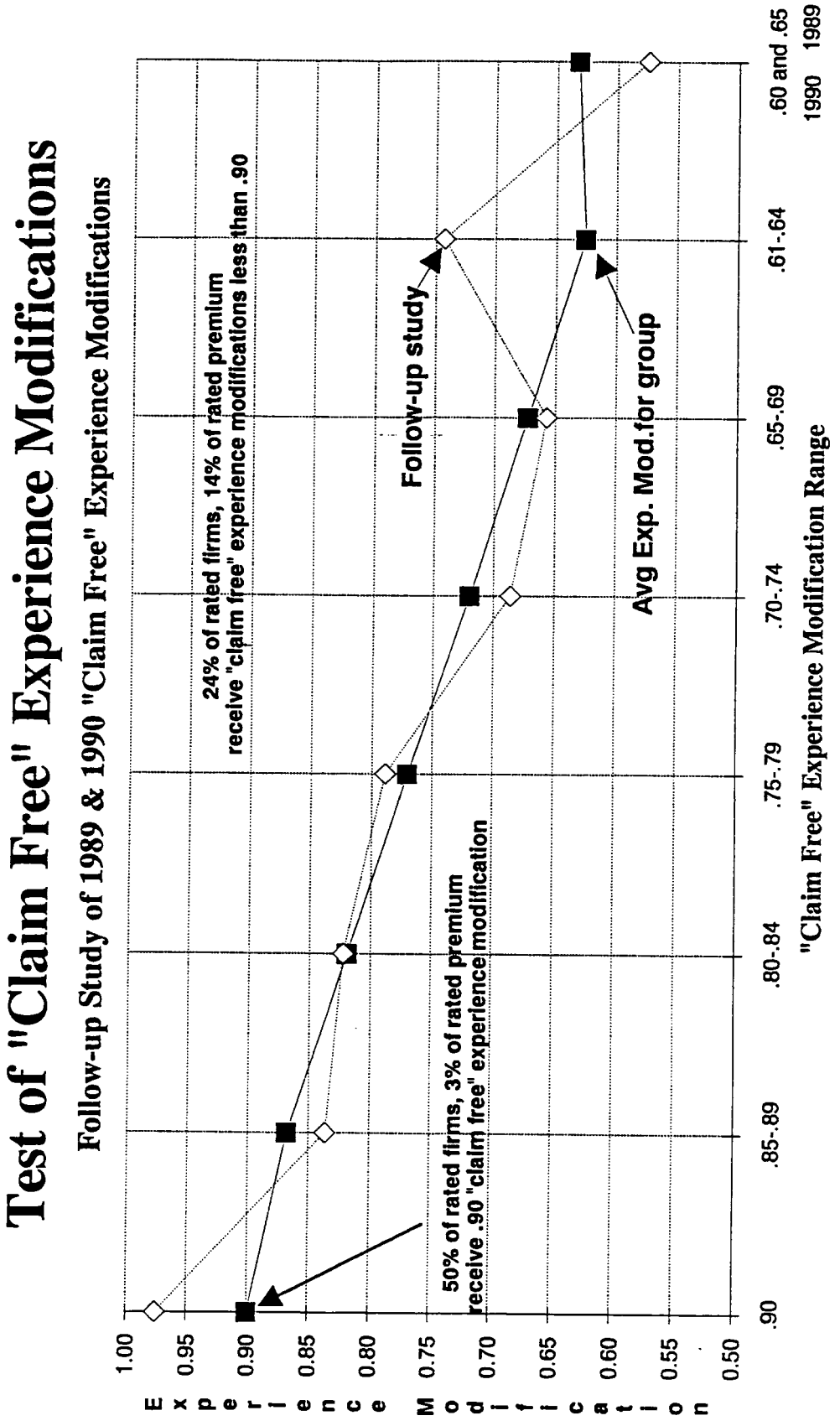
Issued January 1, 1990

WAC 296–17–860 Transition adjustment. In the event that an employer has no compensable accidents during the experience period and the experience modification calculated in accordance with WAC 296–17–855 is greater than the experience modification shown in Table IV, WAC 296–17–890 then such modification shall be reduced to the value shown in Table IV. For the purpose of this rule, a compensable accident is defined as one which has resulted in, or is expected to result in, time loss compensation, permanent disability or death.

*** WAC 296–17–890 Table IV.**

Maximum experience modifications for firms with no compensable accidents:

Expected Loss Range	Maximum Experience Modification
1,848 & under	0.90
1,849– 1,977	0.89
1,978– 2,116	0.88
2,117– 2,268	0.87
2,269– 2,432	0.86
2,433– 2,610	0.85
2,611– 2,804	0.84
2,805– 3,014	0.83
3,015– 3,243	0.82
3,244– 3,493	0.81
3,494– 3,766	0.80
3,767– 4,063	0.79
4,064– 4,389	0.78
4,390– 4,745	0.77
4,746– 5,135	0.76
5,136– 5,564	0.75
5,565– 6,035	0.74
6,036– 6,552	0.73
6,553– 7,123	0.72
7,124– 7,752	0.71
7,753– 8,447	0.70
8,448– 9,216	0.69
9,217–10,067	0.68
10,068–11,012	0.67
11,013–12,062	0.66
12,063–13,230	0.65
13,231–14,533	0.64
14,534–15,988	0.63
15,989–17,615	0.62
17,616–19,439	0.61
19,440& Over	0.60


Test of "Claim Free" Experience Modifications
Follow-up Study of 1989 & 1990 "Claim Free" Experience Modifications
24% of rated firms, 14% of rated premium receive "claim free" experience modifications less than .90
50% of rated firms, 3% of rated premium receive .90 "claim free" experience modification
Follow-up study
Avg Exp. Mod.for group
Experience Modification
1.00
0.95
0.90
0.85
0.80
0.75
0.70
0.65
0.60
0.55
0.50
.90
.85-.89
.80-.84
.75-.79
.70-.74
.65-.69
.61-.64
.60 and .65
"Claim Free" Experience Modification Range
1990 1989

7/9/91

EXPOSURE BASE

Equity favors hours

Administration favors payroll

Washington State Fund converted from payroll to hours in 1933, apparently to stem the loss of premium caused by wage deflation during the great depression.

The state fund would prefer payroll at the present time but employers and employees are overwhelmingly opposed.

WASHINGTON EXPOSURE BASE .... Worker Hours?

Employee wage basis	Reporting rule	Real Exposure Base
Hourly	Hours Worked	Hours worked
Salary	160 hrs per month	Head count
Piece Work	Payroll divided by average hourly wage for risk class	Payroll

The piece work rule was recently changed to permit reporting of actual hours worked, and assumed minimum wage, if hours not tracked. This may have been a questionable decision.

14.21 SUMMARY OF TESTIMONY

XL MANUFACTURING COMPANY
TESTIMONY OF: JOHN RUSH

14.21.1 SUMMARY OVERVIEW:

XL Manufacturing is a small employer within the state. It has had problems when the Rating Bureau reclassified its business from a machine shop to a metal furniture manufacturer. Mr. Rush fears his Company will be forced to relocate if the rising cost of workers' compensation is not stopped. Mr. Rush also believes the "system" itself is biased towards the employee who knows how to manipulate it; and against the employer. He questioned the insurance industry's practice of high reserving files which impact an employers' experience modification.

14.21.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to the Commission.

14.21.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Cost of Actual operation	3
Equity/Small Business Employers	3
Loss Control	2
Cost Factors/Drivers	3
Job Classification/Classification Rating	3
Need For Workers' Comp Reform/ Benefit Increases	2

14.21.4 SUMMARY OF TESTIMONY

Testimony was received from John Rush, General Manager for XL Manufacturing Company. Mr. Rush represents a small employer, and more specifically, a small manufacturer of wheel chairs located in the Chico area. Mr. Rush gave a brief history of his company and its growth to the present 1991 payroll which will exceed $500,000. Mr. Rush fears that his company will be forced to relocate to another state because of the Workers' Compensation system in California.

Mr. Rush went on to explain the steps his company had taken to create a safe work environment. These included:

A. Designing production tools out of light weight aluminum which protects hands from being smashed and backs from being strained;

B. Locating the welding shop, metal cutting shop and machining operations in separate buildings to protect other from exposures related to noise and weld flash;

C. Potentially dangerous operations (powder coating and chrome plating) are given to other specialists and are not handled in-house;

D. We follow the advice of our insurance carrier's loss control advisers including performing environmental tests for noise and aluminum dust;

E. All accidents are investigated by management and changes are made as results of these investigations; and

F. Written safety procedures and policies are communicated to all employees on a regular basis.

Mr. Rush indicated that these steps were successful and during the first five years of operation their premium-to-loss ratio never exceeded 6%, however, insurance premiums increased by 50%. Mr. Rush cited the primary reason for this increase was a change in their rating classification.

Mr. Rush indicated that in 1990 their operation was visited by the Workers' Compensation Insurance Rating Bureau and in April, 1990, their classification was changed to that of a "metal furniture manufacturer" (it had originally been classified as a machine shop).

The result was that the rate for the furniture classification was 50% higher than the machine shop classification. Even though Mr. Rush has appealed this ruling and has been visited by another representative of the rating bureau, they are retaining the new classification of metal furniture manufacturer. Mr. Rush explained the rating bureau position was based on the "end product" of the company, not the manufacturing process itself. The Rating Bureau advised Mr. Rush that since the product resembles metal furniture it is the nearest classification available.

Mr. Rush went on to question the Bureau's arguments in arriving at their classification. Mr. Rush indicated the reclassification resulted in other problems. Their insurance carrier billed them retroactively for this new classification. XL Manufacturing was provided with a copy of regulations concerning retrospective rating, and they found an error that the carrier had made. The carrier was allowed to make rate changes only for subsequent policy years.

Mr. Rush also indicated that because of their appeal of the metal furniture classification, the Rating Bureau reinstated the retrospective billing because of a question concerning their upholstery shop. Upholstery operations are rated separately at a lower cost although neither the rating bureau nor the carrier volunteered this information. Mr. Rush had to appeal the decision and have another inspection to obtain a correction. The test audit was performed by the rating bureau more than a year after the reclassification inspection.

Mr. Rush also addressed the issues of insurance carriers putting high reserves on injury claims. Even though these reserves are ultimately deflated, it can take up to 18 months, even on a minor claim.

Mr. Rush pointed out that self-insurance is not available for the small guys and asks that some type of risk retention group be available regarding Workers' Compensation insurance. This would be similar to what Mr. Rush's industry has done in the area of products liability insurance.

Mr. Rush concluded by making several observations about the California Workers' Compensation system:

A. The system is biased towards the employee although it benefits doctors, lawyers, and insurance companies;

B. The system hurts the employer who has to spend time fighting it and these costs are ultimately passed down to the consumer;

C. Employers are treated with contempt and are usually presumed to be at fault when a person is injured; and

D. Most employees are aware that this system is easy to manipulate.

14.21.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. Rush's testimony:

A. You spoke about big employers having the opportunity to self-insure and then you gave a example of a group of employers concerning a different type of insurance, what was that?

ANSWER: It is a self-insured products liability group.

B. You mentioned the 80/20 rule what does that mean?

ANSWER: 80/20 rule is basically that the classification covers 80% of the people in it and the 20% aren't being treated fairly can look at the experience modifier as a salvation.

C. Could you give us an idea of what percentage of your payroll goes to Workers' Compensation?

ANSWER: 11 percent.

D. What were you under the previous category?

ANSWER: Seven percent

14.21.6 WRITTEN MATERIAL SUBMITTED

No written materials were presented by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.22 SUMMARY OF TESTIMONY

BURGER KING
TESTIMONY OF: MARK GERLACH AND RICHARD BRENING

14.22.1 SUMMARY OVERVIEW

Mark Gerlach and Richard Brening offered a joint presentation based on their recent experience of soliciting insurance bids and analyzing the carrier responses.

Mr. Gerlach emphasized the importance of retrospective versus prospective pricing and the way it works when purchasing insurance for groups. He emphasized that the "buying decision is prospective even though the pricing arrangement and adjustment is retrospective. He also emphasized the lack of information given to employers in the marketplace and the difficulty in comparing bids between insurance companies. There are hidden costs (medical cost containment programs) and not all services are spelled out. Lastly, most insurance carriers don't quote a retention percentage, or, if they do, its difficult to compare with other carriers that haven't broken down their bids in a similar fashion.

Mr. Brening indicated that his preference would be a prospective pricing arrangement similar to the way in which the liability insurance purchase is handled. He also discussed the importance of appropriate and expeditious claims handling and explained his thought process during his group's recent comparison and purchase of workers' compensation insurance.

14.22.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to this Commission.

14.22.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	3
Cost of Actual Operation	2
Equity/Small Business Employers	2
Loss Control	1
Minimum Rate Law	1
Prospective vs. Retrospective Rating	3
Rate Stability	3
Safety incentives	2
Appropriate/Expeditious Claims Services	2
Brokers' Role: Commissions/ Marketing	2
Dividends	2

14.22.4 SUMMARY OF TESTIMONY

Testimony was received by Richard Brening and Mark Gerlach. Richard Brening is the chair of the Insurance Committee of the Northern California Franchisee Association, which is a association of Burger King Franchisee owners. Mark Gerlach has represented Mr. Brening's association in the past in its purchase of group workers' compensation insurance for their association. It is a safety group program.

TESTIMONY OF MARK GERLACH

The testimony began with Mark Gerlach summarizing why they came forward today.

A. Background

Mr. Gerlach indicated the central issue the Commission has is the question of retrospective versus prospective pricing. Mr. Gerlach was present to discuss how retrospective pricing works in the case of purchasing insurance for this group.

Mr. Gerlach began by giving a background of the association. There are about 50 franchisees with about 230 restaurants operating solely in Northern California. In 1990 they had a premium of $3.3 million. From an insurance standpoint it is a good size association and it is located in Northern California which is an advantage for workers' comp insurers. Mr. Gerlach believes its a very favorable group to insure, and there were a number of bids.

Mr. Gerlach explained that during the past few years some of the group members were dissatisfied with the current carrier and he was called in to help them decide on a new carrier. He indicated that the current carrier was giving them decent dividends but they didn't like the service.

B. Process of selecting carrier

Mr. Gerlach then explained the process of getting a new carrier. He indicated that they contacted four brokers, one direct writer, and the current carrier asking for bids. The direct writer refused to bid indicating they did not want any group business and eventually Mr. Gerlach and Burger King ended up interviewing three brokers and the current carrier. The ultimate decision was made to go with one of the new carriers. Mr. Gerlach indicated that a number of problems arose during this selection process including determining which companies to go to. Dividends and service varies among insurers. It's difficult for the average policyholder to get information about dividends. Also, when you're trying to select companies you're not dealing directly with the company, you are dealing with the brokers. You buy your insurance through the broker not through the company and many brokers represent or push one or two specific companies so it makes it harder to track down the different variables in the marketplace.

Mr. Gerlach indicated the next problem that arose had to do with the bids on insurance and what type of questions you ask. The average buyer does not know the different medical cost control programs that insurance companies have or the dividend programs, etc.

Mr. Gerlach indicated that although they got bids from six companies, only one of the bids included information about a retention level on both an individual and group basis. Mr. Gerlach explained that a retention level is basically how the insured quotes your dividend in

the bid. You can't be promised a dividend, but when they give you a bid that includes a retention level, which tells you how the dividend will be calculated.

Mr. Gerlach indicated that in a group program individual members will get individual retention levels according to how much premium they have and then the group, as a whole, will also have a separate retention and you can get a group bonus. Mr. Gerlach indicated that in the present bidding situation only one of the carriers gave both the individual and group retention level so it was very difficult to compare it to the other bids. Many of the carriers, when asked about their retention percentage, just put in a question mark.

Mr. Gerlach cited another example of receiving incomplete pricing information. Following an oral interview with a broker, somebody asked a question about medical cost control services and it came out that service had a charge based on the percentage of savings the medical cost control saved the group. This was not divulged during the 90 minute interview.

Mr. Gerlach cited another examples of pricing problems including the fact that one carrier refused to waive a guaranteed premium option, while other carriers would waive the premium.

C. Summary

In summary, Mr. Gerlach pointed out there is extreme difficulty in trying to make an educated evaluation of what the possible retrospective price is going to be from these different carriers. There is virtually no way to making a direct comparison between one company and the next. Mr. Gerlach believes this works directly towards the question the Commission has facing it: is retrospective pricing competition good or is prospective pricing better. Mr. Gerlach indicated that this brings the Commission back to the advantages of prospective pricing. Mr. Gerlach stated that when you look at prospective pricing, the insurance company can maintain low prices only if it has low losses. It can maintain low losses only if efficient, if it has good loss control, if it has services to provide to the employer concerning safety, loss control and minimizing the cost. If it does not do that, then losses are going to increase and it will not be able to maintain low prospective prices. The system would be at a great advantage if the buyer had the ability to shop on a prospective basis and they would be better able to make a decision, on an educated basis, rather than guessing what their return is likely to be under the retrospective program.

This concluded Mr. Gerlach testimony.

TESTIMONY OF RICHARD BRENING

Richard Brening added several words following Mr. Gerlach testimony and completed this joint presentation by indicating he was extremely upset with the unfairness issue of Workers' Compensation. This issue, coupled with purchasing insurance, makes his job hard. He believes there is a lot of "trust me, trust me, trust me" with insurance carriers. He does not believe they are motivated to keep losses down because they receive automatic increases in their rates every year, which is guaranteed.

Mr. Brening went on to explain about the 11 Burger Kings that he manages. He does not believe the insurance company gives him any help in fighting fraudulent claims. He also does not believe that purchasing workers' compensation insurance is similar to buying liability insurance.

14.22.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. Gerlach's and Mr. Brening's testimony.

A. You buy for all the franchisees in your association?

BRENING: We have a group of franchisees and an insurance committee that makes recommendations. Each franchisee is welcome to go whatever direction they want, but we generally get 80-85 percent participation.

B. And do they pay the same rate that was negotiated?

BRENING: The rate is fixed by the state.

C. Ok, for your category you're paying the same thing?

BRENING: Yes

GERLACH: Let me explain. The Insurance Code has a specific provision in it for safety groups under workers' compensation. What that means is that you buy insurance as a group. The rates and classifications and all the rules of the manual are applied to you as an individual even though you are a group. The group operates as a safety group and the dividend is paid to the group as a whole. The group of Burger King franchise owners buy their insurance through this program and the association as a whole is paid a dividend at the end which is then distributed to the members. In many cases that will be the way that smaller employers can qualify for dividends, by being a member of a group.

D. How do you distribute the dividend? Is it even or do you distribute it according to the safety of the individual franchisees?

BRENING: Based on premium. Basically the reason for the group would be as a member of the group I get my own dividend and then being a member of the group I will pick up another dividend if the group does good as a whole.

GERLACH: Basically they're distributing to the members according to the individual retention factors that I was talking about, and those individual retention factors will distribute the dividend to the members according to the member's loss ratio. If the member has a bad loss ratio he may not get a dividend. However, if he has a real good loss ratio he may get a great dividend. But they get a group bonus on top of that, and that group bonus in this particular group is distributed according to the premium. In other groups it might be distributed in the same percentage as the underlying dividends are distributed but it is up to the association as to how that is distributed.

BRENING: Concerning the dividend, with liability insurance I don't get a dividend. We pay a competitive rate and we accept it. The dividend is nice but it is unfair because you don't know what you're going to get. I would rather pay up-front a fair amount to take care of the coverage and not worry about the concept.

E. You would rather have stability so you know what to plan on your premium?

BRENING: Yes.

F. Because you could have a prospective rating plan that also has dividends in it if you wanted to, but you would not be interested in that option?

BRENING: We kind of have it now. We originally had Travelers Insurance for our liability insurance and then changed to All State who is really aggressive in fighting its claims. When they came in and saw my loss ratio for three years, they put me in a specific loss category, and treated me as a preferred client. They said they would give me a reduced rate over another Burger King guy who might have higher losses but doesn't get as involved as we do. The salesman indicated to me that we were getting a dividend up-front, if you will, because we do care and we fight aggressively all claims.

G. How large is just your franchise?

BRENING: I have 11 Burger Kings.

H. You said that the carriers with whom you have dealt, the workers' compensation carriers, have given you no assistance in planning or implementing safety programs?

BRENING: They do that.

I. OK I apologize I must have gotten that wrong. I thought you said that the companies didn't help at all.

BRENING: No in that part they do. With us it's the claim handling. My managers on the front lines fight claims and call the doctors more intensely than the insurance companies. The insurance company really has no motivation to push for us.

J. You have been satisfied with the safety program?

BRENING: Yes, Yes.

K. Do you think the dividend, rather than having prospective rates, gives either you or another franchise an incentive to be safer? If you had the information, if the system was regularized, where you could make a comparison in terms of the dividend you could expect, do you think having the dividend at the end, rather than paying the prospective rate (such as with health insurance) that having the dividend at the end is an extra incentive?

BRENING: It is if the system is fair.

L. In other words, you're not necessarily against a dividend system, its the information flow and how it is compared?

BRENING: Even a fellow like me who does a good job, last year I only had an eight percent loss which was 8,000 dollars on a $100,000 premium. In 1991 I have paid a $130,000 premium and I have a back claim reserved for $60,000. It's an unfair situation. We're going to lose everything. If you take off retention (that's 20-25 percent) and $60,000 reserved for this claim, if you could guarantee fairness then I would say dividends would be fair. I really like the All State thing, that I know what my costs are going to be.

M. We have heard that companies like knowing that with the dividends, they've already paid enough. So what you are getting is a pay back. If you went the other way around and then you had a bad year, your rates all of a sudden would go up next year and with this instability -

- do you see as much instability with the dividend system or do you think there would be more incentive?

BRENING: There's really no motivation for the insurance company to turn lose that money.

N. When you were looking at various carriers, did you consider the state fund and if so why not?

BRENING: We have been with State Fund for 7 or 8 years and that's the company we dropped this year. I've been happy with State Fund, but their service varies depending on the district you are in. I opted for a change because they're not aggressive on claims. We're now with Republic Indemnity who promises within 24 hours they will call the doctor or send an investigative nurse to the employees door step. They've also promised within 10 days to provide us with a complete status report on the injured worker so you know what has happened. The longer these things go on without somebody contacting people, --

O. Would it be fair for me to say that the same problems exist in what ever system you have, but the only difference between the two systems is that you like the stability of the up-front pricing of prospective prices versus the retrospective prices? The service can be different no matter what your system is. Are you trying to tell me something else?

BRENING: True. I think of the culture of the organizations such as Allstate versus Travelers. But the culture at State Fund is just not as aggressive. There's no motivation. All State is the best insurance company I've ever been with because they fight every claim. If it's legitimate they will pay it but if it's not they don't. I think its the culture I am concerned with more than anything. What's their motivation? There's no real motivation. They're winners and no matter what happens they're going to win.

P. So what would the difference be under a different prospective system?

BRENING: Well you paid your premium. It's up to them to keep losses down.

Q. You stated you thought that claims handling at the State Fund was not aggressive but you liked the safety services. What sort of safety and health services are you getting in bids from other companies?

BRENING: They all promise you everything and anything. State Fund had a video tape for us and they gave us posters, they also visited your restaurant if you needed them.

GERLACH: Republic promised to provide a specific program. This would include a loss control specialist being sent to every restaurant in the association within the first 3 or 4 months to complete a survey of the physical location and the loss history of that restaurant. They're going to look for unique things at that location or employer or Association-wide problems they can identify. They will then develop an association-wide program to handle the injuries. They also promise that they would develop a special video tape for Burger King to train people how to use the machinery.

BRENING: These guys will promise you anything, a video tape, whatever else you want. They just want us to sign up with them. The safety part and all those things are just a part of it. It is claims handling that's so unfair. Safety is not a problem because the carriers will give you what ever you want there.

GERLACH: They'll promise you anything.

BRENING: They'll promise you the world just to get you to mail the premiums in.

14.22.6 WRITTEN MATERIAL SUBMITTED

There was no written material submitted by these witnesses.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESSES WHO AGREE THAT THIS IS A FAIR REPRESENTATION OF THEIR TESTIMONY.

14.23 SUMMARY OF TESTIMONY

ROUND TABLE PIZZA
TESTIMONY OF: ALLEN TOY

14.23.1 SUMMARY OVERVIEW

Mr. Toy testified from the perspective of a small business owner in California. His testimony focused on a tragedy that occurred at his Round Table Pizza Restaurant when the Sacramento "thrill killer" murdered three of the restaurants' employees. The impact of these death benefits will effect his experience modification for the next three years and he anticipates a 50% increase in premium. Mr. Toy points at the unfairness of penalizing the employer for an act which is not under the employers control.

Mr. Toy hopes the Commission will examine ways to make our present workers' compensation system more affordable and equitable.

14.23.2 REQUESTS MADE TO THE COMMISSION

Mr. Toy asked the Commission not only to come up with ways to make workers' compensation more affordable but also to devise more equitable ways in which the social burden can be shared.

14.23.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Cost of actual operation	3
Equity/Small Business Employers	3
Loss Control	2
Need for Workers' Comp Reform/Benefit Increases	3

14.23.4 SUMMARY OF TESTIMONY PRESENTED

Mr. Toy gave testimony before the Commission concerning the operation of nine Round Table Pizza Restaurants in the greater Sacramento area. He described the typical profile of their non-management work force and the type of people they normally hire. He explained that their business operates under a franchisee license from Round Table Franchise Corporation in San Francisco. Mr. Toy explained that because they are part of a larger franchise group, they can take advantage of their size to make group purchases. This includes the purchase of insurance. Mr. Toy further explained the Round Table Owner's Association retains a risk management firm to put together bids for an insurance package for restaurants, covering both general insurance and workers' compensation.

Mr. Toy went on to state that their workers' compensation costs per employee have soared higher every year, out pacing inflation. He thinks this cost is compounded by the problem of having one of the highest base costs for workers' compensation in the nation. Mr. Toy feel the system penalizes the employer who is unfortunate enough to have experienced any increase in claims whether or not they could have done

anything to prevent the situation which gave rise to the claim. Mr. Toy explained that this penalty is represented by an increase in the employer's experience mod which passes a large amount of that cost of claims back to the employers for the following three years.

Mr. Toy went on to cite an extreme example which occurred at one of their restaurants. Their restaurant was victimized by the Sacramento "thrill killer" who robbed and killed three employees who were on duty that evening. This happened even though their employees were trained not to resist during a robbery and the restaurant was located in upper class part of town. Police called this a random act of senseless violence, and both the employees and Mr. Toy's restaurant were victims. A stigma is still attached to the restaurant because of this tragedy.

Mr. Toy explained that this incident resulted in three separate workers' compensation death claims for a total of $285,000 in benefits. Mr. Toy compared this to his workers' compensation premium which is $120,000 a year. These three death claims will add 48.7 percentage points to Mr. Toy's experience modification which translates into a yearly increase of approximately $57,000 in premium before considering the increase in any base rate. This increase will stay with them for the next three years in order to be figured into their experience mod.

Mr. Toy pointed out the ironic fact that there were no grieving families to receive these benefits. Since the employees were young, single adults without dependents, their families were not eligible to receive a death benefit. Rather these benefits (penalties if the employer is unlucky enough to have this happen) went to the Subsequent Injuries Fund, a state agency designated to receive this funding in situations such as the above.

Mr. Toy summarized by stating that even though this example is unusual, it illustrates the tremendous cost burden which the current workers' comp system puts on employers. Mr. Toy could accept being responsible for claims arising out of their negligence, such as poor training or unsafe working conditions, but it is difficult to live with the cost of claims over which they have no control, nor with the fraudulent claims which increase in times of economic decline.

Mr. Toy asked the Commission not only to come up ways to make workers' compensation more affordable but also to devise more equitable ways in which the social burden can be shared. Mr Toy fears that if the Commission fails to do so, there will be a decline in business, and jobs and the quality of life for everyone who lives in California.

14.23.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. Toy's testimony:

A. What is your percentage of Workers' Compensation costs to payroll?

ANSWER: It's currently $120,000 on a payroll of $1.8 million.

14.23.6 WRITTEN MATERIALS SUBMITTED

Written materials were submitted by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.24 SUMMARY OF TESTIMONY

J.C. PENNY COMPANY
TESTIMONY OF: DONNA MOSLEY

14.24.1 SUMMARY OVERVIEW

Ms. Mosley spoke from the perspective of a large employer with a multi-state operation. She is responsible for monitoring claims throughout the western portion of the country and gave a comparative analysis based on what her Company has experienced.

Ms. Mosley believes claims are reserved higher in California because there is a strong bias in favor of the employee, the cost drivers are "out of control" and additional reform is needed.

Although J. C. Penney isn't considering relocation from California, Ms. Mosley believes some of the cost for workers' compensation is passed back to the consumer.

14.24.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to the Commission.

14.24.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Cost of Actual Operation	3
Equity/Small Business Employers	3
Safety Incentives	3
Appropriate/Expeditious Claims Services	3
Cost Factors/Drivers	3
Loss Control	3
Need for Workers' Comp Reform/ Benefit Increases	3

14.24.4 SUMMARY OF TESTIMONY

Ms. Donna Mosley testified on behalf of J.C. Penney Company. She is a Claims Specialist in the Risk Management Department. Ms. Mosley is responsible for all the Workers' Compensation, general liability, and product liability claims generated for locations in the United States west of the Mississippi River. She sees claims from different states and the types of claims generated as well as general comp claims. Ms. Mosley gave the Commission an idea about the number of employees that J.C. Penney Company hired. In California they have hired approximately 15,000 people out of a total of 200,000 country-wide. However, 25 percent of their workers' compensation costs come out of the state of California. California is the largest, most expensive state, the second most expensive being Texas. Texas only represents 11 percent of J.C.

Penney's workers' compensation costs. The cost of doing business in California for workers' compensation is enormous. Ms. Mosley directed her testimony to a couple of different issues:

A. LOSS CONTROL INCENTIVES

As a larger employer, J. C. Penney is on a recurred loss retro program which allows them to try to control the losses, thereby reducing their cost. This year J.C. Penney instituted a nationwide program of prevention and claims cost containment to try to control their workers' compensation costs. Ms. Mosley believes they have been successful during the first six months of this year in California. They have reduced the number of accidents by 17%. Although the costs have dropped only 4%. Ms Mosley advised the Commission that J.C. Penney's average cost per claim in the state of California has actually increased this year even with the reforms that went in effect in 1990.

Ms. Mosley indicated that part of what they see from a large employer standpoint is that the problem is more than just the rating laws; it the actual laws in the state of California. She believes there is a need for additional reform. From the perspective of a company that sees claims in more than one state, reserves here in California are much higher than in those other states. Ms. Mosley indicated that they have been with the same insurance company for 18 years and are very happy with them. Because of the cost of claims in California though their reserves are much higher for the same injury, for the same type of accident that is in another state, such as Texas, or Oregon, or Colorado.

B. CLAIMS HANDLING

In California, there's a real bias towards the employee / the injured worker. They are presumed to be injured on the job and it is up to the employer to prove that there was not a workers' compensation injury. Ms Mosley points out that as a result of this bias, their insurance carrier is more willing to settle a claim, rather than to take it before a judge, have a trial and lose the claim for a substantially larger amount. Ms. Mosley indicated that with this type of claims handling they believe a lot of costs are paid which are unjustified.

This concludes the testimony of Ms. Mosley.

14.24.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Ms. Mosley testimony.

A. Since you do have experience with a number of different states, you are emphasizing the issue of a presumption that a person injured has been injured on the job. Does this differ from other states?

ANSWER: In other states our experience is that we were given better defenses or our defenses are listened to. Claims adjusters and supervisors in California seem to indicate that if we take it before a judge we will lose it. We will plain, flat out lose it. We have lost so many cases in the past even though we have had good background.

For example, in Southern California we had an employee that was injured the first day on the job. She had a preexisting foot condition and aggravated that condition by wearing high heels all day. We had no knowledge of this when the claim started and we tried to fight that claim and lost. We paid for an employee to work for us for one day who aggravated foot condition just

because she was wearing high heels. That is some of what we are dealing with in California. Aggravation of a preexisting condition is compensable in other states, but not to the same degree. The law is not construed as liberally as in other states.

B. Apparently 7% of your employees nation-wide are in California but 25% of your --

ANSWER: In 1990, 25% of our workers' compensation costs came out of California.

C. What impact is that having on your company's decision to continue doing business in California, if any? How are you offsetting that costs.

ANSWER: For my perspective this is a tough question. Obviously we are still doing business in California and we intend to be here in the future. It is not impacting our business and we are not looking at withdrawing from the state of California. But certainly this is something that we have to consider in pricing our merchandise and that type of thing.

D. Do you have any observations on prospective versus retrospective pricing? Are your observations that other cost drivers are what you perceive to be affecting claims settlements?

ANSWER: That's what driving our cost. Certainly with an incurred loss retro, we're really paying for the amount that is paid out by an insurance carrier plus we are paying a handling fee above that. Our costs are driven by exactly what is paid out by the insurance carrier. We have accident prevention programs both internally and externally. Our insurance carrier comes in on a regular basis to meet with the store and make sure the safety teams are active, and they do inspections and teach people how to inspect the premises.

E. I have a question concerning reserves. You said reserves were higher in California. Is that just dollar amounts are higher because of claims or is that on a percentage basis?

ANSWER: We see a lot of claims in California where someone has a back injury and immediately the insurance carrier puts a reserve for vocational rehabilitation, such as $20,000. Immediately they put up a reserve for permanent partial disability (this is another $10,000 - $15,000) depending on whether surgery is completed or anticipated. There are higher costs in that area. Vocational rehabilitation is one reason we have higher reserves in this state.

F. Am I understanding you correctly that you are saying costs are higher? If a person has the same injury in another state they would reserve differently in a different state?

ANSWER: They are, yes. Yes.

G. So it is a function of the reserving and not so much the particular fact that it is a high claim or administration here?

ANSWER: Basically what you are seeing here is an anticipation that you're going to get a lot more benefits in this state, such as temporary total disability, permanent partial disability payments and possible vocational rehabilitation benefits. A lot of states don't provide vocational rehabilitation. They provide permanent partial disability but not to the extreme extent. A permanent partial disability settlement that I might see in another state, like Colorado, would not be as high as it is in California for the same injury.

H. It's the probability of the claim being higher that is driving the reserves up?

ANSWER: That's correct, that's it exactly.

14.24.6 WRITTEN MATERIALS SUBMITTED

No written materials were submitted by this witness.

14.25 SUMMARY OF TESTIMONY

LANDRY PERSONNEL GROUP
TESTIMONY OF: LEE LANDRY

14.25.1 SUMMARY OVERVIEW

Mr. Landry is a small business owner who presented his concerns to the Commission. He feels the minimum rate law guarantees too large a profit to insurance carriers and workers' compensation costs are driving small employers from California.

Mr. Landry also feels that the system has gotten away from its original purpose of providing care to injured workers and needs to be restructured.

14.25.2 REQUESTS MADE TO THE COMMISSION

Mr. Landry asks the Commission to "start over" and take the complications out of the system.

14.25.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	2
Cost of Actual Operation	3
Equity/Small Business Employers	3
Minimum Rate Law	3
Profitability	2
Prospective vs. Retrospective Rating	2
Appropriate/Expeditious Claims Services	1
Cost Factors/Drivers	3

14.25.4 SUMMARY OF TESTIMONY

Mr. Landry testified on behalf of his company, Landry Personnel Group, a temporary employment agency located in the Sacramento area.

Mr. Landry explained his background. For 21 years he has had a temporary help service that has grown from a family owned organization into a total personnel group. Mr. Landry prefaced his statement by saying that first of all there are two types of employees: our staff and most laws fall fairly with them, but the real problem deals with the second type of employee, the temporaries. Last year Landry Personnel Group issued over 1,700 W-2 forms. Their temporary payroll is close to $2 million and Mr. Landry indicated that he pays $125,000 in workers' compensation premium.

Mr. Landry argues that we should not call this insurance. Rather, the employer is giving somebody money so they can hold it for the employer, draw interest and take whatever they want out of it and then pay claims without trying to keep the cost down. Mr. Landry was concerned with the "retention factor". He explained that as a person operating a small business, he has to work hard to keep costs down and give excellent service to his customers.

Mr. Landry cited an example where he took over truck drivers from Manpower. A week later, one of these truck drivers was having coffee in Oakland and suffered a heart attack. Mr. Landry indicated his account was charged $33,000. It was not a retroactive payment and it wasn't for a full year. He got hit with the whole thing. Mr. Landry indicated that if he had not gotten an attorney to contact the State Fund to make sure they were doing the right thing, they might not have fought it.

Mr. Landry argued that there's very little aggression in pursuing claims. He cites other industries that have been deregulated and thinks that it should be done in the area of workers' compensation. He believes insurance companies are being given a guaranteed 35% gross profit. Concerning the minimum rate law, he argues fixing the gross profit guarantees insurance companies won't get hurt. Mr. Landry indicates it is the employers that get hurt. He believes competition would be better, let them have a level playing field if their going to be in business. Mr. Landry indicated that he was tired of the government coming into companies in some industries and not allowing them to fail. If they can't do their job they shouldn't be in it.

Mr. Landry indicated that when he first started in 1970 he was able to spend all of his time servicing his customers, testing applicants, etc. Now he spends too much time dealing with things like workers' compensation and with people who have no motivation to do the best job. Mr. Landry cited other people who receive benefits from the workers' compensation system including attorney's and medical people. This all effects the business owners.

Mr. Landry suggests starting over. He thinks the complications should be removed from the system; tax employers another way. Mr. Landry points out that we've gotten so far away from what we are trying to do (help people that were hurt on the job) that we're off in little niches trying to make things fit without understanding what else is happening. Mr. Landry believes that workers' compensation is "out of control" and that companies are going to lose people and start moving to other states because it cost so much money in California.

This concludes the testimony of Lee Landry.

14.25.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. Landry's testimony:

A. You mention about having money up-front. Can I infer you don't like the retrospective system and would rather pay your premiums up-front? And if you had a bad record your premium might go up, but you don't like the dividend system?

   ANSWER: If you are a business person and you have to bill people for services, you have to know what your costs are. If it costs me $100 to build a widget and I figure I can sell it for $135, I've made a profit and everybody has been paid well. If, after the fact somebody comes in and penalizes you and all of a sudden you find out that it cost you $125 to make the widget but you already sold it for $135, you're out of business. You're gone. That's what happening with workers' compensation in our industry.

12 years ago we went before the board because they were saying if you are a temporary help worker you are going into a different area with different classification codes and that became a horror. Eventually we handled it by saying that the classification code would depend upon the location of the temporary. If they were sent to an assembly line we would use the classification code of the clients. That keeps it clean. There are some cheaters but then you go back to the 80/20 rule. For the most part our association in California is trying everything to do it right. I investigated self-insurance but I was told that only $400,000 or more in premiums would be worth trying to do it. What I really resent more than anything else, is telling a company who is in business that they're going be guaranteed 30 to 33% gross profit. This is ridiculous.

14.25.6 WRITTEN MATERIALS PROVIDED

Written materials were submitted to the Commission by this witness.

THE ABOVE TESTIMONY HAS BEEN REVIEW BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.26 SUMMARY OF TESTIMONY

ASSOCIATION OF CALIFORNIA WATER AGENCIES, JOINT POWERS INSURANCE AUTHORITY
TESTIMONY OF: JERRY STOCKETT

14.26.1 SUMMARY OVERVIEW

Mr. Stockett testified from the perspective of a public agency joint powers general manager who would like the opportunity to purchase aggregate excess insurance but is prevented by law, from doing so. Mr. Stockett gave examples of the manner in which costs could be saved by his pool. He asked the commission to recommend this arcane law be repealed.

Mr. Stockett also discussed the safety incentive program which his pool established for its employees.

14.26.2 REQUESTS MADE TO THE COMMISSION

Mr. Stockett asks that the Commission give serious consideration to striking down the statutory law that prohibits the purchase and sale of aggregate excess coverage in California

14.26.3 MATRIX ITEMS DISCUSSED

ITEMS	WEIGHT ASSIGNED
Aggregate Excess Insurance	3
Safety Incentives	3
Self-Insurance/Pools	3
Loss Control	2

14.26.4 SUMMARY OF TESTIMONY

Mr. Stockett began his testimony by summarizing his qualifications and indicated he is presently the General Manager for the Association of California Water Agencies (A.C.W.A.) which is a joint powers authority in California. He indicated that of the 600 public agency water districts in the state, 300 of those participate in Mr. Stockett's joint insurance authority, primarily in their liability program. His organization has approximately 40 participants in the workers' compensation program.

He indicated they had long sought the opportunity to purchase aggregate excess coverage because it is an important coverage for their small pool. The 40 water agencies covered in their workers' compensation program have approximately 1,200 employees and an annual payroll of $40 million. They generate premiums of about a million dollars a year. One of the problems when you get a group that small is that you have volatility in the amount of claims submitted. Mr. Stockett indicated that when they first began to purchase specific excess coverage the retention was $100,000 per occurrence. Over the years this has grown so that the amount is now $225,000 per occurrence. That is a fairly large sum for a small pool such as ACWA and it would be helpful if they could purchase aggregate excess coverage to limit the total amount

of those $225,000 self-insured retentions in a year. As you know, that is not available in California to public agencies (or private agencies for that matter).

Mr. Stockett went on to share some information with the Commission. Concerning accident frequency rates, Mr. Stockett believes that one of the substantial benefits of self-insurance is the ability to concentrate on safety. Mr. Stockett provided a chart showing the years they have been handling their workers' compensation pool. He concluded by summarizing that in the year ending 1991, his pool had an accident frequency rate of 4.38. They have been very successful as a small pool in terms of helping their districts get their exposure under control in terms of the numbers of accidents.

Mr. Stockett went on to state that they were not nearly as successful in terms of the total cost of claims. Again he referenced his handout. Mr. Stockett indicated that their pool started out with a very poor performance. Claims were much higher than had been expected and they became very aggressive in working with the districts in terms of inspections and recommendations. In summary Mr. Stockett pointed out that if his group had an aggregate excess cap, they could have made the cost to these districts much more stable over time.

Mr. Stockett indicated there's a problem when they have a bad year. Member districts that participate in this program and who sit on the board of directors want to know if this is a new trend, should they get out of self-insurance, stay in, etc. It is a question of survivability of small pools to have an ability to cap losses in a single year and to spread that cost over time. Mr. Stockett's group is very much in favor of striking down that statutory law that prohibits the sale of aggregate excess coverage and they ask the Commission to give serious consideration to doing so.

Mr. Stockett continued to discuss the awards systems they have in place. Mr. Stockett explained that for those 40 districts participating in workers' compensation they designed a safety awards program. In many cases the districts are small, some having as few a four or five employees. Mr. Stockett's organization developed an awards system that would be accessible to all 40 districts. They set aside $5,000 a year for awards and use about $2,000 of it for a vacation to Hawaii. They take another $2,000 and buy prizes worth $500 a piece and then take the remaining amount and purchase gift certificates. The agencies that participate in this program report a list of employees that have been "accident free" during the course of that year. If their name is on that list, then they can participate in the drawing for the prizes. In terms of "accident free", it doesn't mean that they haven't had a workers' compensation claim, but the accident was not in violation of a safety policy. The districts report that this is very effective for them in terms of trying to encourage their employees to do their work in an accident free way.

14.26.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. Stockett's testimony.

A. Do you know the reason this was put in law (referring to the preclusion against the sale of aggregate excess insurance)?

ANSWER: I don't know the reason. My attorney tells me that is a hard piece of information to come by, that the state does not keep good track of why they did this. The only thing I can tell you is the law was passed in 1965 and it is found in Section 703.5 of the California Insurance code. It almost looks like an afterthought, but I really don't know why it was put in. All I know is that it is frustrating to not be able to buy it in California when most other states make it available to pools and self-insurance pools to help facilitate the process.

B. Let me understand this. The $225,000 is self-insurance of each of those water power districts you have?

ANSWER: It is $225,000 per accident that this pool would have to absorb, whether it came from one district or two or more with a single accident.

C. Who imposes the $225,000 limit?

ANSWER: The excess insurance market tells us what level they will start the excess insurance at. We have attempted to buy it at a lower attachment point and they will not sell it because they think the activity of claims at that lower attachment is unattractive.

D. So companies in the competitive marketplace are saying $225,000 is it?

ANSWER: That's right. In some cases other public agencies are still able to buy it as low as $200,000, but most are at $250,000.

E. What you're saying, if you have a specific incident that is going to be long term, you can buy specific excess insurance for that incident. To say if the expenses of this particular accident go above here, insurance kicks in?

ANSWER: That's correct.

F. But you can not pool all of your excess claims and buy --?

ANSWER: Buy a stop loss, if you will, on the sum of those self-insured retentions, those deductibles.

G. Maybe this is better addressed to the audience. I understood until you began to speak, that aggregate excess was available to public employers. Did I simply misunderstand that or did somebody testify incorrectly?

ANSWER FROM AUDIENCE (Mr. Joseph Markey with California Self-Insurers Association): I testified that the insurance code requires an agent, broker or consultant may not discuss aggregate excess insurance. The Insurance Commissioner's rules indicate that no carrier may write excess in California but the other alternative, as I understand it, is that if you went to a broker, in another state, who wrote the insurance in another state and that carrier does not do business in California --

STOCKETT: I believe he's right. You could buy it if you went totally outside of California to do so. But for public agencies in California, that's a difficult proposition.

H. Sure. I understand.

STOCKETT: I would like to show you one other chart here that illustrates some of the value of self-insurance. (Again Mr. Stockett referred to a chart he had provided the Commission). If we compare our self-insurance program with a program which State Fund offers through our parent association, the annual average standard premium for the State Fund group would be $6.4 million. The average amount of losses is $3.1 million. They paid out, over the last six year history that we have looked at, $1.7 million in dividends and they retained for overhead purposes $1,431,000. As a ratio of losses of standard premiums, that's 69% and they're retaining 31% for overhead. In the self-insured program, we're able to pay out 89% of the premium and retain only 11% for the overhead cost. We believe that even though the ultimate cost in the program is

approximately the same, we can deliver, through self-insurance, a much higher ratio of benefits to the injured employee.

I. What percentage of those employees typically end up on that list (award list for being accident free)?

ANSWER: Some where in the range of 70 to 80%.

J. I don't have a good notion of the safety hazards involved with those employees but it would strike me that 20 to 30% in the year having an accident that was the result of a safety violation would be pretty high?

ANSWER: Off hand that's strikes me as high too. The 70 to 80% number may not be accurate. I just gave you that off the top of my head. But water agencies do have a fairly high risk profile in that they have field employees in particular on location, handling all kinds of construction equipment, pipes, and so forth.

K. Do you also provide loss control and safety inspections as part of your workers' compensation coverage?

ANSWER: Yes we do. Our JPIA has four employees that are designated specifically to risk control in both liability and workers' compensation. We have one of these safety inspectors go to each district a minimum of every six months to review their facilities, as well as their practices, and make recommendations. They also give seminars and training in how to prevent these losses.

14.26.6 WRITTEN MATERIALS SUBMITTED

Written materials were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.27 SUMMARY OF TESTIMONY

CALIFORNIA WEBBING INDUSTRIES
TESTIMONY OF: STEVEN KELEN

14.27.1 SUMMARY OVERVIEW

Mr. Kelen addressed the Commission from the perspective of a small employer/manufacturer. He provided the Commission with examples of the inequities of the workers' compensation system, including the fact that the employer must pay for all medical expenses, even those procured by the employee, to support the employee's claim for benefits. Mr. Kelen believes there is fraud in the system and the employer is the "deep pocket". This makes it hard to compare California to other states. He believes the rating increase is a consequence of this "deep pocket". He believes that insurance companies profit despite this fraud.

14.27.2 REQUESTS MADE TO THE COMMISSION

Mr. Kelen pointed out that this Commission has an opportunity to bring order to workers' compensation through reform, and to reverse the inflationary trend of rate increases. He would like to encourage this Commission to start a new system controlled by competitive market forces in a free market system.

14.27.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Competition Between Insurers	1
Cost of Actual Operation	3
Minimum Rate Law	3
Profitability	1
Cost Factors/Drivers	3
Cost of Actual Operation	3
Need for Work Comp Reform/ Benefit Increases	3

14.27.4 SUMMARY OF TESTIMONY

Mr. Kelen is the President of California Webbing Industries. He addressed the Commission concerning several items. He began by stating that California is almost the only state requiring employers to pay for all medical / legal expenses in workers' compensation litigation whether the employer wins or loses. He classifies this situation as a "deep pocket" and this is one of the reasons it is difficult to compare California to other states. Mr. Kelen went on to state that this deep pocket created a number of difficult situations he wanted to focus on during the course of his talk.

Mr. Kelen went on to cite, as an example, an injured worker from Mr. Kelen's plant that was involved a drug related incident. Management discharged the employee because of this drug situation, but prior to dismissal

sent the individual to a doctor for an examination. That doctor indicated that the individual was healthy and had no work-connected injuries.

Following the individual's dismissal, he went to a clinic which rendered an opinion that the individual had been injured, had a back injury, headaches, etc. and was temporarily disabled. These are the so-called "stress mills" that are available throughout the state but especially in the Los Angeles area. Mr. Kelen went on to say that these stress mills take advantage of the system. They advertise their services on TV, the radio, etc. The individual that Mr. Kelen had discussed ran up a great number of medical bills in a short period of time. The bills included opinions concerning orthopedics, internal medicine, neurology and psychiatry. There were also bills for blood work, x-rays, etc. The Labor Code itself does not restrict the number of bills that can be run up and the dollar amount of the medical costs is practically unlimited. There is also a provision in the Labor Code requiring prompt payment for reasonable charges.

Mr. Kelen went on to state that his insurance company did reject the claim, although they accepted all these medical bills as reasonable charges. The insurance company had it's own doctor that examined the individual and determined him to be healthy but only increased the amount for medical bills. All the medical bills incurred by the individual as well as the insurance company were posted to Mr. Kelen's account, together with a reserve for future expenses. Proof was not a consideration. Mr. Kelen feels that the employer is not "guilty until proven innocent" but "guilty". The reserves remain on a file for three years, which are reported to the Rating Bureau and remain and become statistics. The result is that their experience modification was increased and so was the rate for others in the entire classification that Mr. Kelen's company belongs to. The result was an increase in insurance premiums.
Mr. Kelen indicated that the individual he had discussed -- his claim will not go to trial. It will probably be settled in a few years; that person will receive a couple thousand dollars, and the medical and related bills will be in the 10 thousands. He fears his insurance premiums will go sky high.

Mr. Kelen cited C.W.C.I. statistics that once an Application is filed with the WCAB it will take 25 to 28 months to be resolved. When a case is closed, the reserve amount should come off, but there is no incentive for the insurance company to close a case any sooner. The excessive length of time of the cases is a main contributor to the high premium.

Mr. Kelen stated that the total insurance premium paid by employers, including self-insured employers, is approximately $10 billion dollars. Four or five years ago this was $6 billion dollars. The cost is going up by $1 billion dollars each year. He also indicated that the cost of litigating these claims has increased 500% during the 1980's and has dramatically increased during the last five years.

Mr. Kelen then discussed the magnitude of this figure in relation to other figures in the California state budget to show how dramatic the cost is. He compared it to the total corporate tax collected ($4.5 billion), individual income tax collected ($16.9 billion) and sales tax collected ($13.4 billion).

Mr. Kelen also cited the total budget of Chicago which is $3 billion, and the cost of the Iraq war to the taxpayers will be approximately $7.5 billion. The largest financial failure in history was Lincoln Savings & Loan which was $6.5 billion. The workers' compensation system is a much bigger failure and costs more. The figure is repeated every year. Mr. Kelen says it is beyond his ability and scope to estimate the losses in jobs in business which would have contributed to more tax revenue in the state. He feels the state is being harmed by this continued high cost item.

Mr. Kelen also gave his opinion concerning the minimum rate law. He believes that the free market system is superior over other types of systems. He thinks it is self evident that insurance companies should operate under the same competitive market conditions as their customers. He believes the repeal of the minimum rate law would be a big step in the right direction. It should be done with a general overhaul of the workers' compensation system to avoid a big mistake. Repealing the law by itself will not solve the problem.

Mr. Kelen believes the workers' compensation system is in shambles and the situation gets worse every year. Mr. Kelen cited a proposed increase of 11.9% which is waiting for the Governors approval. He believes this suggested rating increase is a consequence of the "deep pocket" which is being manipulated by participants who are abusing the system. The insurance industry is no exception to this. Mr. Kelen stated that insurance companies profit from claims whether they are real or fraudulent and the longer lasting the claim, the more premium income. Insurance is a business and no business would work against its best interest.

Mr. Kelen concluded by pointing out that this Commission has an opportunity to bring order into this area through reform and to reverse the inflationary trend of rate increases and to start a new system controlled by competitive market forces in a free market system. He believes that if the Commission does so there will be a greatly improved business environment in the state of California.

14.27.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. Kelen's testimony.

A. Was the workers' compensation rate of spinning and weaving a part of your testimony?

ANSWER: Yes. The rate in California is the highest. Massachusetts is fairly high and that was the reason the textile industry from Massachusetts went to the Carolinas. The rate in California is higher that the rate of Massachusetts.

B. How many spinning and weaving businesses are in California?

ANSWER: Not many and that is why a false claim effects the rate very much. We are the only one on the west coast making synthetic webbing.

C. What proportion of your total cost is workers' compensation?

ANSWER: I can not answer this off-hand but I will submit a written answer to your question. It goes roughly $150,000 a year.

D. The Ohio figure, when you say it is "impossible" you believe that's an incorrect figure?

ANSWER: I know the figure is true. We checked the figure because we were skeptical. There is no spinning or weaving in Ohio so that was one of the reasons I did not include it on the form.

E. What are the products that are provided in the spinning and weaving industries?

ANSWER: (Mr. Kelen responded as to what his Company provided): Synthetic webbing. The most common is your seat belt in your automobile, car seats, back pack and ski equipment and sporting goods equipment. Webbing is used for tie downs for the air cargo industry and in trucking. It is also a soft re-enforcement of soft luggage.

F. Is there danger to the worker and is that determined by toxicity of the material?

ANSWER: No. We have a very good record. In 18 years we had one small accident which was settled for $7,000 some years ago. We have a safety program, but our record is so good. Its mostly the situation that it is not a dangerous industry.

G. Is your firm just in California?

ANSWER: Yes we are the only ones on the west coast until we are forced to move from California.

H. Have you considered that?

ANSWER: We do. Its impossible to compete with the Carolinas with ten times less rate. Their cost is much cheaper.

I. Do I understand you correctly that the workers' compensation rate is one of the reasons you might consider moving out of California?

ANSWER: That's the only reason.

J. That is the only reason?

ANSWER: Yes. I feel like a clerk in a liquor store in a dangerous area where a robber can come in any time and ask for money. Two people may come in the door and one of them is an attorney and the other is a misguided person, and the gun is a doctors' certificate.

K. Are your employees covered by a union contract?

ANSWER: No.

L. Are you eligible for experience rating?

ANSWER: Our experience modification rating when we started 18 years ago was 100% as it was for everyone. By 1988 we were down to 58% because we didn't have accidents. Then we began getting a bunch of bogus claims which we couldn't defend and our experience rating went up again to 91%.

M. Do your employees have health insurance?

ANSWER: We had insurance in the past with Blue Shield, but now we are self-insured. We cover reasonable medical expenses with no deduction, 80% of it.

14.27.6 WRITTEN MATERIALS PROVIDED

Written materials and video tapes were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.28 SUMMARY OF TESTIMONY

STATE OF CALIFORNIA, OFFICE OF SELF-INSURANCE PLANS TESTIMONY OF: MARK ASHCRAFT

14.28.1 SUMMARY OVERVIEW

Mr. Ashcraft gave his perspective as the Manager of the Office of Self-Insurance Plans for the State of California. He discussed in general the role of aggregate excess insurance and the phenomenon of employee leasing. He explained that from his point of view, the self-insured essentially functions as a workers' compensation insurance carrier.

Mr. Ashcraft supports the repeal of the insurance code section which prevents sale of aggregate excess insurance by admitted California carriers. He doubts there would be a "mass exodus" into self-insurance and explained the financial and other guidelines that must be met for a private employer to become self-insured.

14.28.2 REQUESTS MADE TO THE COMMISSION

Mr. Ashcraft recommended the Commission review the prohibition of sale of aggregate excess insurance, and seriously consider repealing this archaic provision in the Insurance Code.

Mr. Ashcraft urged the Commission to examine the phenomenon of employee leasing in this State as a means to get around the minimum rate law.

14.28.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Aggregate Excess Insurance	3
Self-Insurance/Pools	3
Appropriate/Expeditious Claims Service	1
Minimum Rate Law	1
Solvency (Security of Benefits)	3

14.28.4 SUMMARY OF TESTIMONY

Mr. Ashcraft is the Manager of the Office of Self-Insurance Plans, Department of Industrial Relations for the State of California. His department regulates permissibly self-insured employers pursuant to Labor Code Section 3700. Written material was also submitted by Mr. Ashcraft to the Commission. Mr. Ashcraft's presentation briefly summarized three of the areas covered in that written material.

A. SELF-INSURANCE

Mr. Ashcraft began by indicating that Labor Code 3700 establishes three different ways by which an employer can provide workers' compensation coverage for it's employees. The most common is to buy a policy of insurance from the workers' compensation carrier. The second is to become permissibly self-insured and the third is to be legally uninsured (only the State of California has this designation).

California has the largest self-insurance program in the country with 1,466 private companies being self-insured and 2,195 public sector agencies being self-insured. Of the public sector agencies, 1,300 of them belong to 87 Joint Powers Authorities which are group self-insured. In 1990, 35% of California payroll was covered by self-insured programs. Each year approximately 60 to 75 new private companies become self-insured for the first time.

Mr. Ashcraft indicated that there has never been a mass movement towards self-insurance, rather there is a very consistent and stable movement that exists every year. To become self-insured the company must apply with Mr. Ashcraft's department. The private sector does not have a "right" to become self-insured, they must qualify. Mr. Ashcraft then explained the details for a private sector company to become self-insured (a 19 page application, detailed information about their past experience and financial capabilities).

Mr. Ashcraft advised that all self-insurers report their liabilities once a year on an annual report and private self insurers are required to post a security deposit to secure all reported liabilities. Mr. Ashcraft's office also audits the self-insureds on a three year cycle to insure that their reports are realistic. Mr. Ashcraft indicated that 75 to 80% of self-insured utilize a third party administrator to handle their claims. Many of the insurance carriers provide administration services to self-insured businesses. The self-insured company pays dollar one coverage on every liability it runs in its workers' compensation self-insurance program. They're required to pay the same benefits any carrier in California must pay. In the workers' compensation system a self-insured is viewed as just another insurance carrier.

Mr. Ashcraft then addressed guaranteed funds and indicated that the private self-insureds collectively guarantee that if a self-insured goes bankrupt or the security is inadequate, the self-insurers, through assessment, would pay those liabilities. The self-insured security funds (SISF) is the equivalent of C.I.G.A.(California Insurance Guarantee Association).

Mr. Ashcraft indicated that most self-insurers limit their liability by purchasing specific excess insurance. Some also purchase aggregate excess insurance coverage.

Mr. Ashcraft indicated that there are some self-insureds that leave self-insurance in a given year. They are required to pay all their self-insured claims until they are done and continue to post minimum deposit indefinitely. They must also buy insurance for their continuing operations if they continue to operate in this state.

B. AGGREGATE EXCESS INSURANCE

Mr. Ashcraft then addressed the topic of aggregate excess insurance. He reminded the Commission from his point of view, the self-insured is just another insurance carrier. Mr. Ashcraft explained that like any other insurance carrier, they have a certain number of employees that are in their insurance pool and based on the size of that pool, they can estimate the number of claims every year that will be generated. There's always a risk, as with any pool, that you might have a claim for every single employee, such as with an earthquake situation. Many self-insurers would like to purchase stop loss insurance. Mr. Ashcraft defined that as: if the losses in any one

year exceed a certain level then the losses stop at that point and the insurance policy picks that up. This is called aggregate excess insurance.

Mr. Ashcraft indicated that Insurance Code section 703.5 prohibits California brokers from discussing aggregate excess insurance. Also, Mr. Ashcraft indicated that California admitted carriers are prohibited from selling aggregate excess. However, it is easy to pick up the telephone and buy this type of coverage out of state and most self-insurers in the private sector can do so. It is not against the law for a California company to have aggregate excess insurance, they just can't talk about it with their broker and can't buy it from an admitted carrier.

Mr. Ashcraft inquired of the Commission: wouldn't it be better, and won't the state of California be better served if admitted carriers could sell this line of insurance to self-insurers who want to purchase it? Mr. Ashcraft pointed out that this would enable the Insurance Commissioner to overlook this group of insurers who are selling this insurance currently. Mr. Ashcraft stated that he believes self-insurance would be improved by having aggregate excess available to all private and public self-insurers and that it be sold by California insurance carriers. He recommended the Commission seriously consider repealing this archaic provision in the insurance code.

C. EMPLOYEE LEASING

Mr. Ashcraft indicated that self-insurance does not use premium or experience modifiers as insurance companies do. (Self-insurers are responsible for every claim.) The point of rate-making is to try and spread the risks that are out there in the insurance pool. If the insurance company relies upon rate making rules to evenly apply risk and experience to the individual employer. Some employers are clever enough to figure out ways to get around rate-making rules. Mr. Ashcraft pointed out one of these ways that can be used to circumvent insurance rate making (the use of employee leasing). Mr. Ashcraft urged the Commission to look at the problem of employee leasing in the state. Nationally it is a serious problem to insurance carriers. Mr. Ashcraft indicated that employee leasing can be perfectly legitimate although it has the potential of being illegitimate.

Mr. Ashcraft defined employee leasing as a contractual arrangement in which a leasing company is the employer of all or part of the clients' work force. The employment responsibilities are allocated between the leasing company and the client employer while allowing the client employer to retain management and control of its business. The leasing company pays and reports wages and employment taxes out of its account and has the right of direction and control over leased employees. Mr. Ashcraft indicated that many of these contracts with leasing companies include the fact they will provide insurance to cover the employees.

The impact on the insurance industry is that an inadequate premium may be collected resulting from the leased employees not being subjected to the employers' experience rating system. Mr. Ashcraft indicated that some leasing companies can evade proper premium by misrepresenting employee classification, payroll and even the location of the client company. Many of these leasing companies operate out of state and report to their carrier that they have several thousand employees. They may not mention that some of leased employees are in high hazard occupations working in California.

Mr. Ashcraft concluded by stating that he did not suggest all employee leasing is an attempt to get around the rate-making system in California, but he pointed out it is increasingly widespread in California and there is a potential for abuse in the rate-making structure.

This summarizes the testimony of Mr. Ashcraft.

14.28.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. Ashcraft's testimony:

A. Concerning aggregate excess on out-of-state insurance companies, if you don't have any operations outside California, can you still get aggregate insurance from a company outside of California?

ANSWER: It would be difficult. The public sector is in that particular box. Joint Powers Authorities would like to buy aggregate excess to protect their members.

B. So legally you're not supposed to get it outside California if you don't have any operations there?

ANSWER: It is not clear whether they can do it or not.

C. If you have it and don't have any operations outside of the state, is that insurance company legally bound to cover losses in California?

ANSWER: I don't know.

D. Does the insurance industry in California want to write aggregate excess or are they opposed to it from your perspective?

ANSWER: I'm told that the existing rule was put into effect because insurance carriers felt there would be a mass rush to self-insure and aggregate excess would allow them to get around the minimum rate law. I think my testimony shows you we already have a large self-insurance program and there is no mass movement to self-insurance. Another phenomenon is the issue of fronted insurance, where the employer basically pays, in a deductible, either all of the cost under the policy or up to some retention level which is generally large.

E. Do you see any pricing discipline as a result of self-insurance upon the manual rates? What would it be in the absence of self-insurance?

ANSWER: Presumably there would be many more employees in the pool and conceivably the rates that would be charged would be dampened because there would be a bigger base. I suspect that the rates would be the same as they are now even with more participants.

F. Self-insurance would seem, by definition, to have the safer record, the safer history, than that classification.

ANSWER: Generally self-insureds come to us for one of two reasons: (1) they think their insurance costs are totally out of control and that they can do better on their own or (2) they feel their safety record is good and that they get no benefit for it in the insurance ratemaking system.

G. On aggregate excess, you can not use admitted carriers, and California brokers can not discuss it?

ANSWER: That's correct.

H. So you're using non-admitted carriers?

ANSWER: That's correct

I. Is there an insolvency issue here?

ANSWER: With self-insurance, the employer is responsible for all the claims. We don't require the employer to carry excess coverage, it is voluntary. For the employer in self-insurance, if his excess carrier went out of business or did not pay, the self-insurer would have to pay the entire loss.

J. Insolvency would not have anything to do with the non- admitted carriers, then?

ANSWER: With insolvency, we turn it over to the Self-Insurers' Security Fund, which has the responsibility to pay the claims. If they can collect or not collect, is a Security Fund problem. If they can not collect, then they must pay.

L. I need some clarification here. Is that aggregate excess a casualty contract?

ANSWER: It's a reimbursement --

M. Is it covered by the state guarantee fund not the self-insured fund?

ANSWER: No they are non admitted carriers.

N. So as a non admitted carrier, the workers would not be covered by the state guarantee fund?

ANSWER: That's correct, if they were not going to pay.

O. In other words, they would have exposure even if they had non-admitted aggregate excess because even with a non admitted aggregate excess policy, self-insureds are primarily responsible for the claims?

ANSWER: Right.

P. If the aggregate excess was insolvent, there's no coverage by the state guarantee fund?

ANSWER: By CIGA.

Q. If we changed the requirement and allowed California insurers to offer aggregate excess, they would be covered under the state guarantee fund?

ANSWER: That would depend on CIGA, because CIGA has a whole list of exceptions.

R. If you were to allow California insurers to offer aggregate excess, they could be covered under the state guarantee fund?

ANSWER: That's conceivably correct, but the payments are going to support the fund like other types of policy.

In the public sector, they would probably establish funded aggregate pools. The way the JPA pools operate, it's more likely that the JPAs would set up a single aggregate pool rather than buy insurance.

S. Concerning self-insurance, is there also some costs self-insurers pay that insurance companies do not?

ANSWER: I'm not sure.

T. Premium taxes for example.

ANSWER: There is no premium tax with self-insurers.

U. There are some costs in self-insurance that an insurance carrier doesn't have?

ANSWER: It goes both ways. There's a license fee that self-insurers have to pay to support my operation that insurance carriers don't pay. There are various costs between the two sides that are different. We don't have a rate-making body because we don't need one, so obviously there's not a cost for that.

V. Do the accident records of self-insurers get fed into the manual rates for insurance?

ANSWER: No.

W. Like the Rating Bureau?

ANSWER: No. Self-insurance statistics were not gathered or compiled for similar reports. The workers' compensation information is used for rate-making purposes. In some industries (e.g. grocers) all the major grocers are self-insured so if you wanted to get information on grocers experience, your data would be very biased because it's really pulling information from very few small grocers. Schools are the same way in the public sector.

X. You keep no database?

ANSWER: No, but we are working on setting up a data collection system.

Y. The 87 Joint Powers Authorities, how are they formed and monitored?

ANSWER: Generally they are homogeneous groupings and tend to be all schools, all hospitals, all cities, etc. A JPA can be created to do almost anything. They tend to be created by third party administrators who help them get everything together and then end up being hired as a third party administrator for the JPA. Once the JPA starts functioning, basically they do everything an insurance carrier does. The JPAs determined funding, collects money, and at the end of the year turns unused money back in the form of a dividend. Many JPA's have an actuarial review their projections and most of them have financial reviews done every two to three years. They function essentially like a mutually owned public company.

Z. Are private sector employers in the same situation?

ANSWER: We do not allow group self-insurance in the private sector, and each self-insurer must qualify on their own.

AA. In terms of operating as if they were an insurance company, how do reserves affect self-insureds? Do they have to set reserves or is it just that they are responsible for it because it would be savings if they didn't?

ANSWER: Self-insurers are required to estimate full liabilities. Our regulations require that liabilities be set for the life of the claim initially, and then they are required to post a minimum of 135% of that in their security deposit. We are proposing, in January, that they post a security deposit of 135% of their known claims, just as now. But they will also post with us an amount

to secure the current years' claims which are unsecured in the present system. We will give them credit for excess coverage, and that will be their new deposit.

AB. So it sounds that there is a break right now as far as self-insurers are concerned?

ANSWER: No. The self-insurers' estimates of future liability is done the same way an insurance carrier does. Also, we are looking over their shoulder, and have been for years; unlike the carriers. Self-insurers have been audited for much longer, and insurance carriers have only started to be audited in the last two years. Self-insurers have had to post realistic reserves for years.

AC. What kinds of security do you require for the firms, and secondly, what do you require of your public entities?

ANSWER: The public entity is not required to post a security deposit. If they are in a JPA, the pools do that.

AD. What security is required?

ANSWER: In the private sector, self-insurers have to post a surety bond, letter of credit, proof of securities or cash, or a combination of these.

AE. Could you give us an example of two of the smallest private sector employers that would be self-insured?

ANSWER: We have some public sector school districts in the hinterlands that have one or two employees. The smallest one in the private sector was a company that had 12 employees. Their income came from collecting royalties, and that was their business. The income of those 12 people was $350 million a year. And we have everything in between.

AF. It is said that the primary reason for joining or becoming self-insured was that employers didn't feel that they were getting their premium reduced enough if they had a good experience mod and if they were good risks. Is that right?

ANSWER: Yes. They think that.

AG. Are your really good, best risks that are good on safety opting out because of self-insurance?

ANSWER: The logic is good, but every insurance carrier could do a fronted policy for a good risk and I sometimes wonder why they don't do that.

AH. Do you have any idea what percentage self-insurance represents of the California employees?

ANSWER: Not off the top of my head.

AI. If a public sector employer can self-insure with one or two employees, why can't a private self-insurer?

ANSWER: They could if they could reach the financial requirement.

AJ. But public entities are not meeting the financial requirements?

ANSWER: They are not required to by statute.

AK. From your perspective, would you ever consider taking private employers on a self-insured basis if they didn't meet the financial requirements?

ANSWER: The financial requirements are guidelines and there are several of them. Our job is to evaluate their financial capability. If you are a small company, though, you have to evaluate why they are becoming self-insured. You have to evaluate each one individually. It's hard to set standards in stone, because the moment you do there will be a company that comes in with a different set of financials.

AL. As to companies that become self-insured when they could have fronted policies, do you think this is related to the minimum rate law?

ANSWER: I don't know.

AM. If I'm an insurance company, perhaps I have less incentive to offer these types of policies when I have the minimum rate law?

ANSWER: I don't know. You'd have to ask the carriers.

AN. What would be your agencies' incentive not to say "no", if an organization didn't meet every letter of every guideline -- what's it to you?

ANSWER: We don't try to sell self-insurance. We have all the business we can handle without doing anything.

AO. Do you have numbers on the ratio of public sector organizations that are self-insured against the "universe" in California?

ANSWER: I heard there are about 5,500 public sector agencies, but I'm not sure that's the total number. Many public sector agencies are post Prop 13 tax collection agencies and don't really have any employees.

AP. What percentage, or what is the number of actual self-insured?

ANSWER: 2,195 right now.

AQ. Unrelated to the insurance question, how is the money being used that is being kept in this fund? Is the State tapping into it?

ANSWER: Most of it actually exists in surety bonds, which is just an instrument guaranteeing that if the employer goes bankrupt, the surety will pay. A letter of credit is a piece of paper from the bank. The cash and securities are posted in the name of the Department of Industrial Relations, in trust, for that specific self-insurer and is held by the State Treasurer.

AR. Under what conditions can a self-insured lose their license besides the financial reasons? Do you keep complaint files on the self-insurers or is there any way to get at the claim payment procedures?

ANSWER: The Labor Code specifies a number of specific things that the Director can revoke certificates for. Most self-insurers that have certificates revoked, actually leave voluntarily. Many are revoked for financial reasons; they can no longer meet the financial requirement. I've been the Manager for 4 years, and we have never revoked anyone's certificate for improper claims handling. We do see a lot of complaints from various employees and we have found that most

of the time they involved litigated cases, where the employee has their point of view and the administrator of the claim has their point of view. The only way the issue would be decided would be to go before a Judge.

AS. Was Lincoln Savings & Loan self-insured?

ANSWER: No.

AT. Do you audit safety plans? I know that as a requirement of self-insurance, they are supposed to, at least, have someone on file as the "safety manager".

ANSWER: An applicant for self-insurance has to demonstrate that they have an effective safety and health program. We make them have a neutral, licensed professional engineer do a safety and health evaluation (similar to Cal-Osha) and the employer has to fix any serious violation.

AU. That's only for new applicants?

ANSWER: There is no continuing requirement that they report to us. Under Cal-OSHA requirement, employers are required to have a written safety program that Cal-OSHA enforces. If they find a self-insurer that does not have one, then they notify the Director and then we would ask why we shouldn't revoke their certificate of self-insurance because they don't have a safety and health program.

AV. How large is your office and what type of background of these people?

ANSWER: We have 28 people. Most of the people are field auditors that go out and do audits of the self-insured's for liability. They are estimating future liability of the claims. The rest are clerks. The people that evaluate the applications, are people that formerly were auditors.

AW. Could you touch briefly on the annual reports that you require from self-insured?

ANSWER: Each self-insurer submits a five page annual report with general information about their administrator and insurance coverage. They report all their liabilities for the last 5 years, in detail; give us a list of all their open indemnity files and calculate their security deposit based on the liabilities they have reported.

14.28.6 WRITTEN MATERIALS SUBMITTED

Written materials were submitted to the Commission by this witness.

THE ABOVE TESTIMONY HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.29 SUMMARY OF TESTIMONY

ZERO CORPORATION
TESTIMONY OF: WILFORD GODBOLD, JR.

14.29.1 SUMMARY OVERVIEW

Mr. Godbold presented his view as a C.E.O. and representing the Chamber of Commerce. He believes California companies are leaving the state because of several reasons including workers' compensation costs. In particular he cited the stress claim as taking both a financial and emotional toll.

Mr. Godbold cited a recent report from the California Business Roundtable which supports his concerns.

14.29.2 REQUESTS MADE TO THE COMMISSION

Mr. Godbold strongly requested this Commission to examine the cost drivers, specifically the volume of stress claims and soft tissue back injuries.

14.29.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Costs of Actual Operation	3
Self-Insurance/Pools	1
Cost Factors/Drivers	3

14.29.4 SUMMARY OF TESTIMONY

Mr. Godbold is the President and C.E.O. of Zero Corporation, a New York Stock Exchange Company with about $200 million in revenues. He addressed the Commission as both a C.E.O. and a representative of the California Chamber of Commerce. He heads a task force on "Saving California Jobs". He has recently had to relocate his business from California to Salt Lake City because of high workers' compensation costs and other business costs. Mr. Godbold indicated he was not here to discuss detail concerning workers' compensation but from the point of view of an employer that has problems dealing with workers' compensation. He indicated that his company was self-insured. They did that so they could keep the profit that the insurance company would otherwise make.

Mr. Godbold indicated that he was hoping the Commission would look at stress claims because this whole area is "pathetic" and is highly damaging to the California business/jobs environment.

Mr. Godbold cited a recent report from the California Business Roundtable which supports his concern.

This summarizes the testimony of Mr. Godbold.

14.29.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

What follows is a summarization of questions and answers raised by the Commission following Mr. Godbold's testimony:

A. We have heard a lot of speculation about business leaving California for reasons such as workers' compensation rates. It sounds as if you have done some investigation, would you please tell us what you are finding?

ANSWER: The California Business Roundtable just finished it's study yesterday. As I remember the numbers, 23% of the companies in California were planning to either leave or move operations out of the state. That is a 64% increase from November, 1990. The next startling statistic is that 37% of the manufacturing companies in California are planning to leave.

B. 37%?

ANSWER: Yes. More than one third. More than one in three. It was 23% in November of last year. The Governor recognizes this as a dramatic issue, so it's something you might have within your control and can do something about.

C. In what you and your group have been looking at, you mentioned a number of concerns from regulations in general to environmental. Do you have a rough feeling of where workers' compensation rates in the system would rank as far as the reasons you have been looking at?

ANSWER: I do and I may have it in my briefcase.

D. Of the various reasons that a company might consider leaving, where would workers' compensation issues fall in the ranking?

ANSWER: In 1991 86% of the 1,462 California firms surveyed indicated that workers' compensation was the most harmful problem to business. I can't remember how many questionnaires went out, but statistically it was a dramatic response and gives a good spread of numbers. It's absolutely clear that workers' compensation in the perception of business men, is the top problem.

E. Is that report just out?

ANSWER: Just came out yesterday. I have a fax of it.

F. Can we get that as a part of the record as well as send it to us?

ANSWER: Sure. It's good to take a look at it because just focusing on workers' compensation it is a dramatic problem. It is also an emotional problem for business men and women because, with the advent of stress claims, and I don't know if you have talked about it yet, but the perception is that stress claims are just wrong. 93% of them, if you like statistics, are fraud. (That is my guess, no one else's.) California is one of five states in the country that have stress claims. My recollection is either there are two states or California stands alone to permit stress recovery with no injury. The other four states permit recovery only <u>if</u> there is a physical injury and stress follows. Stress, and workers' compensation in general, are major issues business men and women look at to determine whether they want to do business here in California.

G. From your comments would you say that the problem that the business community sees with workers' compensation is the nature of the claims and how they are adjudicated rather than the

minimum rate system?

ANSWER: I can't speak to the minimum rate because it doesn't make much difference in my business.

H. But of the business people you know, are they complaining about the fact there is no front end competition or is it other kinds of things they're worried about?

ANSWER: There are two different questions. One is in terms of minimum rate. If you like a free economy, which is the most efficient, you want to be able to have open bids. As a business person I would like to get bids from three different self-insurers and match that against the self insurance costs for me to run it and have an outside administrator. Secondly, the nature of claims in terms of stress. In a personal situation, this has been a difficult year for most companies. In one of the entities that we just acquired, when we downsized, every employee filed a stress claim on being laid off. That is pathetic.

I. Again, without pushing you, but weighing those two, if you could have competition in rates or a radical change in the types of claims and adjudication of claims, which do you think?

ANSWER: I think the most insidious issue is the stress claim. That's the most insidious because it is both financial and emotional. If that were taken care of, then the next issue would be free competition on the rates because that's important and that's how we ought to be doing business.

J. Other than the statistics you have with you, what portion of your evidence -- are you personally aware of a lot of others leaving the state?

ANSWER: Sure, absolutely. Sitting in a breakfast about three months ago, there were seven C.E.O.'s and four of them were looking at leaving California. Workers' compensation pops right up to the top when you ask them why. The vocational rehab people, applicant's attorneys, and doctors are taking a tremendous amount out of the system. In my case, regarding the two operations we are moving from California to Salt Lake City, we're saving about 60% in workers' compensation costs and the benefits are going to be about the same. Statistically, California, in terms of insurance premiums, is the third highest state in the whole United States. In terms of benefits to the injured worker, it's down around 36. You know something is wrong in the system.

L. Are there any statistics that the Chamber or others might have about what percentage of costs of any sort that workers' compensation represents to a typical business or in any type of business?

ANSWER: I don't remember the source, but it was something like 3% of payroll, which can be very significant. I'm sure you can get something from the Chamber of Commerce.

RESPONSE FROM AUDIENCE (Steve Kelen): I have to correct you, the manufacturers factor is not 3%, it is between 10 and 20%.

M. We recognize these other items that you mentioned as the main cost drivers, but regrettably we may have no power in any of this, but we certainly don't have any in those cost drivers. The cost drivers will have to be solved through Legislative reform and other mechanisms. But we can, I think, influence the competition part of the workers' compensation issue.

ANSWER: Terrific.

14.29.6 WRITTEN MATERIALS PRESENTED

Written materials were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.30 SUMMARY OF TESTIMONY

SCHOOLS EXCESS LIABILITY FUND
TESTIMONY OF: JOHN WILSON

14.30.1 SUMMARY OVERVIEW

The focus of Mr. Wilson's presentation pertained to the availability of aggregate excess insurance and its purchase by public entities within the state of California.

14.30.2 REQUESTS MADE TO THE COMMISSION

Mr. Wilson asked that the Commission consider repealing that section of the Insurance Code that prohibits the sale of aggregate excess insurance to self-insured employers, both public and private, by admitted carriers within California.

14.30.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Aggregate Excess Insurance	3
Self Insurance/Pools	3
Safety Incentives	2

14.30.4 SUMMARY OF TESTIMONY

Mr. Wilson began by stating his background and that he represents the Schools Excess Liability Fund, a joint powers authority in Sacramento. His group has a program in the area of excess workers' compensation which covers 194 school districts with $2.6 billion of covered payroll. There are primary pools that obtain their excess coverage from SELF. Mr. Wilson indicated that SELF's liability program is a larger program than the workers' compensation program. He indicated that SELF is a member of CAJPA (California Association of Joint Powers Agencies) and Mr. Wilson is chairman of the Legislative Committee for that association.

Mr. Wilson went on to state that CAJPA asked the legislative committee to sponsor legislation to delete that section of the Insurance Code which prohibited the discussion of and purchase of aggregate excess insurance by admitted California carriers. The result of that effort was that the bill was referred to the Rate Study Commission for action.

Mr. Wilson stated that aggregate excess insurance is a risk management tool available elsewhere in the nation. California employers can purchase this coverage outside of California. Some states require this coverage as a condition of becoming self-insured.

Mr. Wilson also stated that he was once involved with the Self-Insurers Security Fund and in that capacity he believes that assessments to self-insured employers would have been significantly reduced if this coverage had been in effect.

Mr. Wilson also believes there is a "free speech" issue raised by this section of the Insurance Code.

As far as who supports this legislation, Mr. Wilson stated that the insurance industry may have had valid fears when the legislation was originally introduced, fearing a vast movement into self-insurance. However, the lack of this coverage has not affected the growth of self-insurance and nearly all public sector employers self-insure their programs. Mr. Wilson does not believe there is a valid argument that removing this regulation would undermine the rate structure in California.

As far as safety, Mr. Wilson stated that his experience revealed that safety efforts increase in most self-insurance programs -- there is a direct cost incentive.

He stated that an excess pool such as SELF doesn't really consider safety or the rate structure because they don't deal with the primary workers' compensation market, but are a provider of excess coverage. SELF purchases excess coverage at the $2 million level and aggregate excess coverage is another option SELF should be able to consider in deciding the stability of their pool.

Mr. Wilson asked the Commission to recommend deletion of the aggregate excess restriction from the Insurance Code as it pertains to public sector employers.

14.30.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

A. What kinds of carriers usually offer aggregate excess? Is there a problem with regulatory issues?

ANSWER: No. There are adequate markets for this coverage and there are markets that specialize in this coverage. Several companies may move into California and actively pursue this market if this restriction is deleted.

B. Is there any justification not to allow aggregate excess--I am trying to think if there is a regulatory problem--who offers it, any thing at all?

ANSWER: I am not aware of it. The only arguments we heard before the Senate Committee had to do with the safety issue and the undermining of the rate structure--that insurance companies will offer minimum premium programs by bypass the system.

C. Do you purchase it now outside the state?

ANSWER: No. We were buying specific excess coverage from within the state. If it were possible to secure our program with aggregate excess, we might assess our members a lower rate for coverage.

D. If the Commission agreed with your recommendation, would you suggest a threshold level where excess liability would not extend below?

ANSWER: No. Subsequent to this restriction being put into law, the financial requirements for self-insurance have been substantially increased. There is a regulating agency (Self-Insurance Plan, State of California) which will not allow self-insurance unless the financial criteria is met.

14.30.6 WRITTEN MATERIALS PRESENTED

There were no written materials presented.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.31 SUMMARY OF TESTIMONY

STATE OF CALIFORNIA, OFFICE OF BENEFIT ASSISTANCE AND ENFORCEMENT
TESTIMONY OF: CHRISTINE BAKER

14.31.1 SUMMARY OVERVIEW

Ms. Baker discussed OBAE's responsibilities to audit both insurance carriers and self-insured entities to assure there is appropriate and expeditious claims handling and that benefits are paid to injured workers in a prompt and thorough manner.

14.31.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to this Commission.

14.31.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Appropriate/expeditious claims service	3
Data Availability/ Impartiality	2

14.31.4 SUMMARY OF TESTIMONY

Ms. Baker began by discussing the purpose of the audit unit with the Division of Workers' Compensation, which is to ensure that proper benefits are paid timely and accurately to injured workers. She indicated that penalties are assessed against insurers, self-insurers and third party administrators for failure to do so. The creation of the audit unit was a result of the 1989 Reform Act.

Ms. Baker stated that the statute requires her agency to conduct 50% of their audits based on a random selection, and the other 50% based on information received through the benefit notice unit program and complaints from the public. She explained that they had completed 81 audits in 1990, and 112 so far in 1991. Of those 112 audits, 79 were selected on a random basis and 33 were "targeted" based on complaints.

Ms. Baker then explained the administrative penalties her unit can apply and the types of violations. There are also civil penalties of up to $100,000 if it is found that an employer, insurer or third party administrator has a general practice of conducting themselves in a manner that is inconsistent with the Labor Code. Ms. Baker indicated that OBAE's auditors are expected to be fair, firm and impartial.

She indicated that OBAE issued its first report to the legislature in April, 1991 and addressed the findings of the audits conducted during the calendar year 1990. Ms. Baker indicated that OBAE issued 3,133 administrative penalties totaling $606,650. This year to date, a total of 7,789 penalties have issued totaling $729,125. Ms. Baker referenced the report she handed out to the Commission and explained the type of

penalty and the frequency. The most frequent violation is the failure to pay indemnity within ten days of the date due. Ms. Baker continued to explain the other penalties frequently assessed.

Ms. Baker believes OBAE has an aggressive program and it has been successful in improving the delivery of benefits to the injured worker.

14.31.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

The following is a summarization of the questions and answers raised by the Commission following Ms. Baker's testimony:

A. Do you have any idea how much of these penalties are ascribable to the companies that were targeted?

ANSWER: The data for this year is not going to be available until April 1992. At that time, we could probably take a look at which penalties actually came from the targeted ones and which penalties were assessed.

B. How does a worker who feels he/she is not getting proper service go about getting their complaint lodged?

ANSWER: They can talk to the Information and Assistance officer at the local WCAB district office. There is a form that he submits with his complaint to the OBAE office.

C. Just inform me, when a person has complained, is there an easy way that they can get it resolved without going out and filling 10 or 20 forms, or having to get a lawyer.....

ANSWER: They can write directly to the audit enforcement unit.

D. How would one know about you?

ANSWER: The I & A officer, the 800 number --

E. What is the I & A?

ANSWER: The information and Assistance officer in all the district offices. There is an 800 line for information and assistance on workers' compensation. For a major complaint they can write a letter and we can initiate an investigation.

F. Sounds pretty difficult. What if I don't read English?

ANSWER: If you don't read English, we have a translation service available though AT&T. There are 177 languages available.

G. Do you keep records of complaints by company?

ANSWER: Yes we do. Once a complaint starts, we keep a file on that insurance company.

H. About your sampling procedure, -- 70+ companies seems rather small compared to the total. Is there some attempt to systematically or in a stratified way, do this sampling?

ANSWER: We are now sampling, for the next fiscal year, based on a random sampling basis

on claims adjusted by each entity.

I. Weighted by number of claims?

ANSWER: Yes, and it is totally computer generated, based on a random sampling. There will be companies that will be audited more frequently and those that won't get audited at all.

J. What is your budget?

ANSWER: Right now it is under consideration.

K. Did I get the impression that it was only carriers that you were auditing?

ANSWER: And self-insureds, third party administrators.

14.31.6 WRITTEN MATERIAL SUBMITTED

Written materials were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HER TESTIMONY.

14.32 SUMMARY OF TESTIMONY

STATE COMPENSATION INSURANCE FUND
TESTIMONY OF: BRAD RICHMOND, SAFETY & HEALTH MANAGER AND NORM HANSEN, VICE PRESIDENT (GROUP PROGRAMS)

14.32.1 SUMMARY OVERVIEW

Mr. Richmond gave a detailed description of the safety services available from the State Fund to all classes of policyholders, how these services are allocated and how smaller employers can make use of them.

14.32.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to the Commission.

14.32.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Safety Incentives	3
Minimum Rate Law	1
Dividends	1
Equity/Small Business Employers	3

14.32.4 SUMMARY OF TESTIMONY

Mr. Richmond is the Safety & Health Manager for SCIF. He discussed his background and experience in the field of industrial health, as well as his educational background. Mr. Richmond went on to discuss the Occupational Safety and Health Act of 1970, and pointed out that the act placed the responsibility for safety solely upon the employer, and provided for enforcement of safety regulations through a system of inspections. California created the Cal OSHA program in the early 70's and there are almost 500 pages of fine print requirements for work place safety.

Mr. Richmond stated that as with any complex regulatory area, there are a group of professionals that communicate and interpret these regulations, namely industrial safety and health professionals. Mr. Richmond stated that most of his peers work for large companies capable of self-insurance, and the remainder are spread among government, private consulting and the insurance industry.

Mr. Richmond pointed out that while large employers have the motivation and financial resources to commit staff to this area, small employers are at a distinct disadvantage. With the advent of SB 198 small employers are having trouble bringing themselves into compliance.

Mr. Richmond stated that there will never by enough government inspectors to enforce this enormous body of safety regulations. Work place safety is a function of the employer's voluntary compliance, and they are

assisted by the insurance provider. Carriers have a direct financial interest in controlling work place injuries. When frequency or severity of losses are reduced, the savings translates into dividends. Mr. Richmond cited a study done by CWCI in July of last year that found that carriers employed 875 full time professionals in the safety and health area. State Fund accounted for 15 - 20% of that total. In contract, Mr. Richmond pointed out that Cal OSHA employs about 240 safety professionals.

Mr. Richmond went on to state that safety is part of State Fund's "mission statement". It is critical that the Fund allocate its safety and health resources as cost effectively as possible.

Mr. Richmond continued by describing the Fund's safety organization

A. STATE FUND'S SAFETY ORGANIZATION

State Fund employs over 130 safety representatives throughout 21 district offices in the state. This allows the district safety rep to develop an understanding of the unique industries characteristic of their area. In addition, 15 safety professionals work out of three group insurance programs and provide safety services to employer associations. These services are supported by the home office which Mr. Richmond manages, and he explained those services in detail, which includes a three year training program, library services, direct mail program, centralized training, etc.

Mr. Richmond stated that there are three levels of safety services provided by the Fund:

1. on-site consulting services to the policyholders;
2. safety training programs to groups of policyholders;
3. direct mail products and information (usually to smaller policyholders)

B. ALLOCATING RESOURCES AMONG INSURED EMPLOYERS

Mr. Richmond stated that accounts that generated $25,000 in premium are assigned to a specific safety representative for on-site consultative services and encompass almost 60% of the Fund's premium. The district offices organize training programs for groups of medium and smaller sized employers, such as their back program or respiratory protection program. The Fund's direct mail program is designed to communicate to the widest possible audience of policyholder.

The small policyholder receives services in three ways: they request it, the direct mail service and group policyholders receive a specialized level of safety services through their trade association membership. Mr. Richmond stated that currently 22% of the Fund's premium is written through group insurance contracts.

Mr. Richmond stated that groups are a primary mechanism for small employers to benefit from dividends. The California Insurance Code requires the establishment of a safety committee prior to issuance of a group insurance policy. Mr. Richmond discussed ways in which the Fund provides safety assistance to these groups, including the recent SB 198 legislation.

Mr. Richmond brought examples of some of the products which his Department produces for the Commission to examine during the break.

Lastly, Mr. Richmond indicated that employers seem to be satisfied with the level of safety services provided by their insurance carriers. He referenced a CWCI study on employer perceptions of the workers' comp system which reported that only 3% of California employers identified lack of safety support as a problem.

Concerning the Minimum Rate Law Mr. Richmond stated that it plays a role in supporting the safety effort in creating an up-front pool of expense and dividend dollars which are available to fund these safety efforts. The money has to come from someplace, and lower rate levels will translate into less money available to fund safety services from the insurance industry to policyholders. Mr. Richmond stated that without the dividend system there will be less incentive to commit resources to a comprehensive safety program.

14.32.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

The following summarizes the questions and answers raised by the Commission following Mr. Richmond's testimony:

A. What is the relationship between the forming or founding of groups and the safety effort? Does it ever work out that you recognize from your end a commonality of safety interests among individual firms and recommended creation of a group?

HANSEN: Absolutely. Any association that enters into a group workers' comp plan has to have a safety committee--just for starters. Group insurance is largely viewed as a marketing plan, but once a program is established, there is incentive for the associations to provide safety services on a more aggressive basis than an individual employer might do. The additional emphasis on safety is an outcome of forming an association.

B. But there isn't a mechanism whereby people in the field notice that concrete contractors, for example, are having problems and market them into a group? Have you thought about marketing them?

HANSEN: Typically an insurer does not go out and solicit employers that are having lots of problems.

C. I'm referring to employers that you might now write as individuals but whom the people who are trying to help them with safety might think would benefit from being part of it.

HANSEN: I can speak for State Fund, but I would assume the underwriting profiles of other carriers are similar to ours--being in a group plan is a privilege. It's not for the privileged, but it is a privilege. Most groups insist on employers in that group having active safety programs, good loss records, etc. They are not looking for the concrete contractor who's having problems.

RICHMOND: The insurance carrier has two customers in this relationship--one is the employer but the other is the association. The association places the initial demand to get help to lower the overall loss ratio, and beyond that the employer may place demands.

D. What percentage of your clients are in the "under $25,000 premium" bracket and not members of the group association? What percentage of the small employers are not members of your association?

HANSEN: Roughly 25% of the employers insured by the Fund belong to one form of a group plan or another.

E. Let's just use the under $25,000 in premium.

HANSEN: Probably 25 to 30% of those employers--that's an educated guess. We have an

extensive number of minimum premium policies that don't normally go into associations. If you want a specific number of less than--those that are less than $25,000 that are not minimum premium policies, I can provide that to the Commission in a couple of days. I would say maybe 20%-25%.

F. For employers without experience modifiers, very small employers--$7,000 or $10,000 in premiums or less, how much attention do they get?

RICHMOND: If may be higher than that, I think for '92 it's around $20,000.

G. A person is so small they don't get an experience modifier--how much attention is given to them with respect to the safety programs?

HANSEN: That is one of the benefits of small employers being able to get into group plans.

H. They're not in a group plan--you insure somebody who doesn't have an experience modifier. Do you ever talk to them about safety programs?

RICHMOND: Yes.

I. How do you go about it, what percentage of them are given your insight on safety? How do you get at them.

RICHMOND: Let's take a $7,000 non-group employer. There are two mechanisms: (1) if they request it and (2) primarily by mail from our home office. We mail quarterly newsletters tailored to the industry addressing the CAL OSHA regulations or particular hazards in your industry. We also mail order forms for training programs, audio tapes, booklets, etc.

J. Do these employers ever get an outside visit by your organization?

RICHMOND: In two situations: the first if they request it. The second if they are engaged in a high risk industry.

K. What is my incentive as a small employer to make changes? I have no financial incentive. It costs money to make safety changes--I'm not going to receive a dividend. What's my incentive?

RICHMOND: Let me throw in a qualifier. You could receive a dividend but at this level it won't be a lot of money. If your are inspected by CAL OSHA the average penalty per inspection averages around $200--so that gives you a degree of incentive. An insurance company inspection may lead to an identification of things you must do which the insurer may include as terms and conditions of your policy. If you don't fulfill those safety requirements, it is possible that you may receive a special rating from the insurance carrier. The State Fund surcharges about two percent of our accounts. The incentive depends on how well you've motivated by the safety representative when that person calls on you.

L. If most of these small employers are not receiving on-site visits,---

RICHMOND: There is that risk. It is a challenge to the industry. In a very real sense, it's a public health challenge.

M. In your presentation you concluded that the minimum rate system guaranteed and assured safety. Would you elaborate on that, particularly with regard to other states without exclusive

state funds.

RICHMOND: I will make a start and Mr. Hansen can help me out. The system today provides the opportunity. The insurance system today does not require safety services be provided. What drives that are market conditions. Part of those market conditions is a rating system which enables the insurance industry/State Fund to make that allocation to safety. I submit that if there is a pricing change, say a rate deviation or dramatic reduction in the expense loading factor, then safety is one expense which is not a fixed cost of doing business--it's a discretionary cost, and discretionary costs are vulnerable to cost reduction by the industry. One of the reasons State Fund provides these services is to attract and retail larger profitable insureds. Given the vulnerability of this discretionary service, it is subject to being cut.

N. What determines your budgeting 6% of your expenses for safety programs? Is there a cost benefit type of analysis? What caused you to devote 6% to this activity? What causes other insurers to devote 5%, 6% or 10% to this activity?

HANSEN: There is no magic answer. I think a lot of it is owed to the traditional amounts of services that carriers provide which makes up their total expense dollar. It is very difficult to develop a precise cause and effect relationship between the amount of safety services that a carrier provides and the kind of result that it will achieve on an aggregate basis.

O. The 6% figure is a percentage of your operating expense. That would come out to about 2% of premium?

HANSEN: In that area.

P. You rebate about 15% of premium in dividends every year--approximately?

HANSEN: On the average.

Q. If the minimum rate law were changed, do you think some of the money that was going now for dividends might be shifted into safety and health?

HANSEN: I don't know. Every individual carrier is going to have to make some decisions. Brad made a good point that safety tends to be a discretionary expense on the part of carriers and a policy decision would have to be made as to whether or not there would be a change in the relationship between the dividend payments and the amount of money spent for loss control.

R. Is there any industry-wide study concerning what is spent on safety by carriers?

RICHMOND: No. And the reason is that the 5% figure that I gave you was provided by our actuarial department. The financial structure isn't geared that way as far as explaining where expenses are allocated.

14.32.6 WRITTEN MATERIALS SUBMITTED

Written materials were submitted to the Commission by the witnesses.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESSES WHO AGREE THAT THIS IS A FAIR REPRESENTATION OF THEIR TESTIMONY

14.33 SUMMARY OF TESTIMONY

STATE OF CALIFORNIA, DIVISION OF WORKERS' COMPENSATION TESTIMONY OF: CASEY YOUNG, ADMINISTRATIVE DIRECTOR

14.33.1 SUMMARY OVERVIEW

Mr. Young addressed the Commission in his role as Administrative Director of the Division of Workers' Compensation. He asked that if the Commission allows deviations, that those carriers that deviate only be allowed to do so if they are performing in the claims area and are adequately staffed to get benefits out on time.

14.33.2 REQUESTS MADE TO THE COMMISSION

Mr. Young asked that if the Commission recommends changing the rate law to allow deviations, that the Commission also suggest that if a carrier is not performing "claims-wise", that if the Division of Workers' Compensation finds that they are not staffed properly or getting benefits out in a timely manner, that these carriers not be allowed to deviate.

14.33.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Appropriate/Expeditious Claims Service	3
Alternate Rate-Making Systems	1
Safety Incentives	1

14.33.4 SUMMARY OF TESTIMONY

Mr. Young is the newly appointed Administrative Director of the Division of Workers' Compensation. Prior to that time he was the principal consultant for the Joint Study Committee on Workers' Compensation and was also principal consultant for the Senate Committee on Industrial Relations.

Mr. Young's testimony was brief and concerned his new role and prior duties as a consultant to the Senate Committee on Industrial Relations. In that role, he worked on a number of bills, including the ones that created and extended the Rate Study Commission. Mr. Young stated that as Administrative Director, he does not have a concern about the kind of rating law that is adopted. Rather, his concern is that if a deviation system (set rate but carriers can deviate) is adopted, if carriers are not performing in the claims area, they not be allowed to deviate. Mr. Young suggests making that one of the criteria by which less money is allowed to go to the carrier to insure their risks.

Another factor in the safety area, might be to ask whether the carrier is providing some minimum level of safety service. Aside from that, Mr. Young's Division is not concerned with the rating law. They want to make certain that the money is there so that the claims are handled and there are less disputes to resolve.

14.33.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

A. Where do the disputes arise from, when you say "less disputes?"

ANSWER: Disputes when people think they are entitled to compensation and the carrier disagrees--honest disputes. The more common is over how much is owed. If people get their checks in a timely manner, they're less likely to start litigation.

B. Do 10% of the companies give you 90% of the problems?

[Question was deferred to Christine Baker with OBAE.]
BAKER: I think that is a hard generalization to make--based on the first year's audit figures, the penalties were distributed pretty much across the board.

C. What is the status of the "promptness of payment" studies that the Division once did? Are they being continued?

ANSWER: They have been suspended because the data that was going in and being processed doesn't give the result it purports to. Hopefully within the next year we will start publishing again.

14.33.6 WRITTEN MATERIAL SUBMITTED

No written material was submitted.

14.34 SUMMARY OF TESTIMONY

UNICARE INSURANCE
TESTIMONY OF: RUSSELL LEATHERBY

14.34.1 SUMMARY OVERVIEW

Mr. Leatherby stated that his observations were based upon that segment of the market with premiums above $150,000, which are larger accounts. He pointed out that Bureau statistics indicate that this market is roughly half of the $8 billion overall market.

Mr. Leatherby stated his purpose for testifying, which was to shed insight from someone that runs an insurance company on how the Minimum Rate Law really acts to provide economic incentives to employers to promote safety.

14.34.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to the Commission.

14.34.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Minimum Rate Law	3
Safety Incentives	3
Dividends	3
Competition Between Insurers	3
Rating Bureau Functions	3
Profitability	3
Prospective Versus Retrospective Rating	3
Equitable Distribution of Costs of System	3
Solvency (Security of Payment Benefits)	2
Broker's Role (Commissions/ Marketing)	1
Cost Factors/Drivers of System	3
Equity/Small Business Employers	3
Loss Control	3

14.34.4 SUMMARY OF TESTIMONY

Mr. Leatherby began by giving the Commission some background information on Unicare. Unicare's "niche" in the marketplace are the larger accounts, those in excess of $150,000, with the average size being in excess of $400,000. Mr. Leatherby stated that his observations were based upon that segment of the

market. He pointed out that Bureau statistics indicate that this market is roughly half of the $8 billion overall market.

Mr. Leatherby stated his purpose for testifying, which was to shed insight from someone that runs an insurance company on how the Minimum Rate Law really acts to provide economic incentives to employers to promote safety.

Concerning pricing regulation, Mr. Leatherby stated that the Commission has to remember that insurance is not a commodity product. Workers' compensation in California is very different -- it is a service business which focuses on claims management and loss control. There is a tremendous degree of product differentiation in the marketplace as to which people provide claims management services and the degree to which people provide safety to policyholders. If we assume that we are just looking at the most efficient way to distribute potatoes, this is an inaccurate assessment of the real situation.

Insurance is an entirely unique product. What the minimum rate law does is to recognize that we don't know our actual costs until much later after we have priced it. The pricing mechanism is in the form of experience rating and policyholder dividends. Dividends do, in fact, provide incentives for carriers to be efficient.

Mr. Leatherby stated that Unicare takes pride in the fact that he has one of the lowest expense ratios in the business and that is what makes them competitive. In the marketplace, the competition for policyholder dividends requires you to be as efficient as possible in your expenses.

Mr. Leatherby stated that the system in California does recognize that it is impossible for any individual insurance company to adequately price the product on its own in the absence of a statistical gathering, rate-making body like the WCIRB, and Mr. Leatherby feels we are fortunate in the state to have the WCIRB. He stated that the WCIRB is widely regarded as providing a credible data base in the country and we cannot afford to get rid of it.

Mr. Leatherby stated that in a market where no private carrier has more than 6% of the market share, it would be unlikely that any carrier could develop credible rates by themselves. In the absence of a single rate-making body, many small insurance companies would be dealt a "death knell", and that would not add to the competitive environment we are trying to maintain.

Mr. Leatherby added that the minimum rate law is solvency oriented legislation. Mr. Leatherby believes that solvency regulation continues to be a valid purpose for the minimum rate law. Mr. Leatherby believes that a more compelling public policy reason for the minimum rate law is that it provides real economic incentives that promote an employer's active involvement in safety practices and controlling claim costs.

Unicare works with larger employers in controlling claim costs and loss control. When Unicare gives a sales presentation, we do not talk about pricing considerations, but we talk about safety programs, claims management, and getting injured workers back to work. Mr. Leatherby believes that a system that allows this kind of focus is the product of a very sound public policy.

Mr. Leatherby also stated that what an employer pays for workers' compensation should be directly related to his own claims experience. The incentives to reduce loss costs and promote safety are eliminated when a lower up-front price becomes the primary objective of the buyer. If we permit future indiscriminate price cutting, we will invite abandonment of safety efforts by both carriers and employers. We have a "level playing field" right now were service and safety-oriented efficient carriers succeed and inefficient carriers don't. More importantly, the safety conscientious employer succeeds and has a competitive advantage in the marketplace. The poorly run employer does worse. That is the way it should be.

There have been a number of things said about the system in the past year, including the statement that

the minimum rate law guarantees a profit. Mr. Leatherby does not believe we have a system that guarantees this. Likewise, Mr. Leatherby does not feel we need a system that guarantees losses. The important thing is that we must maintain a system of premium regulation that has several characteristics:

A. We must allow for adjustments at the back end;

B. We must maintain strong economic incentives for employer and carrier involvement in the claims process;

C. We must have a system that allocates actual costs to individual employers based upon their own experience;

D. We must maintain an accurate, credible database for rate-making, as well as a Bureau with strong enforcement policies; and

E. We must insure a competitive environment where there are a number of carriers of all sizes, with competition focused on reducing/preventing work place injury.

Mr. Leatherby concluded by stating that he would hate to see the workers' compensation industry parallel the airline industry so that in 10 to 15 years there are basically three companies, similar to American Airlines, United and Delta. The strength in our system is the fact that we have a number of specialty carriers -- smaller specialty carriers, like Unicare, funded by California capital, run in California, run with a knowledge and with a relationship to the policyholders that the large Eastern multi-line companies do not have.

Mr. Leatherby fears that when we discuss open rating, it is not the efficient that will survive, but those large companies that have the staying power, who generally are least efficient or customer oriented, but they are going to thrive. That is not the kind of system we have had, and we want to make sure the small specialty company thrives. In terms of safety and claims management, these companies are the more outstanding corporate citizen.

14.34.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

The following is a summarization of the questions and answers raised by the Commission following Mr. Leatherby's testimony:

A. You refer to yourself as a small specialty company. How many competitors do you feel you have?

ANSWER: Typically, in our niche there are a number of companies. We could run up against 30 or 40. But what is happening in the marketplace is that there are three segments: the State Fund, the large national Eastern multi-line companies and the California specialty companies. Over the last few years the large Eastern companies are losing market share and workers' comp is increasingly a mono line product -- no longer packaged with liability and the demand is for claims services and loss control. That is what is being purchased.

The worst situation is a period of time in which we have fat workers' comp rates, such as 1977 to 1981, when we had very redundant rates with very large dividend ratios. What you were finding in the marketplace was that the large multi-line companies would literally underprice the liability in a package to get the workers' comp because they felt it was profitable. In the mid-Eighties there was a period of about 3 years of rate inadequacy, and for the last 4 years we have had a more fair market where the rates are not fat, and this whole phenomena of large Eastern companies coming in and underpricing other lines to get workers' comp is not

the case.

The general perception is that the large carriers are trying to figure out a way of getting out of workers' comp nationally without sacrificing the liability and package business associated with workers' comp. You have to understand workers' comp nationally is going at about 120% combined ratio and nobody is making money on that.

B. Do you also provide any third party administration?

ANSWER: No. We haven't at this point -- maybe 5 to 6 years ago, but that is not what we want to do at this point.

C. Your customers are companies for whom self-insurance is an option?

ANSWER: We are really writing the segment right below that. Every year we lose one or two big accounts to self-insurance. When the account gets to be $4 to $5 million dollars, they should go into self-insurance and we don't fight it. We have not seen a tremendous movement into self-insurance because of the bonding requirements and because some of the other issues: wanting to have a fixed costs, etc.

D. I guess in your opinion the rate-making system -- there may be other things going on that are causing a great deal of concern with respect to employer costs and employee benefits, but you would say its not really the rate-making system - that the rate-making system is appropriate.

ANSWER: My basic belief is that it is true. We have a human resource problem. The work comp system has gotten so large and so complex, so fast. We don't have a system-wide, adequate human resource to handle it the way it should be. (Mr. Leatherby then discussed case loads for claims examiners.) If the government wants to give some directives, they should do it in the whole area of claims. Companies that are well staffed, like ours, with experienced people will support the improved standards. If you look at the expense provision in the rate, it breaks down to four areas: (1) commissions, (2) premium tax, (3) underwriting expense and loss adjustment expense. The loss adjustment expense is driven by the underlying system. The cost of handling claims, shortage of claims examiners, staffing, is what we call unallocated expense and that is going up dramatically. Those companies that are trying to staff their companies responsibly are going to have to spend more money in that area to comply with OBAE. Now, where the big bucks are going is the other half-allocated loss adjustment expense - attorneys fees, investigation, etc., and those costs are absolutely going through the roof, especially in the Los Angeles and Southern California area. As far as efficiency, right now we are running 15 - 17 percent of our premium dollars in handling claims. There are going to have to be reforms on the other side of the equation - the benefit delivery side.

E. Let me ask you hypothetically what you think about layering on top of that a territorial charge or debit, i.e., a surcharge for L.A. and a credit for Chico, on the existing system.

ANSWER: There is an actuarial basis for that. I think that is fine, but what the L.A. Chamber of Commerce is going to say about whether that is a reasonable alternative, I don't know.

F. Is there a solution -- underwriting, redlining certain areas and not having coverage?

ANSWER: I don't have a strong opinion on that, but you do have regional differences. As a matter of public policy in rate-making you may want to ignore those differences.

G. Was that 16 to 17 percent only allocated loss adjustment cost or was that allocated --

ANSWER: That was both. We have been working with the Bureau, but the whole unit statistical information does not completely capture all of the expenses in this area, and so the rate filings for years, has never adequately reflected the true cost of loss adjustment expense. Most companies run anywhere from 13 to 18 percent and the rate filing includes about 11 percent. From my point of view, when I look at the expense provision, I get frustrated. Whatever overstatement there could be on the underwriting expense side of it, it's more than made up on the inadequacy of the allocation for loss adjustment expense.

The Commission needs to have a good understanding of this. When I show a 15% expense ratio, people will compare it to the 32.8 percent charged for expense provision. Add the 15 to 16 percent that we are looking at for loss adjustment expense and that would show you that we are just barely getting under that 32.8 percent. When you look at the companies writing minimum premium, the ones that have much higher expenses, the smaller accounts, the reality of it is that their expenses are going to shoot right through 32.8.

H. Run that by me again -- you've got 16% expense. What is the other part we are not capturing?

ANSWER: When you are looking at expense provision, remember that it includes loss adjustment expense. Again, I get back to four components: loss adjustment expense, commission, premium tax and underwriting expense.

I. So you're making adjustments on the loss side or dividends?

ANSWER: We have to make it up on beating the loss ratio. We have to be selective with our risks to pick accounts that are going to produce something less than 67% that is in the rates.

Now, concerning dividends and getting them out of the system. I would like you to be with me when I go out to tell one of my large accounts that the system no longer accommodates dividends and the fact that you have got a 10% loss ratio and we are not going to adjust your pricing or reflect your individual experience because the rates are so low now and the loss ratios on the other accounts are so bad that we are not going to have enough for you. We have to have some provision for a "risk charge" -- the degree of risk sharing. If you've got 10 accounts and all the same size: nine have a 150% loss ratio and the last one has a 10% loss ratio, that guy has every expectation that he ought to get a dividend. But guess what -- he won't get one because the company lost its shirt on the other nine accounts.

For example, when the Commissioner of Insurance has chosen to take 1.2 -- that will reduce the up-front cost for insureds across the board, but who does it hurt? Those larger accounts with a lower loss ratio. Their net cost of insurance goes up because it raises the risk charge, -- the degree of risk sharing. That is another reason why, when you talk about risk charge, why don't smaller employers get dividends -- first of all, expenses on smaller employers are higher, and secondly, the risk charge on a smaller employer is much greater than it is on the larger accounts. The amount of risk sharing from those small accounts is enormous.

14.34.6 WRITTEN MATERIAL SUBMITTED

There was no written material submitted.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

14.35 SUMMARY OF TESTIMONY

PACIFIC ACTUARIAL CONSULTANTS
TESTIMONY OF: WENDY JOHNSON

14.35.1 SUMMARY OVERVIEW

The focus of Ms. Johnson's presentation concerned actuarial and funding considerations of public entities when funding their programs, and, specifically, the subject of aggregate excess insurance availability.

14.35.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to the Commission.

14.35.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Aggregate Excess Insurance	3
Self Insurance/Pools	3

14.35.4 SUMMARY OF TESTIMONY

Ms. Johnson addressed the Commission as a representative of CSAC Excess Insurance Authority for whom she serves as an actuary. She serves many other public entity pools in California, as well as self-insured employers. Ms. Johnson stated that CSAC provides coverage to 35 counties in California with a total payroll of about $1.0 billion dollars. CSAC was founded in 1979.

Ms. Johnson addressed the typical way in which it would be cost effective to provide aggregate excess insurance. The attachment point for aggregate excess insurance would begin at some level above the estimated expected loss costs for the year. There would be no direct impact on the estimated expected loss costs because of the presence of the aggregate excess insurance . Ms. Johnson stated that most public entity pools maintain rather significant funding margins in excess of expected loss costs in order to provide for the unforeseen possibilities. The manner in which the amount of the margin is calculated involves consultation with an actuary who will estimate the distribution of the expected possible amounts of total loss costs and determine the amount of money that must be added in order to reach some rather high probability level. This will result in a "confidence level".

Ms. Johnson stated that if there was an ability to purchase aggregate excess insurance coverage, these pools could reduce the funding margins they maintain and still have a financially secure program. Ms. Johnson pointed out that for public entities that work with taxpayer-provided budgets, there would be some benefit to the public.

Ms. Johnson pointed out that with the ability to purchase aggregate excess insurance , the pool would be protected during a time when the loss costs are significantly higher than was originally estimated. Now, a

pool may need to make a retrospective assessment and that can cause severe financial hardship when the assessment needs to be paid. Ms. Johnson referenced CSAC, now in their 13th year of operation, and stated that there were 2 years when they were significantly underfunded in relationship to the actual costs. CSAC has had to collect several assessments in order to make their claim payments and this has created hardships for the counties involved.

Ms. Johnson also stated that if a number of the bankrupt companies now being handled by the Self-Insurers' Security Fund had been able to purchase aggregate excess insurance , the assessments to other self-insured employers for their coverage by S.I.S.F. would have been significantly lower.

14.35.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

The following is a summarization of the questions and answers raised by the Commission following Ms. Johnson's testimony:

A. Concerning reserving practices, do you see a different reserving practice between State Fund, private carriers and self-insureds?

ANSWER: Do you mean loss reserving practices or claim reserving practices?

B. Claim reserving practices.

ANSWER: Oh, they are very different.

C. If the State Fund reserves differently for claims than a private carrier doing self-insured claims, and especially the claims reserving for the well, take State Fund, goes into the -- very large percentage of a minimum rate law, couldn't the reserving practices heavily influence what that minimum rate might be?

ANSWER: Yes. My own experience is not too germane to address the difference between State Fund's reserving practices and private carriers. But I can comment quite directly on the differences in reserving practices between most insurance carriers and most third party administrators. In general, the average case reserve maintained by an insurance carrier will be higher than the average case reserve maintained by a third party claims administrator. The Department of Self-Insurance requires a third party administrator to go through and specifically examine each claim on its own merits , whereas an insurance carrier is more willing to place an average reserve based on its past experience, e.g. a back claim runs $20,000 so we will put up $20,000 on all back claims.

D. Do you see keeping the reserves on any longer?

ANSWER: I see so many differences in that, I don't think I can generalize between the two.

E. In California, with its earthquake exposure, what are the implications with and without the possibility of buying aggregate excess insurance?

ANSWER: In the event of a large earthquake, there would be a number of people injured in the course of their job. The possibility of an earthquake is one of the risks that both self-insured employers and insured employers need to take into consideration. The chances of collecting on your aggregate policy in the event of a large earthquake are much greater than they are if there is no earthquake, which means that any carrier who wrote aggregate coverage in California would want to price it more conservatively than they would in other states. For

the employer, it would definitely be another source of protection.

F. Do you know of any reasons to retain the prohibition against aggregate insurance?

ANSWER: No. There may be business interest reasons on the part of specific groups of people who have some reason to have business interests, but they're not public policy reasons, and they're very easily arguable as well.

14.35.6 WRITTEN MATERIAL SUBMITTED

Written materials were submitted to the Commission by this witness.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HER TESTIMONY.

14.36 SUMMARY OF TESTIMONY

THE INDUSTRIAL MEDICAL COUNCIL
TESTIMONY OF: DR. IRA MONOSSON

14.36.1 SUMMARY OVERVIEW

Dr. Monosson addressed the Commission in his role as chairman of the Industrial Medical Council and as a practicing physician involved with the workers' compensation industry, specifically provided medical-legal opinions concerning injured workers. Dr. Monosson believes that the Industrial Medical Council will be able to regulate the medical profession and prevent fraud and abuse by being able to exclude those abusers from practicing in the field of workers' compensation.

14.36.2 REQUESTS MADE TO THE COMMISSION

There were no requests made to the Commission.

14.36.3 MATRIX ITEMS DISCUSSED

ITEM	WEIGHT ASSIGNED
Cost Factors/Drivers of the system	3

14.36.4 SUMMARY OF TESTIMONY

Dr. Monosson began by admitting that there is a problem with the system. There are problems with fraud. CWCI suggests that it may amount to half a billion dollars a year or more. The costs keep going up each year. Dr. Monosson relied on statistics of the CWCI concerning the total cost of litigation, which in 1990 was about a billion and a half dollars. Just a little less than that was for medical legal reports. Med-legal costs are running in the range of around $3,500 per case.

Dr. Monosson stated that one of the biggest problems he sees is that the applicant's side is spending a great deal and causing more med-legal bills than the defense is--a ration of about two to one. Dr. Monosson suggested that another problem occurred in the 1980's when "mills" began to crop up around the state. The entry doctor sets off a chain reaction--from one specialist to three, four or more. Sometimes it is needed, but in other cases it is abusive.

Dr. Monosson explained that right now the Industrial Medical Council is writing its first fraud regulations. The major thrust will be fraudulent advertising, and the Council has the authority to regulate and punish physicians. He indicated they will work with the District Attorney's office as well. The Industrial Medical Council wants to be able to establish regulations for all physicians in the comp system and remove them from the system, if they abuse it. We are also focusing on the writing of med-legal reports, to remove those who write fraudulent or incompetent reports from the system.

Dr. Monosson went on to discuss the QME, or qualified medical evaluator system that was established as a result of the 1989 reform act. Dr. Monosson stated that if a physician is involved with the fraud mentioned above, he can be removed from the QME panel and won't be allowed to see patients in that part of the system. But this only applies to post 1-1-91 injuries that are excepted by the employers as work related.

Dr. Monosson stated that the Industrial Medical Council is desperately understaffed and took a bit hit with this budget situation, and that has put a crimp in their ability to get the job done.

14.36.5 ISSUES DISCUSSED FOLLOWING TESTIMONY

A. One of the areas I am concerned with has to do with the quality of service--both to employees and to employers. Could you discuss--setting aside the issues of fraud and stress--the things that make handling claims expensive and how that affects in injured worker getting benefits. What things are different in California that makes these costs higher--are there other things about the California system--its regulations or procedures that make us different from anybody else.

ANSWER: That is a very broad question for a guy with my background. Let me go back to fraud for a second. Say its around half a billion. You subtract that from the $11 billion cost of the system in 1990, it doesn't make that big a dent. But its going on all over the country, but bigger in California for a lot of reasons. California is an innovative state and is the biggest state. We have a huge working force and it keeps growing. Part of the reason costs are the way they are is because of population growth. Insurance companies point fingers at lawyers and doctors saying they charge too much and vice versa. They're probably both right. I think that the profit margin being made on both sides is more than necessary. (Dr. Monosson believes the insurance companies are utilizing the minimum rate law to reap excessive profits. This needs to be eliminated to allow for open competition in a market economy system that would reduce costs to employers.)

The medical community accepted a rollback of medical legal fees. The expectation was that it would be about 20%, but the way the legislation was written was so convoluted it finally amounted to 5%.

But in answer to your question, we have a system that may be one of the most adversarial in the country and claims examiners have a jaundiced eye for the claims that come across their desks. I do a fair amount of med-legal reporting and treating. The people I see don't trust the claims adjusters. But I can understand the claims adjusters' views. In Los Angeles they have these intake clinics that generate false claims--not just stress claims. I can understand why the insurance companies won't just accept cases on the surface.

I'm hoping that this QME system will help. If all the doctors who participate in the system are scrutinized by the Industrial Medical Council and regulated by them, then people can start trusting cases. Doctors won't push fraudulent cases because they will fear being thrown out of the system. But that only applies to the new injuries and with the old claims there are abuses to beat the band--excessive treatment, all kinds of things. Lessening the sense of mistrust is going to allow the delivery of more and quicker treatment to people who need it.

B. Your field is industrial medicine and the vast number of people you treat are injured on the job, as compared with pediatricians, who don't deal with injuries that are work related. Are there medical reasons for keeping the workers' comp system separate from the rest of the health care system, or are the reasons primarily paperwork and assignment of cost reasons?

ANSWER: The original intent was to provide a no fault system so people could get taken care of and treated and get back to work or get retrained. There are no good medical reasons for it to remain a separate entity. At one time doctors didn't want to get involved with workers' comp cases--the fees were so low. But now doctors can make a decent living by treating industrial injuries. And another aspect of it is that a law was passed in 1984 to set up the current system, and there was too much inflation built into the medical-legal fee schedule, and that attracts people into the system.

C. Where is the inflation, on the medical or the legal side?

ANSWER: The medical side. That is one of the reasons behind the rollback concept in 1989. (Dr. Monosson went on to discuss the formula used to calculate 73rd percentile which will be used to set the fee range for July, 1992.) The Industrial Medical Council is going to propose that we look at this and possibly make a recommendation to the medical profession, for a voluntary freeze and not accept pay increases for 1992. I think an increase needs to occur in the treatment end. but the Industrial Medical Council right now will recommend only a very modest increase--probably around 5%. So a little increase is needed. Once the economy recovers, we should go ahead and try to catch the treatment side of the fee schedule up with what is going on in the usual and customary in the medical community outside of workers' comp.

D. To what extent is medical evaluation and medical treatment separated in the workers' comp system? Should they be? Is it a good or bad thing to have different people doing evaluation or treatment?

ANSWER: I don't think it should be separated. I see nothing wrong with the system as long as the physicians who are doing it know that there is somebody watch-dogging so they don't overdo it. Because the risk of the type of abuse is there. It is not fraud, but it is abuse. I understand why they did separate it. They did it because the treating doctor establishes a rapport with the patient and may unconsciously give him a little too much. On the other hand, the insurance company selected doctor wants to be chosen again tomorrow, and they might pare down what the level of disability is. One way of eliminating the treating physician bias is to separate those things. If the system was regulated in the manner I talked about, I believe you would be able to control those kinds of problems.

E. Concerning the adversarial problems you are encountering in the system, what proportion is the old line physical injury versus those that are either mental/physical, physical/mental or mental/mental?

ANSWER: I really can't tell you, except to say that my strongest suspicion is that the straight stress claims (mental/mental) probably are viewed with more skepticism than straight injury claims.

(Dr. Monosson agreed that stress claims apparently went up again in 1990.) The way the system is today, so many of these cases wind up becoming a stress claim and then you wind up with the whole issue being clouded by this adversarial monster. I run across cases like that every year. I usually call the adjuster and discuss the case with them and try to straighten the mess out before it becomes hopeless. The problems overlap so much. By the way, the number of stress claims have been declining over the past years.

[Discussion involving the audience followed concerning the decline of stress claims and disagreement with that statement.]

If that is the case I absolutely agree with you, and I wasn't aware of this. Maybe the number of stress claims is increasing all over the state. I know its increasing in L.A. I think that part of that is due to the advertising. I am not sure what to do about this but give us (the Industrial Medical Council) the authority to regulate the doctors and put a lid on their participation in this and I think you'll see a significant improvement. But it's going to take years, especially with the Council's staff members and budget.

14.36.6 WRITTEN MATERIAL SUBMITTED

No written materials were submitted.

THE ABOVE HAS BEEN REVIEWED BY THE WITNESS WHO AGREES THAT THIS IS A FAIR REPRESENTATION OF HIS TESTIMONY.

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SECTION 15.0

COMPARATIVE STATE ANALYSIS QUESTIONNAIRE PROCEDURES

15.1 QUESTIONNAIRE STRATEGY III-15.0-1

15.2 QUESTIONNAIRE TRANSMITTAL III-15.0-1

15.3 QUESTIONNAIRE DOCUMENTS III-15.0-6

SECTION 15.0

COMPARATIVE STATE ANALYSIS QUESTIONNAIRE PROCEDURES

15.1 QUESTIONNAIRE STRATEGY

A detailed questionnaire strategy was developed in order to expedite the analysis of the various state Workers' Compensation systems as compared to the State of California. A questionnaire package ultimately was developed to include a personalized transmittal letter, objectives and responsibilities of the Commission, an explanation of the subject questionnaires and the questionnaire.

15.1.1 QUESTIONNAIRE DISTRIBUTION

All fifty states and the District of Columbia were scheduled for receipt of questionnaires. Two questionnaire packets were transmitted to each state as well as the rating bureaus and directed as follows:

State Insurance Commissioner

State Workers' Compensation Benefits Director

Workers' Compensation Rating Bureau

15.1.2 QUESTIONNAIRE FORMAT TYPES

Three different Workers' Compensation Analysis questionnaires were developed for specific purposes:

QUESTIONNAIRE I - BASIC

This is a broad spectrum questionnaire encompassing a wide range of Workers' Compensation Information. The questionnaire was distributed to State Insurance Commissioners as well as State Workers' Compensation Administration directors.

QUESTIONNAIRE II - TECHNICAL

This is a technical questionnaire intended for the Department of Insurance of each state. It was distributed to all state Insurance Commissioners.

QUESTIONNAIRE III - BUREAU

This is a technical questionnaire intended solely for the various rating bureaus. The development of the questionnaire was the responsibility of AIS Risk Consultants, Inc. and involved the assistance, coordination, refinement and printing as well as distribution by the Commission staff.

15.2 QUESTIONNAIRE TRANSMITTAL

The transmittal packet was comprehensive in nature and personalized with respect to name and title. In addition to the transmittal letter the packet included the following items:

Workers' Compensation Rate Study Commission Position Statement applicable to objectives and responsibilities

Staff questionnaire explanation

Questionnaire

The following is a sample of the individual staff transmittal letter contents directed to each state Workers' Compensation Administration director. The letter transmitted to each state Insurance Commissioner was similar, however, it was expanded to include a discussion of both Questionnaires I - Basic and Questionnaire II - Technical.

EXHIBIT 15.1
QUESTIONNAIRE TRANSMITTAL LETTER SAMPLE

The state Workers' Compensation Administration director's letter is located on the following page.

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

STAFF

RICHARD H. SOPER, CMC
Executive Director
& Project Manager

GLENN M. SHOR, Ph.D., M.P.P.
Assistant Project Manager

SUSAN M. WRIGHT, J.D.
Senior Consultant

LORI B. ARLEN, M.B.A.
Statistical Analyst

VIRGINIA R. SUNDT
Project Administrator

Date

Workers' Compensation Administration Director
Department Name
Street Address
City, State ZIP

Subject: Workers' Compensation Insurance and Administration Questionnaire Concerning your State

Dear Mr./Ms. (last name)

On behalf of the State of California Workers' Compensation Rate Study Commission, we are soliciting your assistance in completing our questionnaire related to your states workers' compensation insurance and rate setting. In this packet of information you will find:

1. Position statement of the State of California Workers' Compensation Rate Study Commission applicable to objectives and responsibilities. Included in the position statement are the following key segments:

   a. Text of the State of California Legislature's mandate to the Commission.

   b. Overview of Staff Consulting Team concerning project scope, strategy and objectives as well as identifying the primary consulting team members.

   c. Identification of consulting technical sub-contract resources (economic and actuarial) to the Commission.

2. Workers' compensation system comparative analysis Commission Staff questionnaire explanation.

3. Questionnaire I - Basic (prepared by the Commission Staff)

Please make certain that the key individual participating on this project is identified along with telephone number in order that we may contact him/her in the event we need to follow-up on a particular question.

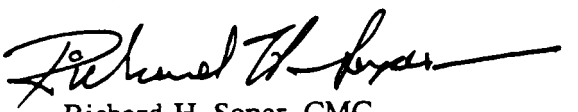
In addition to receiving this questionnaire, you may be contacted by the Commission sub-contract technical resource people. AIS Risk Consultants, Inc., a firm based in New Jersey, may contact you relative to self-insurance within your state. You may also be contacted concerning insurance regulation by the firm of Milliman & Robertson, based in New York City.

All of this information is being compiled to assist the California Commission in its analysis of California's worker's compensation system. Some of the information requested may overlap, however, we ask that you complete each questionnaire in its entirety to the extent possible. We would appreciate the return of your completed questionnaire on or before January 6, 1992.

On behalf of the State of California Workers' Compensation Rate Study Commission, we appreciate your assistance regarding the Commission's Workers' Compensation System Comparative Analysis Questionnaire. We assure you that we are firmly committed to sharing our findings with you and your State in exchange for your participation on this vitally important national project.

We thank you in advance for your assistance. Please feel free to contact us should you need any assistance or clarification regarding our request.

Very sincerely yours,



Richard H. Soper, CMC
Workers' Compensation Rate Study Commission
Executive Director & Project Manager

Glenn M. Shor, Ph.D., M.P.P.
Assistant Project Manager

Susan M. Wright, J.D.
Senior Consultant

/lrd

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Each individually transmitted packet included a specific memorandum explaining the questionnaire or two questionnaires as enclosed. In addition, the transmittal letter was modified to clarify both enclosures.

The following is a summary identifying the contents of each specific questionnaire packet transmitted:

15.2.1 STATE INSURANCE COMMISSIONER PACKET

Questionnaire Transmittal Letter
(Insurance Commissioner version)

Workers' Compensation System Comparative Analysis - Staff Memorandum
(Insurance Commissioner version)

Workers' Compensation Rate Study Commission -
Objectives & Responsibilities
(Position Statement)

Questionnaire I - Basic

Questionnaire II - Technical

15.2.2 STATE ADMINISTRATIVE WORKERS' COMPENSATION ADMINISTRATOR PACKET

Questionnaire Transmittal Letter
(Workers' Compensation Program Administrator version)

Workers' Compensation System Comparative Analysis - Staff Memorandum
(Workers' Compensation Program Administrator version)

Workers' Compensation Rate Study Commission -
Objectives & Responsibilities
(Position Statement)

Questionnaire I - Basic

15.2.3 WORKERS' COMPENSATION RATING BUREAU PACKET

Questionnaire Transmittal Letter
(President of Rating Bureau version)

Workers' Compensation System Comparative Analysis - Staff Memorandum
(President of Rating Bureau version)

Workers' Compensation Rate Study Commission -
Objectives & Responsibilities
(Position Statement)

Questionnaire III - Bureau

15.3 QUESTIONNAIRE DOCUMENTS

In addition to the previously reviewed questionnaire transmittal letter, there are various documents that were included in the transmittals to the respective states and rating organizations. The following documents have been reproduced in this report:

Workers' Compensation System Comparative Analysis - Staff Memorandum

Workers' Compensation Rate Study Commission - Objectives & Responsibilities (Position Statement)

Questionnaire I - Basic

Questionnaire II - Technical

Questionnaire III - Bureau

Each of the previously identified documents are identified and included as an exhibit.

15.3.1 WORKERS' COMPENSATION ANALYSIS STAFF MEMORANDUM

Three different staff memoranda of a similar format were developed to be used specifically for the state Insurance Commissioner, the Workers' Compensation State Administrator and the concerned Rating Bureau.

The following exhibit is the staff memorandum used in each state Insurance Commissioner packet.

EXHIBIT 15.2
STAFF QUESTIONNAIRE EXPLANATION MEMORANDUM
STATE INSURANCE COMMISSIONER PACKET

The state Insurance Commissioner staff memorandum concerning questionnaire explanation is located on the following page.

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

STAFF

RICHARD H. SOPER, CMC
Executive Director
& Project Manager

GLENN M. SHOR, Ph.D., M.P.P.
Assistant Project Manager

SUSAN M. WRIGHT, J.D.
Senior Consultant

LORI B. ARLEN, M.B.A.
Statistical Analyst

VIRGINIA R. SUNDT
Project Administrator

To: Workers' Compensation Questionnaire Participants

Subject: Workers' Compensation System Comparative Analysis
Commission Staff Questionnaire

Date: November 29, 1991

QUESTIONNAIRE TASK OVERVIEW

On behalf of the State of California Workers' Compensation Rate Study Commission, we would appreciate your assistance regarding a Workers' Compensation System Comparative Analysis. We are soliciting your assistance in completing two questionnaires relative to your State's Workers' Compensation insurance and ratesetting.

It is our intent to develop information which will serve as a database for model arrangements to be analyzed and compared to the existing State of California Workers' Compensation system. We assure you that we are firmly committed to sharing our findings with you and your state in exchange for your participation in this vitally important national project.

The following information relates to our project authorization and sharing of developed information:

CONSULTING PROJECT AUTHORIZATION

The California Department of Insurance has to contracted for an Executive Director (Soper & Associates) of the Workers' Compensation Rate Study Commission. The Workers' Compensation Rate Study Commission created by Chapter 892 of the Law of 1989, pursuant to Section 11748 of the Insurance Code, is authorized to evaluate the California Workers' Compensation Ratesetting Law and compare it to systems utilized by other states. The existing code was significantly modified by Assembly Bill 971, passed this year. In summary, AB 971 extended the operating duration of the Commission as well as appropriating additional project funding.

AVAILABLILITY OF CONSULTING PROJECT FINDINGS

On behalf of the State of California Workers' Compensation Rate Study Commission, we are firmly committed to sharing our developed information and conclusions with you and your State in exchange for your assistance on the project.

AVAILABLE CONSULTING ASSISTANCE

The attached represents our two (2) Workers' Compensation System Comparative Analysis Questionnaires. It is our intent to provide you with an overview of the information we desire to develop. Furthermore, it is our request that you complete the subject questionnaire and work with one of the Senior Project Consultants in their task assignment of developing our database information. We certainly understand that certain information may not be readily available or may not be applicable due to the nature of your Workers' Compensation system.

We are most willing to provide assistance as warranted in completing two (2) questionnaires and may be reached as follows:

Glenn M. Shor, Ph.D., M.P.P.
Tel: (510) 525-1875

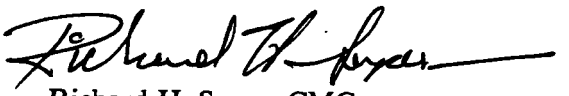
Susan M. Wright, J.D.
Tel: (916) 422-5432

Richard H. Soper, CMC
Tel: (310) 544-4049
FAX: (310) 544-0498

Some of the information requested may overlap, however, we ask that you complete each questionnaire in its entirety to the extent possible. We would appreciate the return of the completed questionnaire on or before January 6, 1992.

We thank you in advance for your assistance. Please feel free to contact us should you need any assistance of clarification regarding our request.

Very sincerely yours,



Richard H. Soper, CMC
Workers' Compensation Rate Study Commission
Executive Director and Project Manager

Glenn M. Shor, Ph.D., M.P.P.
Assistant Project Manager

Susan M. Wright, J.D.
Senior Consultant

/lrd

OVERVIEW.QO2

15.3.2 WORKERS' COMPENSATION RATE STUDY COMMISSION - OBJECTIVES & RESPONSIBILITIES (Position Statement)

A Position Statement concerning the Commission objectives and responsibilities in order clearly to communicate the task assignments to the various questionnaire recipients. The content of the Commission Position Statement is as follows:

1.0 Commission Overview

2.0 Commission Organization

3.0 Commission Mandate

4.0 Consulting Project Authorization

5.0 Consulting Project Scope

6.0 Consulting Strategy Overview

7.0 Consulting Office Information

8.0 Consulting Technical Resources

9.0 Consulting Team Organization

Exhibit 1.0
Consulting Team Organization Chart

Exhibit 2.0
Commission Directory

The subject document is reproduced in the following exhibit:

EXHIBIT 15.3
STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION
OBJECTIVES & RESPONSIBILITIES

Please refer to the following page for the sample Commission Position Statement.

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

OBJECTIVES AND RESPONSIBILITIES

1.0 COMMISSION OVERVIEW

The Worker's Compensation Insurance Rate Study Commission was established by the California Legislature in September 1989 (Chapter 892 of the Laws of 1989) as part of an overall reform package in workers' compensation. Pursuant to section 11746 of the Insurance Code, the Commission is mandated to evaluate in its entirety California's workers' compensation ratesetting law, and to compare the effects of that law with those produced by alternative ratemaking systems used in other states.

Assembly Bill 971 appropriated significant funds to the Workers' Compensation Rate Study Commission for the 1991/92 fiscal year to fund staff and consultant positions and to pay incidental expenses, as provided, necessary to achieve goals of the Commission established by the specific statute. The declaration is that AB 971 is to take effect immediately (July, 1991) as an urgent statute.

In defining the universe of alternative systems, states relying on an exclusive state fund are to be included. The Commission has two additional statutory functions: To assess whether the functions currently performed by the California Workers' Compensation Insurance Rating Bureau should be transferred to the Department of Insurance, and to determine whether public self-insured employers should be permitted to purchase aggregate excess insurance from legally admitted California insurers.

2.0 COMMISSION ORGANIZATION

The statute creating the Commission provided that the Commission was to consist of eight members, four appointed by the Governor, and two each by the Speaker of the Assembly and the Senate Committee on Rules. Commission members are required to be deans or tenured faculty of the schools of business, public policy, or public administration of accredited California universities. The Commission held its first meeting on December 15, 1990. The Commission has held monthly open meetings since that date. The final report of the Commission, originally due in September 1990, is now due by March 1, 1992.

3.0 COMMISSION MANDATE

The substantive mandate of the Commission follows:

"Insurance Code Section 11746...

> The Commission shall evaluate, in its entirety, the present workers' compensation insurance ratemaking process and the relative effectiveness of workers' compensation insurance ratemaking systems in other states, and other similar matters affecting workers compensation insurance ratemaking as the commission deems appropriate. The Commission shall include an analysis of all aspects of the current system by which minimum rates are established in California, including an analysis of the extent to which this system fosters or discourages competition between insurers. It shall include an analysis of the states which use an exclusive state fund to provide workers' compensation insurance to employers, and the advantages and disadvantages of establishing an exclusive state fund in California. It should also include an analysis of whether the functions currently performed by a licensed rating organization should instead be performed by the Department of Insurance.
>
> The Commission shall consider in its evaluation the extent to which the present California workers' compensation ratemaking systems and proposed alternatives meet the following goals:
>
> 3.1 Provides appropriate and expeditious claim services to injured employees.

3.2 Assures security of the payment of benefits from the insurer to injured workers.

3.3 Provides financial incentives to insured employers to maintain safe operations.

3.4 Provides the lowest net cost to insured employers consistent with the protection and services provided and the losses and expenses incurred.

3.5 Provides a fair and equitable distribution of the costs of the system to insured employers reflecting, to the extent consonant with sound principles of insurance, the actual losses and expenses of individual employers.

3.6 Encourages availability of insurance to all sizes and classifications of employers to assure a stable, predictable, and competitive insurance market.

3.7 A reasonable rate of return." (Workers' Compensation Rate Study Commission Mandate, AB 276 Conference Report No. 1, September 15, 1989.)

4.0 CONSULTING PROJECT AUTHORIZATION

SOPER & ASSOCIATES consulting strategy and support services are provided via a contract award by the State of California for the project of "Contract - Executive Director" of the Workers' Compensation Rate Study Commission. The consulting project commenced June 18, 1991, with the master contract phase effective July 1, 1991 through May 30, 1992.

5.0 CONSULTING PROJECT SCOPE

The scope of the *SOPER & ASSOCIATES* consulting project is to serve as staff to the Commission. The primary objective of the project involves the California Workers' Compensation Ratesetting Law and provides for an in-depth comparative analysis of the systems used by other states. This analysis is sufficiently complex that a consulting team support staff is required for the Project Manager and the Assistant Project Manager. The principal charge of the project encompasses effective support service for the Commission, compliance with identified contract tasks and production of the Commission Report.

6.0 CONSULTING STRATEGY OVERVIEW

The principal objective of the *SOPER & ASSOCIATES* consulting strategy proposal is to interface with the identified needs and project objectives of the Workers' Compensation Rate Study Commission. The consulting team is able to draw on existing experience in the overall program analysis concerning the priority of socio-economic considerations regarding the various stakeholders interest.

The Principal of *SOPER & ASSOCIATES*, Richard H. Soper, CMC, is serving as the Contract - Executive Director for the Commission and operates as the consulting Project Manager. His technical responsibilities include: Client Liaison, Project Management, Representation of Client in Speaking and Reporting Activities as Warranted as well as Risk and Insurance Management Overview Coordination. The primary *SOPER & ASSOCIATES* consulting members in addition to Mr. Soper are:

GLENN M. SHOR, Ph.D., M.P.P.
Senior Associate Consultant of *SOPER & ASSOCIATES* serves as the Assistant Project Manager. His technical responsibilities include: Statistical and Rating Analysis, Research, Workers' Compensation Considerations including Occupational Medicine, Disease, and Disability.

SUSAN M. WRIGHT, J.D.
Senior Associate Consultant of *SOPER & ASSOCIATES* is involved in key facets of legal and administrative project task considerations. Her technical responsibilities include: Workers' Compensation Program Administration, Self-Insurance and Claims Management.

VIRGINIA R. SUNDT
Director of Administration of *SOPER & ASSOCIATES* is serving as the Project Administrator.

Their services are supplemented and supported by consulting team members of proven professionals who possess diverse consulting and research as well as property, casualty and Workers' Compensation experience.

7.0 CONSULTING OFFICE INFORMATION

Consulting Office Communication and Staffing Information:

SOPER & ASSOCIATES
P.O. Box 3727
Palos Verdes Peninsula
California 90274

Telephone: (310) 544-4049

FAX: (310) 544-0498
Dedicated telephone line. Automatic facsimile machine compatibility: CCIIT Group III.

Modem: (310) 544-0498
Reserved telephone line. IBM 386 compatible systems, baud rate 2400 bps, and the following primary programs:
"WordPerfect 5.1"
"Lotus 1-2-3, Release 2.2"

RICHARD H. SOPER, CMC, Principal
Car Phone: (213) 300-8174
Residence: (310) 377-4289

VIRGINIA R. SUNDT, Director of Administration
Cellular Portable Phone: (213) 300-8173

LORI R. DANIELS, Senior Project Coordinator

LORI B. ARLEN, M.B.A., Statistical Analyst

8.0 CONSULTING TECHNICAL RESOURCES

Additional assistance in the form of technical resources are considered necessary from such experts as actuaries or economists who are retained as a subcontractor to the *SOPER & ASSOCIATES* consulting organization and are identified as follows:

DAVID APPEL, Ph.D.
Director - Economic Consulting
Milliman & Robertson, Inc. Tel: (212) 279-7166
Two Pennsylvania Plaza FAX: (212) 629-5657
New York, NY 10001

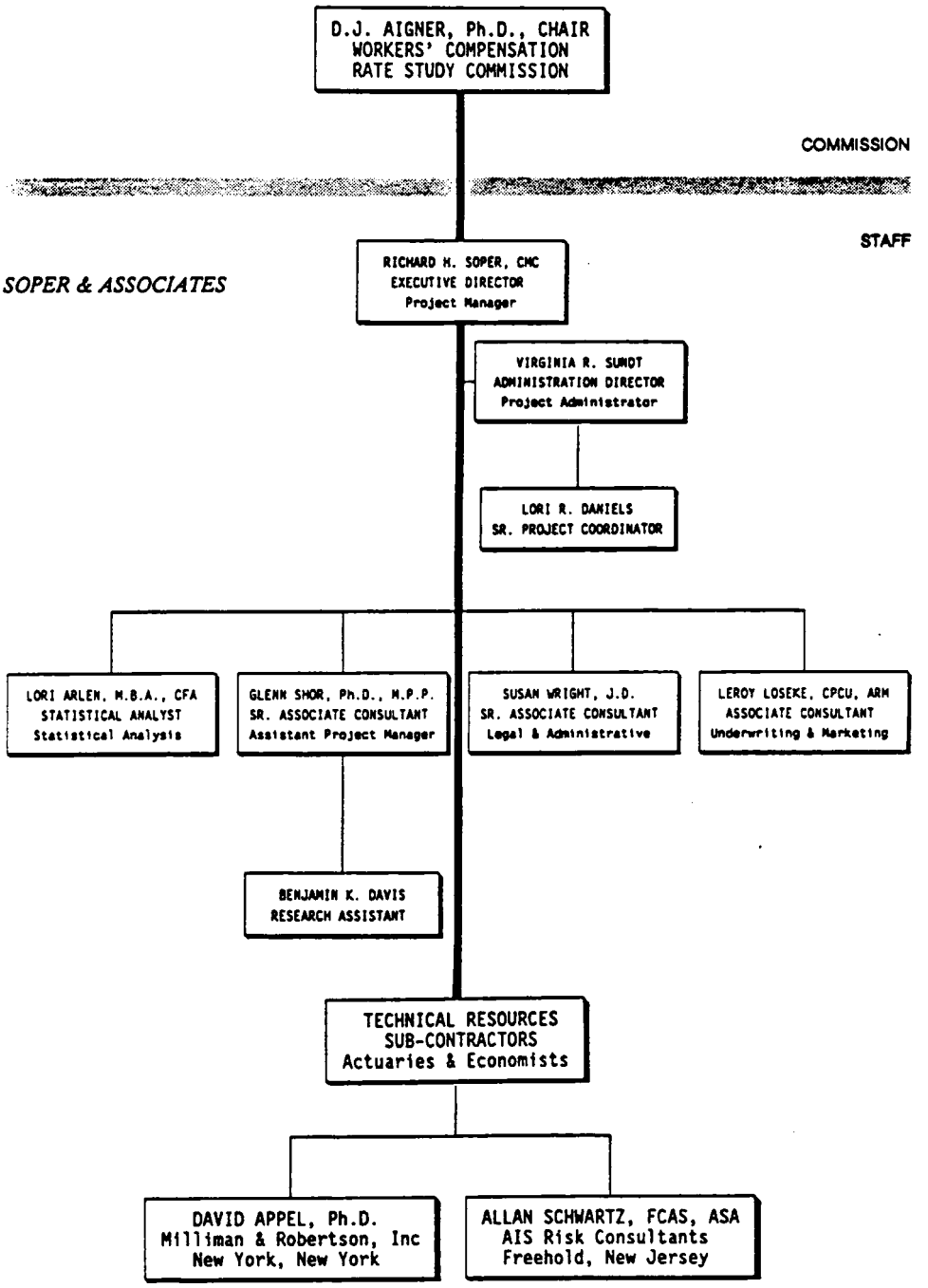
ALLAN I. SCHWARTZ, FCAS, ASA, MAAA, FCA
President
AIS Risk Consultants Tel: (908) 303-7470
Freehold, New Jersey 07728 FAX: (908) 780-7173
4400 Route 9 South

9.0 CONSULTING TEAM ORGANIZATION

In order to illustrate clearly the project consulting team operational strategy, an organizational chart has been developed to identify reporting authority as well as responsibility to the Commission. The chart depicts

chain of command and responsibility to the Commission, as well as providing for technical resource capabilities.

EXHIBIT 1.0
CONSULTING TEAM ORGANIZATION CHART



10.0 COMMISSION DIRECTORY

Please refer to the following page for Exhibit 2.0 representing a directory of the State of California, Workers' Compensation Rate Study Commission.

EXHIBIT 2.0
COMMISSION DIRECTORY

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

DR. DENNIS J. AIGNER, DEAN (Commission Chairman)
University of California, Irvine
Graduate School of Management
Irvine, CA 92717
Tel: (714) 856-6855 FAX: (714) 856-8469

DR. PATRICIA A. CHESHIER, PROFESSOR
California State University, Sacramento
Dept. of Insurance & Finance
School of Business & Economics
Sacramento, CA 95819
Tel: (916) 278-7386 FAX: (916) 278-7690

DR. STEWART L. LONG, PROFESSOR
California State University, Fullerton
Dept. of Economics
Fullerton, CA 92634-9480
Tel: (714) 773-3683 FAX: (714) 773-3990

DR. WILLIAM E. NEELEY, PROFESSOR
California State University, Stanislaus
801 W. Montevista Ave.
Turlock, CA 95380
Tel: (209) 667-3388 FAX: (209) 667-3333

DR. MELCHIOR D. POWELL, DEAN
California State University, Long Beach
Graduate Center for Public Policy and Administration
Long Beach, CA 90840
Tel: (310) 985-4178 FAX: (310) 985-1624

DR. SUSAN D. SCHAEFER, PROFESSOR
California State University, Hayward
Dept. of Management & Finance
School of Business & Economics
Hayward, CA 94542
Tel: (510) 527-2159 FAX: (510) 527-0576

DR. JAMES C. VAN HORNE, PROFESSOR
Stanford University
Graduate School of Business
Stanford, CA 94305
Tel: (415) 723-2761 FAX: (415) 725-7979

STAFF:

MR. RICHARD H. SOPER, EXECUTIVE DIRECTOR
SOPER & ASSOCIATES
P.O. Box 3727
Palos Verdes Peninsula
California 90274
Tel: (310) 544-4049 FAX: (310) 544-0498

15.3.3 QUESTIONNAIRE I - BASIC

This is a broad spectrum questionnaire encompassing a wide range of Workers' Compensation Information. The questionnaire was distributed to State Insurance Commissioners as well as State Workers' Compensation Administration directors.

EXHIBIT 15.4
QUESTIONNAIRE I - BASIC

The Questionnaire I - Basic commences on the following page.

WORKERS' COMPENSATION ANALYSIS QUESTIONNAIRE
QUESTIONNAIRE I - BASIC

A. STATE: _____

1. Which organization is responsible for Workers' Compensation system administration?

   a) Name of Worker's Compensation agency

   _____

   b) Individual in charge including name, title, address, telephone number and FAX number, and name of administrative assistant

   Name: _____ Title: _____

   Address: _____

   _____

   Telephone: _____ FAX: _____

   Admin. Assistant: _____

2. Does your state maintain a public advocate or independent counsel which monitors your workers' compensation system, legislation and ongoing administration.

   Yes No (circle one)

   Please explain: _____

3. Indicate the direct chain of reporting authority between the Governor and the Workers' Compensation System Administration, via a single line organizational chart technique. (Please attach an organizational chart of the appropriate administrative government segment, if possible. In the event a chart is not available, please attach a separate sheet of paper with a single line diagram.)

B. PROCESS OF INSURANCE REGULATION RELATED TO WORKERS' COMPENSATION

1. Insurance Commissioner

   a) What method is utilized concerning the Office of Insurance Commissioner?

      1) Elected (circle one)

      2) Appointed

      3) Civil Service

4) Other

Please explain: _____

b) What year did the present Commissioner assume office? _____

2. Rating Bureau

a) What type of rating bureau do workers' compensation insurers belong to:

1) National Council on Compensation Insurance? (circle one)

2) Independent state rating bureau?

b) Is membership by insurers mandatory or voluntary? (circle one)

Please explain: _____

c) What are the roles of Rating Bureau?

1)	Rate Filing	Yes	No	(circle one)
2)	Data Collection	Yes	No	(circle one)
3)	Job/Industry Classification	Yes	No	(circle one)

4) Other

Please explain: _____

_____

C. INSURANCE RATE REGULATION

1. What is Type of Regulation? (circle all that apply and briefly explain)

a) Administered Pricing without deviations

_____

b) Administered Pricing with deviations

_____

c) Pure Premium Rates

_____

d) Overhead expenses

e) File and Use, Use and File, or Flex Rating

f) Reserving Practices

1) Procedures and Policy

2) Adequacy of Reserves

3) Prior accuracy of Reserving Practices

g) Audit Practices of Department of Insurance or other governing authority with regards to insurance carriers

h) Incurred But Not Reported Claims Policy

2. During the 1980s was there a change in Ratemaking System from one of administered pricing to open competition?

a) Year of Change _____

b) Type of Change _____

c) What were the reasons for making the change?

3. Is there available information regarding the amount requested by insurance rating bureau and amount granted by Insurance Commissioner in regulated rates

Yes No (circle one)

Please explain: _____

_____

4. Has your state ever considered establishing a workers' compensation minimum rate law?

Yes No (circle one)

Please explain: _____

_____

D. FINANCIAL STABILITY OF INSURANCE CARRIERS

1. Insolvency Activities and History

a) How many companies writing workers' compensation insurance became insolvent in your state from 1980-1990[2]? _____

Please explain: _____

b) Are there formal structures to handle insolvency, such as a state guarantee fund?

Yes No (circle one)

Please explain: _____

_____

c) What kind of Early Warning system for insolvency do you utilize?

_____

_____

2. What has been the level of profitability for workers' compensation insurers in your state during years 1980-1990[2]? Please include the data source with answer.

_____

_____

3. Has your state had problems with Availability of Workers' Compensation Insurance?

a) For the small[3] employer Yes No (circle one)

Please explain: _____

_____

b) For the medium[3] employer Yes No (circle one)

Please explain: _____

_____

c) For the large[3] employer Yes No (circle one)

Please explain: _____

_____

E. INSURANCE MARKET STRUCTURE

1. Is private insurance allowed? Yes No (circle one)

_____

_____

a) Number of Companies writing workers' compensation insurance in state? _____

b) What percentage of total market is currently written by the five (5) leading workers' compensation insurance companies in the state? _____ %

c) How has the percentage changed over the past 10 years for the 5 leading insurance companies in the state?

Please explain: _____

_____

2. Is there a State Fund?

a) Type of Organization (circle one)

1) Competitive

2) Mandatory (Monopolistic/Exclusive)

b) Year of Establishment of State Fund? _____

c) Premium Earned by State Fund for years 1980-1990[2]?

_____

_____

d) Losses Incurred by State Fund for years 1980-1990[2?]

_____

_____

_____

e) Dividends Paid by State Fund for 1980-1990[2]?

_____

_____

_____

3. Self Insurance

a) Is self-insurance legally permitted in state for workers' compensation?

Yes No (circle one)

Please explain: _____

_____

b) Is specific excess insurance required of all self-insurers?

Yes No (circle one)

Please explain: _____

_____

c) Is it permissible to buy aggregate excess workers' compensation insurance from a legally admitted insurance carrier?

Yes No (circle one)

Please explain: _____

_____

d) Is it permissible for small employers to participate in a workers' compensation self-insurance pool Yes No (circle one)

Please explain: _____

_____

4. Is there an Assigned Risk Pool (ARP) for workers' compensation?

Yes No (circle one)

Please explain: _____

_____

a) Financial stability of ARP in recent past

Please explain: _____

_____

b) What are the requirements for getting insurance from ARP?

Please explain: _____

_____

c) What percentage of market does Assigned Risk Plan cover currently and during the past 10 years?

Please explain: _____

_____

5. Can employers join safety pools or joint powers authorities and self-insure workers' compensation as a group?

Yes No (circle one)

Please explain: _____

_____

F. COSTS OF WORKERS' COMPENSATION COVERAGE

1. Premium Rate

a) What was the total premium earned on workers' compensation insurance for the years 1980-1990[2]?

_____

_____

_____

b) What were total losses incurred for 1980-1990[2]?

c) What was the total amount of Investment Income for the years 1980-1990[2]?

d) What was the Average Manual Rate for the state for years 1980-1990[2]?

2. Summary of Cost Components for all workers' compensation insurers

a) How much were incurred costs for Medical Benefits for Treatment during the years 1980-1990[2]?

b) How much were incurred costs for Income (indemnity) Benefits for the years 1980-1990[2]?

1) Temporary total disability

2) Permanent Partial disability

3) Permanent Total disability

_____

_____

_____

4) Death Benefits

_____

_____

_____

5) Any other benefits

Please explain: _____

_____

_____

c) What were the costs for Med-Legal Evaluations for the years 1980-1990[2]?

_____

_____

_____

3. Does your state provide rehabilitation as a workers' compensation benefit?

Yes No (circle one)

Please explain: _____

_____

a) If the workers' compensation system does not provide a rehabilitation benefit, is it provided by any other means as a state benefit?

_____

_____

_____

b) What is the scope of the rehabilitation benefit?

_____

_____

_____

c) Approximately what is the current cost of rehabilitation within the state?

_____

_____

_____

4. Does your state recognize the "stress claim" as an "injury" within the workers' compensation system?

Yes No (circle one)

Please explain: _____

_____

a) If the workers' compensation system does not provide a "stress claim" benefit, is it provided by any other means as a state benefit?

_____

_____

_____

b) What is the scope of the "stress claim" benefit?

_____

_____

_____

c) Approximately what is the current cost of the "stress claim" within the state?

_____

_____

_____

d) If the "stress claim" is not a covered workers' compensation benefit, what is the legal remedy for one claiming such an injury?

5. Insurer Costs

a) What percentage of premium went for Commissions and Brokerage during the years 1980-1990[2]?

b) What percentage of premium went for Loss Adjustment Expenses during the years 1980-1990[2]?

c) What percentage of premium went for General Expenses during the years 1980-1990[2]?

d) What percentage of premium went for Profit during the years 1980-1990[2]?

e) How much of earned premium was rebated as Dividends to Policyholders during the years 1980-1990[2]?

_____

_____

_____

f) Do you have a Pie Chart showing the breakdown of costs for the most recent year? Attach copy, if possible.

Yes No (circle one)

Please explain: _____

_____

6. What kinds of Premium Discounts can be applied to policies?

a) Are discounts available for large business size?

_____

_____

_____

b) Are discounts available for renewal of business?

_____

_____

_____

c) Other Options

_____

_____

_____

G. SAFETY PROGRAMS, INCENTIVES, DIVIDENDS AND PENALTIES

1. Does your state have a Schedule Rating Plan? Yes No (circle one)

Please explain: _____

_____

a) Who is eligible?

_____

_____

_____

1) Size of risk (employer)

_____

_____

_____

2) Type of business/industry

_____

_____

_____

3) How many employers, comprising what percentage of payroll participate in the plan?

_____

_____

_____

b) What factors are considered in setting rating risks?

_____

_____

_____

1) Physical Hazards Control

2) Formal Loss Control Programs

c) What range of discounts/debits are allowed in plan?

d) Who does inspection of risks to determine eligibility and degree of premium credit or debit? (circle all that apply and briefly explain)

1) Individual insurance carrier

2) Rating Bureau or other centralized rating body

3) State OSHA or other occupational safety and health persons

4) Independent reviewer, certified by state

2. Experience Rating

a) What is the premium threshold for eligibility?

b) Trend in eligibility (i.e. premium level) for years 1980-1990[2]

c) How many employers qualify for experience modification?

3. Dividends

a) Amount returned to policyholders for years 1980-1990[2]?

1) Breakdown by type of insurance carrier (e.g. state fund, stock, mutual)

2) Are dividend structures filed with or otherwise regulated by the Insurance Commissioner?

4. Insurer Provision of Health and Safety Services

a) Does your state require insurance carrier to provide Health and Safety services?

b) Is there any information on how many inspectors are employed by carriers, and what type of work they do?

_____

_____

_____

c) Does the state require insurers to report expenditures for Health and Safety?

_____

_____

_____

5. Are employers required to have a Health and Safety program? Yes No (circle one)

Please explain: _____

_____

6. Are there any state funded health and safety grant programs to assist employers in carrying out Health and Safety activities? Yes No (circle one)

Please explain: _____

_____

7. Are there any loan programs for businesses wishing to improve Health and Safety or comply with regulations? Yes No (circle one)

Please explain: _____

_____

_____

8. Are there any other incentives related to prevention? Yes No (circle one)

Please explain: _____

_____

_____

9. Does your state allow employers or insurers to provide 24 hour coverage programs which combine health insurance benefits and workers' compensation? Yes No (circle one)

Please explain: _____

_____

_____

H. STATE STUDIES OF WORKERS' COMPENSATION SYSTEM

1. Has your agency or other agencies of state government or the state legislature conducted any studies of the state workers' compensation system in recent past?
Yes No (circle one)

Please explain: _____

_____

_____

2. Are you aware of any academic or industry funded studies of your states workers' compensation system, especially related to insurance ratesetting? Yes No (circle one)

Please explain: _____

_____

_____

Footnotes:

1. It is our recommendation that one individual be assigned to this project and we will make every effort to work directly with him/her.

2. Wherever the identified time period is "1980-1990" we would like to obtain the subject statistical information by individual years. Please indicate the data for each identified year available, as well as the yearly periods. (i.e., fiscal or calendar year)

3. A small employer is defined as 10 employees or less, a medium size employer is defined as between 10 and 200 employees, and a large employer is over 200 employees.

QUESTIONNAIRE ASSIGNMENT

Individual Responsible for Workers' Compensation Questionnaire

Name: _____ **Title:** _____

Department: _____

Address: _____

_____

_____

Telephone: _____ **FAX:** _____

Optional Remarks Concerning Questionnaire: _____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

WCCAN251.SSQ

15.3.4 QUESTIONNAIRE II - TECHNICAL

This is a technical questionnaire intended for the Department of Insurance of each state. It was distributed to all state Insurance Commissioners.

EXHIBIT 15.5
QUESTIONNAIRE II - TECHNICAL

The Questionnaire II - Technical commences on the following page.

WORKERS' COMPENSATION ANALYSIS QUESTIONNAIRE
QUESTIONNAIRE II - TECHNICAL

STATE INSURANCE DEPARTMENT QUESTIONNAIRE

State Insurance Department: _____

Does your Insurance Department analyze the following items in reviewing overall premium / loss cost changes proposed in Workers' Compensation filings? For each issue that is reviewed, please explain in detail what type of review is made and provide a copy of the Department's most recent analysis of each such issue.

1.	Loss and/or Premium Development	Yes _____	No _____
2.	Loss and/or Premium Trend	Yes _____	No _____
3.	Underwriting Profit / Investment Income	Yes _____	No _____
4.	Loss Adjustment Expenses	Yes _____	No _____
5.	Non-Tax Underwriting Expenses (e.g., Commissions and Brokerage, Other Acquisition Expenses, General Expenses and Premium Discount)	Yes _____	No _____
6.	Miscellaneous Premium Tax Provisions	Yes _____	No _____
7.	Other Premium Tax Provisions	Yes _____	No _____
8.	Assessment Provisions	Yes _____	No _____
9.	Years and Types (e.g., policy vs. accident vs. calendar year, financial vs. unit statistical, etc.) of Experience Used	Yes _____	No _____
10.	Benefit Evaluation Factors	Yes _____	No _____
11.	Statistical Data Sources (e.g., Financial, Unit Statistical, Detailed Claim Information, Special Studies, etc.) Used	Yes _____	No _____

12. How experience of State Fund, if any, is considered. Yes _____ No _____

13. Other items considered Yes _____ No _____

If yes, please describe.

_____

_____

14. Which role(s) does the Department of Insurance have regarding Workers' Compensation filings?

A. Party to case (i.e., presents testimony) Yes _____ No _____

B. Decision maker Yes _____ No _____

C. Both party to case and decision maker Yes _____ No _____

D. Other Yes _____ No _____

If yes, please describe.

_____

_____

15. Please indicate the types of personnel used by the Department of Insurance in evaluating Workers' Compensation filings.

A. Actuaries Yes _____ No _____

Fellows of Casualty Actuarial Society (FCAS) Yes _____ No _____

Associates of Casualty Actuarial Society (ACAS) Yes _____ No _____

Students in Casualty Actuarial Society Yes _____ No _____

Fellows of Society of Actuaries (FSA) Yes _____ No _____

Associates of Society of Actuaries (ASA) Yes _____ No _____

Students in Society of Actuaries Yes _____ No _____

Member of the American Academy of Actuaries (MAAA) Yes _____ No _____

Other Yes _____ No _____

If yes, please describe.

_____

_____

B. Economists Yes _____ No _____

C. Chartered Property Casualty Underwriters (CPCU) Yes _____ No _____

D. Accountants Yes _____ No _____

E. Statisticians Yes _____ No _____

F. Other Yes _____ No _____

If yes, please describe.

_____

_____

16. Does the Department of Insurance use employees or consultants to examine these filings?

A. Employees Yes _____ No _____

B. Consultants Yes _____ No _____

C. Both Yes _____ No _____

17. Have parties other than the filer and Department of Insurance been involved in the analysis of Workers' Compensation insurance filings? Yes _____ No _____

If yes, please indicate which of the following entities have been involved.

A. Attorney General's office Yes _____ No _____

B. Public / Consumer Advocate's office Yes _____ No _____

C. Employer groups (e.g., manufacturing association) Yes _____ No _____

If yes, please describe.

_____

_____

D. Employee groups (e.g., AFL-CIO) Yes _____ No_____

If yes, please describe.

_____

_____

E. Individual insurance companies Yes _____ No _____

F. Other Yes _____ No _____

If yes, please describe.

_____

_____

G. Have these groups presented expert testimony concerning the technical aspects of filing? Yes _____ No____

H. Has the participation of these groups been of assistance in evaluating filings? Yes _____ No____

Please explain answer.

_____

_____

18. Do specific statutory and/or administrative time frames apply to the following steps taken in the processing of Workers' Compensation filings?

A. Notice of hearing Yes _____ No _____

If yes, please describe.

_____

_____

B. Submission of pre-filed testimony Yes _____ No _____

If yes, please describe.

_____

_____

C. Start of hearing Yes _____ No _____

If yes, please describe.

_____

_____

D. Length of hearing Yes _____ No _____

If yes, please describe.

_____

_____

E. Regulator's decision on filing Yes _____ No _____

If yes, please describe.

_____

_____

F. Other Yes _____ No _____

If yes, please describe.

_____

_____

19. Can rates / loss costs other than those approved by the regulator be implemented? Yes _____ No _____

If yes, please describe.

_____

_____

20. Are there specific data and information which must be included in Workers' Compensation filings, either as a result of statutes, regulations, rules or other circumstances?

Yes _____ No _____

If yes, please describe and provide copies of the statutes, regulations, rules, etc.

_____

_____

_____

_____

21. Are there specific data and information which must be provided by the filer during the review process for Workers' Compensation filings, either as a result of statutes, regulations, rules or other circumstances?

Yes _____ No _____

If yes, please describe and provide copies of the statutes, regulations, rules, etc.

_____

_____

_____

22. Are there any specific analytic procedures which must be followed regarding the calculations included with the filing (e.g., standard treatment of investment income)?

Yes _____ No _____

If yes, please describe.

_____

_____

_____

23. Are there specific types of data (e.g., financial, unit statistical, detailed claim information, special studies, etc.) which the Department of Insurance has found useful in analyzing Workers' Compensation filings?

Yes _____ No _____

If yes, please describe.

_____

_____

_____

24. Which statutes govern the technical and procedural aspects for the review of Workers' Compensation rate filings?

_____

_____

_____

Please provide a copy of these statutes and/or citations.

25. Which regulations govern the technical and procedural aspects for the review of Workers' Compensation rate filings?

_____

_____

_____

Please provide a copy of these regulations and/or citations.

26. Please fill out the attached table for each Workers' Compensation filing made in your jurisdiction from 1980 to the present.

Please refer to the following page II-9 for the table.

27. Is there any other information you can provide which would be useful in understanding how your jurisdiction evaluates Workers' Compensation filings - from both technical and procedural aspects?

_____

_____

_____

28. Are there rating plans and procedures available in your state which are used to encourage safety, especially on the part of small and medium sized insurers? If yes, please describe and provide a copy of these plans and procedures.

_____

_____

_____

29. Provide a copy of any manuals used in connection with these plans. In addition, provide a copy of any reports/studies that assess how well these plans and procedures are accomplishing their goals.

_____

_____

Item 26 continued:

Please fill out the following table for each workers' compensation rate and/or pure premium (loss cost) filing made in the jurisdictions for which your organization operates, covering the period from 1980 to the present.

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Date of Filing	Was Filing For a Change in	Made	Was Filing Made for		Effective Date for Rates / Pure Premium		Was a Hearing Held (Y/N)	Percentage Change in Rates / Loss Costs	
	Rates	Loss Costs	Voluntary Market	Residual Market	Proposed	Actual		Requested	Approved

QUESTIONNAIRE ASSIGNMENT

Individual Responsible for Workers' Compensation Questionnaire

Name: _____ **Title:** _____

Department: _____

Address: _____

_____

_____

Telephone: _____ **FAX:** _____

WCCAN261.AIS

15.3.5 QUESTIONNAIRE III - BUREAU

This is a technical questionnaire intended solely for the various rating bureaus. The development of the questionnaire was the responsibility of AIS Risk Consultants, Inc. and involved the assistance, coordination, refinement and printing as well as distribution by the Commission staff.

EXHIBIT 15.6
QUESTIONNAIRE III - BUREAU

The Questionnaire III - Bureau commences on the following page.

C215T02F.RHS/GMS/SMW/LAL

WORKERS' COMPENSATION ANALYSIS QUESTIONNAIRE
QUESTIONNAIRE III - BUREAU

WORKERS' COMPENSATION INSURANCE BUREAU QUESTIONNAIRE

Name of Rating Bureau: _____

1. Describe the types of data and analyses used by your organization during the last five years to derive overall workers' compensation insurance rate level changes. This should include all aspects of the overall rate level calculation including, but not limited to:

    a) experience indications

    b) loss development

    c) loss trend

    d) underwriting expenses

    e) premiums taxes; licenses and fees

    f) assessments

    g) loss adjustment income

    h) underwriting profit

    i) federal income taxes

    j) benefit level changes

    k) medical fee schedules and cost containment

    l) treatment of state insurance fund experience

    Also include a copy of the data calls, including instructions, used to gather the information. In addition, include any standard tables and distributions developed.

2. Describe the types of data and analyses used by your organization during the last five years to distribute overall workers' compensation insurance rate level changes to classifications.

    Also include a copy of the data calls, including instructions, used to gather the information. In addition, include any standard tables and distributions developed.

3. Describe the types of data and analyses used by your organization during the last five years to adjust workers' compensation insurance classification manual rates to reflect a particular insured's experience.

   Also include a copy of the data calls, including instructions, used to gather the information. In addition, include any standard tables and distributions developed.

4. Describe and provide a copy of any rating plans used by your organization or its member/subscriber insurers during the last five years to reflect the individual characteristics of particular insureds. Also provide a copy of nay manuals used in connection with these plans.

   The plans should include, but not be limited to:

   a) prospective experience rating

   b) retrospective experience rating

   c) premiums discounts

   d) schedule rating

   e) rate deviations

   f) policyholder dividends

5. Does your organization or its member/subscriber insurers have any plans or procedures used to encourage safety, especially on the part of the small or medium sized insureds?

   Also, provide a copy of any manuals used in connection with these plans. In addition, provide a copy of any reports/studies that assess how well these plans and procedures are accomplishing their goals.

6. Please fill out the attached table regarding rate level changes filed and implemented from 1980 to the present in each of the jurisdictions in which your organization operates.

   Please refer to the following page, III-3, for the table.

7. Is there any other information you can provide which would be useful in understanding how workers' compensation rate filings are evaluated in the jurisdictions in which our organization operates - from both technical and procedural aspects?

STATE OF CALIFORNIA
CALIFORNIA WORKERS' COMPENSATION RATE STUDY COMMISSION
WORKERS' COMPENSATION SYSTEM COMPARATIVE ANALYSIS STAFF QUESTIONNAIRE

6) Please fill out the following table for each workers' compensation rate and/or pure premium (loss cost) filing made in the jurisdictions in which your organization operates, covering the period from 1980 to the present.

Jurisdiction:

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Date of Filing	Was Filing Made For a Change in		Was Filing Made for		Effective Date for Rates / Pure Premium		Was a Hearing Held (Y/N)	Percentage Change in Rates / Loss Costs	
	Rates	Loss Costs	Voluntary Market	Residual Market	Proposed	Actual		Requested	Approved

QUESTIONNAIRE ASSIGNMENT

Individual Responsible for Workers' Compensation Questionnaire

Name: _____ **Title:** _____

Bureau: _____

Address: _____

_____

_____

Telephone: _____ **FAX:** _____

Optional Remarks Concerning Questionnaire: _____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

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APPENDIX A

COMMISSION MEETING MINUTES

A. COMMISSION MEETING MINUTES III-APPENDIX-1

APPENDIX A

COMMISSION MEETING MINUTES

On the following pages are the minutes of the Workers' Compensation Rate Study Commission public meetings. The Commission meetings are held in accordance with the State of California "Open Meeting Laws" and principally the Ralph M. Brown Act and the Bagley-Keene Open Meeting Act. The guide for the conduct of the Commission compliance to the State of California "Open Meeting Laws" is the California Attorney General's Office 1989 Open Meeting Laws Guidebook ("pamphlet").

The following represents the Workers' Compensation Rate Study Commission minutes records Table of Contents exhibit. Please note that the March 1991 Commission meetings were focused on developing Workers' Compensation stakeholder testimony and minutes were not maintained.

The individual meeting minutes are identified in the following Table of Contents exhibit:

EXHIBIT A-III-1
COMMISSION MEETING MINUTES DIRECTORY

Appendix	Commission Meeting Date	Page Location
A.1	December 17, 1990	Page III-Appendix-5
A.2	January 15, 1991	Page III-Appendix-9
A.3	February 15, 1991	Page III-Appendix-15
A.4	April 8, 1991	Page III-Appendix-17
A.5	May 29, 1991	Page III-Appendix-23
A.6	June 12, 1991	Page III-Appendix-25
A.7	July 16, 1991	Page III-Appendix-27
A.8	August 21, 1991	Page III-Appendix-31
A.9	September 20, 1991	Page III-Appendix-39
A.10	October 25, 1991	Page III-Appendix-45
A.11	November 15, 1991	Page III-Appendix-51
A.12	December 13, 1991	Page III-Appendix-59
A.13	January 10, 1992	Page III-Appendix-63

COMMISSION MEETING MINUTES DIRECTORY - Exhibit A-III-1 Continued

Appendix	Commission Meeting Date	Page Location
A.14	January 24, 1992	Page III-Appendix-67
A.15	February 7, 1992	Page III-Appendix-71
A.16	February 20 - 21, 1992	Page III-Appendix-75
A.17	March 6, 1992	Page III-Appendix-83
A.18	March 20, 1992	Page III-Appendix-89

The Workers' Compensation Rate Study Commission meetings are announced by public notice which is sent in approximately 95% of the cases by facsimile transmission. Individuals requesting to be on the distribution list as well as a wide range of Workers' Compensation stakeholders are provided with a public notice agenda prior to each meeting.

The agenda format and distribution arrangement comply with the State of California open meeting laws with regard to notice timing and agenda organizational content. Exhibit A-III-2 represents a sample agenda and concerns the February 7, 1992 Los Angeles meeting of the Workers' Compensation Rate Study Commission.

Please refer to the following page for Exhibit A-III-2.

EXHIBIT A-III-2
SAMPLE COMMISSION MEETING AGENDA

PUBLIC NOTICE

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION
MEETING

FRIDAY, FEBRUARY 7, 1992
1:00 P.M.

HYATT AIRPORT HOTEL
LOS ANGELES INTERNATIONAL AIRPORT
LOS ANGELES, CALIFORNIA

AGENDA

1. Approval of previous meeting minutes.

2. Announcement of schedule of future Commission meetings.

3. Presentation by consulting team member, Dr. G. M. Shor of draft Section 9.0 of the Workers' Compensation Rate Study Report. Dr. Shor will address the topic: "Analysis of California Ratesetting Law as Compared to Systems Utilized by Other States".

4. Presentation by Dr. J. C. Van Horne, Commissioner of draft Section 4.0, "Broader Issues Affecting Ratemaking Process".

5. Presentation of draft Section 5.0, "Prospective v. Retrospective Pricing". Dr. P. A. Cheshier, Commissioner will address Subsection 5.1, "Rate Adequacy". Dr. M. D. Powell, Commissioner will address Subsection 5.3, "Competitiveness & Efficiency of Delivery of Insurance Product".

6. Discussion by the Commission of topics pertinent to Workers' Compensation. These topics will include, but may not be limited to: "Competitiveness, Dividends, Profitability and Payroll v. Hours Worked".

7. Discussion of substantive issues relating to the Commission charge.

For further information about this meeting, contact:

Richard H. Soper, Commission Executive Director
Soper & Associates
P.O. Box 3727
Palos Verdes Peninsula, California 90274
Bus: (310) 544-4049 FAX: (310) 544-0498

or

Dennis J. Aigner, Ph.D., Commission Chairman
Dean, Graduate School of Management
University of California, Irvine
Irvine, California 92717
Bus: (714) 856-6855 FAX: (714) 856-8469

APPENDIX A.1

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
DECEMBER 17, 1990
LOS ANGELES HILTON AND TOWERS HOTEL
LOS ANGELES, CALIFORNIA

MINUTES

The first meeting of the members of the Workers' Compensation Rate Study Commission was held at 2:30 p.m. at the Los Angeles Hilton and Towers Hotel. Those members of the Commission present, and constituting a quorum were:

- Dennis Aigner
- William Neeley
- Melchior D. Powell
- Susan Schaefer
- Patricia Strong
- Victor Tabbush
- James Van Horne

There were no Commission members absent. Also present was Orin Kramer, the Commission's executive director.

The meeting was open to the public, and representatives of Commissioner-elect Garamendi, the State Legislature, and a number of other observers were present.

Mr. Kramer opened the meeting by welcoming the Commission members and guests. The Commissioners then introduced themselves.

ELECTION OF CHAIRPERSON

Mr. Kramer noted that the Commission was statutorily required to elect a chairperson as its first order of business, and that there had not been any discussion or negotiation of that issue prior to convening at the meeting. After a brief discussion, upon motion duly made and seconded, Dennis Aigner was unanimously elected to chair the Commission.

REVIEW OF AGENDA

Chairman Aigner reviewed the agenda, noting that the requirements of the Bagley-Keene Open Meeting Act precluded the discussion of any items not on the agenda.

APPLICATION OF OPEN MEETING LAWS

The Commissioners reviewed the basic requirements of the Bagley-Keene Act. There was a consensus that the Commission would seek to honor both the letter and spirit of the Act, and that meetings would be held in closed session only when absolutely necessary and where the statutory authority to close such a session was clear-cut.

APPLICATION OF POLITICAL REFORM ACT

Mr. Kramer reported that it was unclear whether the Commission would be covered by California's conflict of interest laws. He noted that the statute generally exempts purely advisory commissions except those whose recommendations are routinely and regularly followed. Upon motion duly made and seconded, Mr. Kramer was directed to seek a ruling from the Fair Political Practices Commission as to whether the Commission was covered by the Political Reform Act.

HOUSEKEEPING ISSUES

Mr. Kramer noted that pending further discussions with the Department of Insurance, it appeared that the Commission's offices would open in Sacramento in mid-January. He noted that at present the Commission has no staff in California. It was also noted that Commissioners were entitled to compensation of $100 per diem for days spent at Commission meetings, that transportation costs were fully reimbursable (first class air travel is not reimbursable), and that Commissioners were also entitled to reimbursement for reasonable and necessary expenses, which were to be receipted. Mr. Kramer was asked to seek further guidance on reimbursement ceilings and other restrictions. The Commissioners were asked to provide Mr. Kramer with bills for reimbursement.

REVIEW OF COMMISSION MANDATE

Chairman Aigner led a general discussion of the Commission's statutory mandate. Mr. Kramer passed out a copy of a letter from Assemblyman Burt Margolin discussing the scope of the Commission's inquiry, and it was agreed that Mr. Kramer would indicate to Assemblyman Margolin that the Commission's conception of its charge was consistent with his letter.

DISCUSSION OF ISSUE AGENDA AND BACKGROUND MATERIALS

At the invitation of the Commission, Robert Mike of the California Workers' Compensation Insurance Rating Bureau and his chief actuary, David Bellusci, made a presentation

describing the operation of the California rating system. Mr. Kramer noted that the Rating Bureau supported the current system and that the presentation was intended to be informational and descriptive rather than an advocacy brief. A lengthy discussion ensured during which the commissioners posed questions to Messrs. Mike and Bellusci about the system's operations.

The Commission held a preliminary discussion of the draft research agenda. In response to inquiries by members, Mr. Mike indicated that most of the data that would be sought under the research agenda was obtainable. However, he noted that refining the data requirements and collecting and analyzing the data would be a complex task. Mr. Kramer recommended that the Commission retain a counsel and an actuarial accounting firm, but no decisions were made regarding either the scope of the research agenda or the professional assistance that the Commission would require. The Commission took note that while it had independent statutory authority to engage professional research assistance, and that while funds for such activities were included in the Commission's budget, the release of such funds was subject to the Department's approval. Mr. Kramer was asked to prepare a description of the role of an actuarial consultant for the next Commission meeting.

The Commission had preliminary discussions about the process involved in retaining consultants, and it appeared that such a process would require several months. Mr. Kramer was authorized to continue to pursue discussions with the Department of Insurance as to how that process might be undertaken as expeditiously as possible.

There was general agreement that the Commission's charge involved four basic tasks: (1) reviewing the workings of the California rating system and determining its effects in terms of the policy criteria set forth in the statute; (2) analyzing how the major alternative ratemaking systems work; (3) analyzing the effects of those alternative systems in terms of the statutory criteria cited above; and (4) assessing the experience of states with mandatory workers' compensation funds and the implications of that experience for introducing such an approach in California.

In view of the unanticipated delays in forming the Commission, the magnitude of the research task, and the possibility of further delay in retaining needed professional staff, the members unanimously concluded that the Commission could not properly complete its task before June 30, 1992. Upon motion duly made and seconded, Mr. Kramer was directed to communicate to both houses of the State Legislature the Commission's request that its life be extended until June 30, 1992.

STAFFING

Mr. Kramer noted that he had interviewed approximately a dozen candidates for an administrative position and a word processor position for the Commission, and that discussions on staffing with the Department of Insurance were continuing. In the event that the Commission decided to hire a part-time counsel, Mr. Kramer offered as one possibility Prof. Richard Briffault of Columbia Law School, who has previously staffed a number of

commissions, including one involving insurance regulation. Mr. Kramer requested any additional recommendations from members of the Commission.

SCHEDULING

The Commission agreed that it would hold public hearings but deferred scheduling. The next Commission meeting was scheduled for January 15, 1991 at one of the San Francisco Airport hotels.

CONSTITUENCY OUTREACH

Mr. Kramer indicated that a number of outside parties had expressed an interest in the Commission's deliberations, that he was meeting individually with those parties, and the Commissioners wishing to participate in such meetings should contact him.

ADJOURNMENT

The meeting was adjourned at 5:15 p.m. by Chairman Aigner.

Orin Kramer
Executive Director

/ja

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APPENDIX A.2

STATE OF CALIFORNIA
WORKER'S COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
JANUARY 15, 1991

MINUTES

The Worker's Compensation Rate Study Commission met at 1:00 p.m. at the San Francisco Airport Hilton. Those members of the Commission present, and constituting a quorum were:

- Dennis Aigner, Chairman
- William Neeley
- Melchior D. Powell
- Susan Schaefer
- Patricia (Strong) Cheshier
- Victor Tabbush
- James Van Horne

Members absent: None

Also present was Orin Kramer, the Commission's executive director.

The meeting was open to the public, and representatives of the State Legislature and other observers were present.

REMARKS BY COMMISSIONER GARAMENDI

Commissioner Garamendi opened by describing the symbiotic relationship between the Commission and the Department: the Department would provide financial and administrative support, but the Commission was expected to reach its conclusions and write its report independently. The Commissioner also noted that the Department would be under budgetary pressure, and the Commission expenditures would come from Department funds. Hence, the Department will be rigorous in reviewing the Commission's spending, although the Commission's legitimate needs will be fully met. The Commissioner also noted that Assemblyman Margolin had raised concerns about the scope of the Commission's substantive agenda. The Commissioner observed that the scope of the agenda might have cost implications as well.

The Commissioner indicated that he had reviewed Mr. Kramer's contract, and that the contract needs to be revised. In particular, he noted the need to categorize and adjust expense provisions in the current contract. He also indicated that the timeframe covered by the contract needed to be revised in view of the anticipated extension of the Commission's life. The Commissioner recommended that the Commission retain Mr. Kramer as executive director, but asked the Commission to make its own independent determination as to Mr. Kramer's continued involvement.

The Commissioner indicated that the Department was available as a resource, that it would seek to make people available for some minor research, but that the Department's staffing and actuarial resources were already thinly spread. The Commissioner will meet periodically with the Commission, and Masako Dolan will be responsible for the Commission within the Department.

The Commissioner recommended that the Commission's report be submitted to the Legislature by January 1992. Diane Griffiths of Assemblyman Margolin's staff concurred, suggesting that a submission substantially later would effectively push Legislative consideration of the Commission's findings into 1993. The Commissioner also recommended that the Commission continue its efforts to establish independent working relationships with both houses of the Legislature. Chairman Aigner expressed the Commission's concern about having an adequate timeframe to produce a quality product.

In response to a question from Ms. Schaefer about contracting procedures, the Commissioner indicated that the Department had relied excessively on sole source contracts in the past. The Commissioner indicated that future consulting contracts would be competitively bid, and that winning bidders would be required to subcontract out 20 percent of the bid to minority and female-headed firms, in accordance with state law. The Commissioner indicated that the bidding and contract approval process would probably require three to four months, and that in awarding future consulting contracts, the Department would be highly sensitive to affirmative action requirements. Retention of legal counsel, however, would not be subject to the competitive bidding process.

MINUTES OF DECEMBER 17, 1990 MEETING

Upon motion duly made and seconded, the minutes of the December 17, 1990 Commission meeting were approved.

MR. KRAMER'S CONTRACT

Chairman Aigner indicated that he would poll the commissioners as to whether the retention of Mr. Kramer should be discussed at the next Commission meeting.

Mr. Kramer reviewed the terms of his contract and billings under that contract. He noted correspondence from mid-1990 recently delivered to the Commissioner, which indicated that Mr. Kramer had been unaware of the expense provisions inserted by the Department into

his contract. He noted that during the first five months of the Commission's existence, he had billed $6,000 for expenses and $48,000 for consulting fees, compared to $66,000 and $100,000 allocated in the contract for that period. Mr. Kramer noted that he had not sought reimbursement for the staffing, overhead, and legal counsel costs incurred in connection with the Commission's work.

Ms. Schaefer raised questions about how Mr. Kramer would balance his roles of providing substantive work produce and administrative support for the Commission, and a discussion followed about the breakdown of roles among staff.

POLITICAL REFORM ACT

The Commission discussed a letter from FPPC staff regarding the application of the Political Reform Act. Upon motion duly made and seconded, it was agreed that Mr. Kramer would draft a follow-up letter to the FPPC, and the Messrs. Aigner and Neeley would review that letter.

COMMUNICATIONS WITH THE LEGISLATUREMr. Kramer reported on discussions with legislative staff of both houses on the timing issue and noted that he had written Assemblyman Margolin. Chairman Aigner affirmed that the Commission accepted Assemblyman Margolin's definition of the scope of the Commission's work, and it was agreed to invite the Assemblyman to meet with the Commission at its next public session. In addition, the Chairman and Mr. Kramer were requested to seek to meet with Assemblymen Margolin.

STAFFING

The Commission discussed the roles of legal counsel and the economic/actuarial consultant. Ms. Schaefer indicated that she would seek to identify a California-based law firm or attorney as a candidate for counsel, and it was agreed that the Commission would hold an executive session at its next meeting to review candidates for counsel.

SCHEDULE/HOUSEKEEPING

The Commission agreed to meet in Sacramento on February 15th. Chairman Aigner indicated that he would poll members to determine dates for public hearings in March, and that such hearings would also be scheduled for April. It was also agreed that the Commission would seek Legislative approval of February 28, 1992 as the completion date for the Commission's Report.

Mr. Kramer reviewed expense reimbursement procedures for commissioners.

ISSUE AGENDA AND RESEARCH PROCESS

The Commission agreed that in seeking bids for the economic/actuarial consulting role, it would follow the approach outlined in the background memorandum prepared for the January 15th meeting. That is, the bidder would be given discretion to determine which criteria warranted quantitative research, which states would be analyzed, and which tests would be done in those states. The Commission agreed that the states listed in the background memorandum would be the states the Commission would preliminarily designate for review. It was agreed that the Commission would review a draft RFP at its next meeting.

In terms of the substance of the research agenda, Mr. Van Horne indicated that the solvency record of workers' compensation carriers in California should be ascertained. The Commission also agreed that it would be useful to know how much California self-insureds would have paid in premiums, had they been insured. Ms. Cheshier indicated the need to develop new approaches to ascertain insurance market competitiveness, and she expressed skepticism about data purporting to establish the competitiveness, and she expressed skepticism about data purporting to establish the competitiveness of the California auto market. There was general concern about the difficulty of addressing the "equity" issue, given the variations among the states in the quality of data. Similarly, the sense of the commissioners was that there was no way to measure quantitatively the claims handing issue. Some commissioners suggested the value of loss cost analysis to determine the relationship between safety and rates. Mr. Van Horne questioned how much time delay was involved in recognizing safety improvement through the pricing mechanism. It was suggested by Messrs. Aigner and Van Horne that claim frequency is a better measure than cost in calculating the level of safety. Mr. Tabbush raised the concern that an excessive emphasis on price stability would be inappropriate if used to justify cartel pricing. Ms. Schaefer suggested surveying the State Fund to find out how many of its insureds had been rejected by private carriers. Finally, the Commission agreed to compare profitability among industries, but it was noted that profitability data across industries (or across states in insurance) are often not fully comparable. The Commission noted the absence of standardized formulae for allocating capital and general expenses across different lines of insurance.

Mr. Tabbush mentioned a study on the California workers' compensation rate law that had been prepared by a private consulting firm. Mr. Kramer was asked to ascertain whether the organizations that had funded the study would authorize its release to the Commission.

ADJOURNMENT

It was agreed that Mr. Kramer would present a review of the economics of workers' compensation at the next Commission meeting.

Upon motion duly made and seconded, the meeting was adjourned at 5:30 p.m.

Orin Kramer
Executive Director

/ja

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APPENDIX A.3

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
FEBRUARY 15, 1991
CLARION HOTEL
SACRAMENTO, CALIFORNIA

MINUTES

The Workers' Compensation Rate Study Commission met at 1:00 p.m. at the Sacramento Clarion Hotel. Those members of the Commission present, and constituting a quorum were:

- Dennis Aigner, Chairman
- Patricia (Strong) Cheshier
- Stewart Long
- William Neeley
- Melchior D. Powell
- Susan Schaefer
- James Van Horne

Members absent

- Victor Tabbush

Also present was Orin Kramer, the Commission's executive director.

The meeting was open to the public, and representatives of the State Legislature and other observers were present.

The public meeting of the Commission was preceded by a closed session to discuss personnel issues.

INTRODUCTORY REMARKS

At the open meeting, Chairman Aigner announced that the Department of Insurance had terminated Mr. Kramer's contract, effective March 15th. He also announced that the

Commission would hold public hearings on March 12 and 13 in Los Angeles and, tentatively, on April 8 and 9 in San Francisco. Finally, he indicated that the retention of legal counsel had been tabled indefinitely.

Diane Griffiths, representing Assemblyman Margolin, indicated that the Assemblyman would now be willing to support an extension of the Commission's life, and that he would like to meet with Chairman Aigner to discuss an extension.

WORKERS' COMPENSATION ECONOMICS PRESENTATION

Mr. Kramer made a presentation on the economics of workers' compensation. The Commission requested that he provide the graphics that had not been included in the presentation.

DISCUSSION WITH COMMISSIONER GARAMENDI

Commissioner Garamendi joined the meeting. Chairman Aigner indicated that the Commission would miss Mr. Kramer's expertise. He also indicated that the Commission wished to select Mr. Kramer's successor, that it needed an extension until February 1992 for its final report, and that it anticipated needing a budget of $900,000, compared to the original appropriation of $1,200,000.

Commissioner Garamendi responded that while he would work with the Commission in selecting a new executive director, he wished to retain final authority in the hiring process. With respect to the budget, Commissioner Garamendi indicated that the funding process would be zero-based, and that the Commission would have to prove its needs.

Mr. Van Horne, asked whether a candidate who was competent but had some involvement in insurer interests would be disqualified. Commissioner Garamendi responded that income conflicts needed to be carefully analyzed. He noted that the Commission's work was both an "academic" and "political" exercise and that it was important that its report be seen as credible and unbiased.

APPENDIX A.4

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
APRIL 8, 1991
HYATT REGENCY
BURLIGAME, CALIFORNIA

MINUTES

Members Present:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- William E. Neeley
- Susan D. Schaefer

Members Absent:

- Melchior D. Powell
- Victor Tabbush
- James Van Horne

The Commission first went into Executive Session for the purpose of discussing personnel matters.

The Commission's Public Meeting was opened at 10:15 a.m.

MINUTES

Approval of the minutes of the February 15th meeting was deferred to the next meeting.

It was moved (by S. Schaefer) and seconded (by S. Long) that the attached job description for the Commission's Executive Director be approved. It was adopted by a unanimous vote of those present.

The Commissioners also unanimously agreed to advertise the position immediately for a period of seven days with a deadline for receipt of applications to be set seven days

thereafter in the L.A. Times, SF Chronicle, N.Y. Times, Sacramento Bee and, if feasible, Business Insurance, National Underwriter and the Chronicle of Higher Education. Chair Aigner was directed to work with Ms. Dolan of the D of I to act on these decisions.

A Subcommittee of the Commission consisting of Cheshier (Chair), Aigner and a third member to be named, was designated to screen the candidates and recommend a set of semi-finalists. After further consultation with Commission members, two to three finalists will be selected for personal interviews. A representative of Insurance Commissioner Garamendi will be invited to participate in these interviews.

MEETING SCHEDULE

A date for the next public meeting was not set. It is anticipated to occur in six weeks, after an Executive Director is appointed.

RESOLUTION

In response to Orin Kramer's remarks as quoted in the April 1st issue of the California Worker's Compensation Institute Bulletin and the March 28th issue of Underwriters Report, the Commission unanimously passed the following resolution:

> "The Commissioners have learned that during the speech to the CWC Institute, our former Executive Director, Orin Kramer, predicted what he believed was a likely outcome of the Commission's deliberations.
>
> The members of the Commission wish to reaffirm that we have no predisposition with respect to the issues under consideration, nor have any of us made representations regarding the Commission's final recommendations.
>
> The Commission has not begun its formal analysis, hence any prediction of our recommendations is clearly premature and highly speculative."
>
> Chairman Aigner was directed to send copies of the resolution to each of the aforementioned publications and Mr. Kramer.

ADJOURNMENT

The meeting was adjourned at 11:00 a.m.

/ja

atch: Job Description

WCCA481.MIN

EXECUTIVE DIRECTOR

WORKER'S COMPENSATION RATE STUDY COMMISSION

I. PURPOSE OF THE COMMISSION

The California Workers' Compensation Rate Study Commission (hereafter referred to as "the Commission") was created by Chapter 892 of the Laws of 1989. Pursuant to section 11746 of the Insurance Code, the Commission is mandated to evaluate in its entirety California's workers' compensation ratesetting law, and to compare the effects of that law with the effects produced by alternative ratemaking systems used in other states. In defining the universe of alternative systems, states relying on exclusive state funds (e.g., Ohio, Washington) are to be included. The Commission has two additional statutory charges: to assess whether the functions currently performed by the California Workers' Compensation Insurance Rating Bureau should be transferred to the Department of Insurance, and to determine whether public self-insured employers should be permitted to purchase aggregate excess insurance from admitted California insurers.

The Commission is authorized by statute to engage the services of outside consultants to conduct research. The purpose of this memorandum is to solicit proposals for an executive director to assist the Commission in carrying out its statutory duties.

II. QUALIFICATIONS

The Commission's primary task is to examine the likely effects of various ratemaking systems on the workers' compensation market, and to analyze those effects in the context of specified public policy criteria. Consequently, candidates to be considered for the executive director position must be able to demonstrate substantial expertise in the economics of the property and casualty insurance business in general and workers' compensation in particular, an understanding of workers' compensation rate regulatory systems, and a background in microeconomics and public policy analysis. In addition, the candidate must have a general familiarity with actuarial science, computer auditing, and statistical analysis, and must have some knowledge of workers' compensation data bases. To be eligible for consideration, the candidate must submit three memoranda or reports for review by the Commission, at least one of which preferably would involve workers' compensation issues. Those written materials should demonstrate the respondent's grasp of insurance economics and rate regulation, as well as the ability to frame issues from a public policy perspective. In view of the substantial body of written material to be produced by the executive director, strong writing skills are essential. The respondent should also have some experience in the presentation of the results of insurance economics and public policy research in a public forum.

Although the role of executive director is primarily substantive rather than administrative, the respondent would optimally have some experience in dealing with agencies of government, addressing issues of administrative law, and managing relationships with legislators and external constituency groups.

III. TASKS AND RESPONSIBILITIES

The executive director will have overall staffing responsibility for both the administrative and substantive aspects of the Commission's work. While the Commission currently contemplates retaining an actuarial or accounting firm to gather and analyze quantitative data on the effects of alternative ratemaking systems, the executive director will be overseeing that activity, producing independent research memoranda, and drafting options papers and the Commission's final report. While some limited administrative support will be available from the Department of Insurance, the administrative activities necessary to the completion of the Commission's work will primarily be performed by the executive director. Either the Commission will provide administrative staff support or the costs of such staff will be built into the executive director's contract.

A. Substantive Activities

1. Based on existing Commission research materials, prepare a workplan for the Commission and provide such summaries of existing research as the executive director deems appropriate.

2. Prepare a written review of the statutory, regulatory, and administrative environment of the California rate law. The respective roles of the Department of Insurance and the Rating Bureau, including the activities of the Bureau's Actuarial Committee, should be analyzed.

3. Prepare a written review of the major alternative forms of rate and net price regulation that are used in other states and the manner in which those regulatory regimes are administered in those states. That analysis should include a description of the respective roles of rating bureaus and insurance departments in those states. The Commission has preliminarily suggested a list of 15 states to be examined; however, the executive director may choose to designate alternative states to examine.

The executive director's review and analysis should include, but not necessarily be limited to, the following issues:

a. Data collection, data handling procedures, and data quality.
b. Ratemaking procedures, including approaches used to produce manual rates and experience rating values.
c. Ratemaking methodologies, including differences in approachesto loss development, critical variables such as domestic v. multistate data, treatments

of expense loadings, biases or inaccuracies built into expense methodologies, applications of trend factors, approaches to classification ratemaking, and exposure bases.

d. Other relevant issues including minimum rates, rating plans,premium discount plans, schedule rating plans, policyholder dividend plans and practices, and retrospective rating plans.

Given the time and resource constraints associated with this project, the executive director cannot be expected to undertake an exhaustive review of the procedures followed in 15 states. It is up to the executive director to determine the most cost-effective approach, which can include the use of previous studies, to produce an analysis that will identify the most salient points of difference among the alternative ratemaking systems.

4. Review the experience of exclusive state funds in providing worker's compensation coverage, a comparison of those experiences with the role of the California State Fund, and an analysis of the implications of establishing an exclusive state fund to provide such coverage in California.

5. Analyze the effects of permitting self-insured employers to purchase aggregate excess insurance from admitted California carriers.

6. The actuarial or accounting firm retained by the Commission will undertake a quantitative analysis of the "effects" of alternative ratemaking systems for employers, employees, and insurers. The executive director will work with that independent contractor to refine the research objectives and develop specific research products. The role of the independent contractor is spelled out in a draft RFP prepared by the Commission.

7. Draft options papers and final Commission report.

Note: As the research process unfolds, the Commission may direct the executive director to undertake additional research tasks beyond those specified above. In addition, the executive director may deem it appropriate to prepare briefing papers beyond those specified above. Any such activity will be undertaken in a manner consistent with the terms of the executive director's contract.

B. Administrative Responsibilities

The executive director will be responsible for the various administrative and quasi-administrative functions attendant upon successfully managing the Commissions' business, including but not necessarily limited to:

1. Assuring that the Commission remains in adherence to the laws and regulations of California regarding such matters as open meetings, conflicts of interest standards, and contracting and billing procedures.

2. Maintaining liaison with and assuring the appropriate participation of legislators, interest groups, and other parties affected by the Commission's activities.

3. Managing arrangements regarding public meetings, including notification of interested parties, distribution of materials, and preparation of minutes of meetings.

APPENDIX A.5

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
MAY 29, 1991
HOLIDAY INN CROWN PLAZA
LOS ANGELES, CALIFORNIA

MINUTES

Members Present:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- William E. Neeley
- Melchior D. Powell
- Susan D. Schaefer
- James C. Van Horne

Members Absent:

- Stewart L. Long
- Victor Tabbush

Chairman Aigner called the meeting to order at 1:15 p.m.

Aigner reported to the Commission that the Executive Director position had been advertised in several major newspapers.

Aigner also reported that AB15603 was reported out of the Assembly Insurance Committee and is now under consideration by the Assembly Ways and Means Committee.

The Commission discussed the report writing phase of its charge in light of the possibility of no time extension.

Moved (Van Horne), seconded (Cheshier), Passed: To proceed with the hiring of an Executive Director with the expectation of writing a report by September 30, 1991.

Cheshier reported that the Executive Director Selection Subcommittee (Aigner and Cheshier) had review the applications and was ready to submit a report.

The Commission went into Executive Session at 1:40 p.m. to discuss personnel matters.

The Commission's public meeting was reopened at 2:30 p.m.

Aigner reported that the Executive Director Selection Subcommittee had reviewed 18 applications and had recommended four (Kay Doughty, Glen Schor, Stewart Economics, Soper and Associates) to the Commission. The Commission will interview a representative from Soper and Associates and Glen Shor on June 12 in San Francisco. The next public meeting will be in San Francisco at 4 p.m. on June 12.

ADJOURNMENT
The meeting adjourned at 2:36 p.m.

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APPENDIX A.6

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
JUNE 12, 1991
HILTON HOTEL, SAN FRANCISCO AIRPORT

MINUTES

The Workers' Compensation Rate Study Commission met at 4:00 PM at the Hilton Hotel, San Francisco Airport. The meeting was called to order by Commissioner Schaefer.

Members present:

- Patricia Cheshier
- William Neeley
- Melchior Powell
- Susan Schaefer
- James Van Horne

Members Absent:

- Dennis Aigner
- Stewart Long
- Victor Tabbush (see Announcements, Item 1)

MINUTES

The minutes of the previous meeting on May 29th were distributed and unanimously approved.

SELECTION OF EXECUTIVE DIRECTOR

It was announced that interviews with candidates for the position of Executive Director had been conducted earlier in the afternoon. In addition to the members present as listed above, Dr. Aigner, Chairman and Masako Dolan, Deputy Insurance Commissioner attended

the interviews. Richard H. Soper of Soper & Associates was selected by the Commission to be the Executive Director. Mr. Soper was introduced.

DISCUSSION OF FUTURE COMMISSION SCHEDULE

The bill extending the life of the Commission is in the Ways and Means Committee. Future Commission meetings are scheduled for July 16, 1991 from 1 - 5 PM at the San Francisco Airport Hilton and for August 21 in Los Angeles.

STATUS REPORT, RFP ISSUANCE

No action will be taken on possible issuance of the RFP until the question of extension is resolved.

ANNOUNCEMENTS

1. Commissioner Tabbush has announced that he intends to resign from the Commission due to the pressure of other time commitments.

2. Commissioners were advised that Dr. David Appel has FAXed them a list to topics to be covered in his research on competition.

3. In answer to a question from the "audience", it was stated that Mr. Soper and his firm would be providing administrative support, statistical work and report drafting assistance to the Commission.

ADJOURNMENT

The meeting was adjourned at 4:20 PM.

/vrs

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APPENDIX A.7

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
JULY 16, 1991
SAN FRANCISCO AIRPORT HILTON HOTEL
SAN FRANCISCO INTERNATIONAL AIRPORT

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 1:00 PM by the Chairman, Dennis J. Aigner. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia S. Cheshier
- Stewart L. Long
- William L. Neeley
- Susan D. Schaefer
- James C. Van Horne

Member absent:

- Melchior D. Powell

Also present was Richard H. Soper, Executive Director of the Commission. The meeting was open to the public.

MINUTES

The minutes of the previous Commission meeting held on June 12, 1991 were distributed to the Commissioners and unanimously approved as read.

GUEST SPEAKER

Chairman Dennis J. Aigner introduced the scheduled speaker, William White, Senior Actuary of the Department of Labor and Industries, State of Washington who provided a summary overview of the Washington program and experiences noting that the system is an exclusive state fund.

Mr. White provided a comparative contrast of the ratesetting system in the State of Washington to the system utilized in California. He presented a comprehensive series of analytical exhibits via overhead slide projector. Copies of exhibits presented by Mr. White and corresponding exhibit notes as well as Mr. White's professional biography are available from the Commission Executive Director on request.

FUTURE COMMISSION MEETINGS

The next Commission meeting will be held Wednesday, August 21, 1991 at 1:00PM at the Holiday Inn Crowne Plaza Hotel at Los Angeles International Airport.

Discussion was held concerning the development of a master schedule for all future Commission meetings. Chairman Aigner indicated that a master schedule would be developed concerning all future dates and would be distributed by the Commission Executive Director.

EXECUTIVE DIRECTOR STATUS REPORT

The Commission Chairman introduced the recently appointed Executive Director of the Workers' Compensation Rate Study Commission, Mr. Richard H. Soper, Principal, Soper & Associates. Mr. Soper, in turn, introduced the Associate Consultants present: Glenn M. Shor, Ph.D., M.P.P. and Josephine M. Solberg, CPCU who each gave a brief summary of their professional experience and qualifications. In addition, Mr. Soper provided a summary of the experience and qualifications of the consulting team members, Susan Wright, J.D., Lori B. Arlen, M.B.A. and Virginia Sundt who were not present. The team approach was briefly reviewed in an overhead slide which provided an organization chart. The intended operational strategy was previewed.

Mr. Soper discussed the Project Strategy for accomplishing the Commission's mandate. A presentation was made concerning the Project Completion Strategy encompassing the developed planning and scheduling network. Each member of the consulting team has been provided with a number of specific assignments and a time period of completion. In addition, the priority of the relative tasks has been established as well as a target completion date. The pertinent task descriptions were previewed and in-depth discussions were held concerning expansion and refinement of the scheduling network.

Specific Commissioner comments presented during the strategy review included:

> Commissioner Schaefer requested a draft report be written for review by the Commissioners.

Commissioner Van Horne made the following comments:

> The Commission needs to address the "real cost drivers" of Workers' Compensation which include medical costs, litigation costs, benefits costs and administrative overhead costs.
>
> Also requiring Commission attention are the issues of "retrospective", "prospective" price ratings, safety and loss control rating incentives.

Mr. Soper indicated that the Project Completion Strategy would be revised to reflect the Commissioners comments and recommendations and available for the August 21, 1991 meeting. In addition, specific assignments were given to consulting team members for presentation at the August 21, 1991 Commission meeting.

FINAL COMMISSION REPORT

A brief discussion was held concerning the overall format, development, production and distribution of the final Commission report.

> Chairman Aigner proposed, and the Commissioners unanimously agreed, that the report draft receive a "peer review" and that a list of referees be developed. Furthermore, the report is to submitted in two volumes as follows:
>
> Volume I
> - Position Statement
> - Executive Summary
> - Recommendations
> - Findings Overviews
>
> Volume II
> - Project Findings
> - Support Data
> - Subcontract Resource Reports

STATUS OF COMMISSION EXTENSION

A brief discussion was held concerning the possibility of an extension beyond September 30, 1991. The brevity of the discussion was due to the current legislative activity and any comments concerning extension status were deferred.

ANNOUNCEMENTS

Chairman Aigner announced that there would be a video presentation after meeting adjournment of the KCBS, Channel 2 (Los Angeles) "Special Report: Workers' Compensation Fraud". An invitation was extended to all who wished to view the recent TV network documentary. The presentation was not part of the meeting, however.

ADJOURNMENT

The meeting was adjourned at 4:25 PM.

Richard H. Soper
Executive Director

RHS/JMS/vrs

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APPENDIX A.8

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
AUGUST 21, 1991
HOLIDAY INN CROWNE PLAZA
LOS ANGELES INTERNATIONAL AIRPORT

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 1:00 PM by Chairman, Dennis J. Aigner. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia S. Cheshier
- Stewart L. Long
- William E. Neeley
- Melchior D. Powell
- James C. Van Horne

Member absent:

- Susan D. Schaefer

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members, Glenn M. Shor, Josephine M. Solberg, Virginia R. Sundt and Susan M. Wright. The meeting was open to the public.

MINUTES

The minutes of the previous Commission meeting held July 16, 1991 were distributed to the Commissioners and approved as corrected.

AB 971: IMPLICATIONS FOR COMMISSION MEETINGS/REPORT

Richard H. Soper, Executive Director, indicated that he had prepared a budget interfacing with AB 971 entitled, "Proposed Consulting Project - Strategy and Expenses", Revision No.

3, dated July 23, 1991. Mr. Soper further stated that the budget plan had been previously submitted to Commissioner Aigner, Chairman and Ms. Masako Dolan, Deputy Insurance Commissioner and State of California project monitor. The significant AB 971 consulting project budget modifications involved: (1) increased use of outside resources consisting of actuarial and economic subcontracting capability, (2) a broader analysis of Workers' Compensation systems utilized in other states and (3) an expanded Commission Report.

MEETING SCHEDULE

The following changes to the previously announced meeting schedule were made to accommodate schedule conflicts for the Commissioners:

> The October meeting will be held on October 25th rather than the 18th and switched from the Sacramento Hyatt to the California Room at the Sacramento Chamber of Commerce. The time of this meeting was advanced to 11:00 AM.
>
> The December San Francisco meeting will be held on the 13th rather than the 20th and is scheduled at the customary time of 1:00 PM.

Mr. Soper will make the necessary arrangements to reflect these changes and develop a revised meeting schedule for distribution to Commission members and other interested individuals as well as including it with the next Public Meeting Notice transmission.

EXECUTIVE DIRECTOR STATUS REPORT

The Project Consulting Strategy was discussed at length by Mr. Soper and members of the consulting team: G. M. Shor, J. M. Solberg and S. M. Wright. Overhead view slides were used to supplement and clarify status report items under discussion.

Mr. Soper reported on the "Project Completion Strategy - Planning & Scheduling Network" which was made available to Commissioners and provided to attendees in an abbreviated format. The status report has been developed in the following four (4) divisions concerning task activities and assignments:

1. Consulting Team Administrative Procedures
2. Project Completion Plan Strategy
3. Commission Report Production and Completion Tasks
4. Contract (1A-900145 [01] and CC-915001 [01] Compliance Tasks

Mr. Soper made an in-depth presentation of all task assignments involved in divisions Two, Project Completion Plan Strategy and Division Three, Commission Report production and completion tasks. The presentation involved overhead view slides concerning the various task assignments within the subject scheduling network. He further indicated the schedule coding identifying priority status, task status and consulting team member assignments.

Josephine M. Solberg, CPCU presented a progress report on an eleven (11) year study of statutory benefits that she has undertaken (Project Completion Strategy Item S-3, Page 3 of 18). Final presentation of this summarization has been deferred until November. Figures in this study can be manipulated to find similarities, differences, a common base line, changes in base line, etc.

Source documents for the study are those compiled and summarized by the United States Chamber of Commerce: there is no adjustment for inflation, figures reflect actual cost.

Questions asked by the Commission in response to Mrs. Solberg's presentation include the following:

What are the maximum and minimum benefits in each state?

Are there statistics available specifically indicating what has actually been paid out?

(No).

Chairman Aigner suggested that this study might be arranged by groups of states

having similar factors/dimensions/ratemaking systems thereby allowing an indication of how these factors influence each other and how California compares historically with other states?

Variables to be employed in this study should be indicated - use the four (4)

statutory
benefits with utilization shown as a fifth variable.

Glenn M. Shor, Ph.D., M.P.P., continued the discussion using NCCI data as a source. Bar graph slides presented support the thesis that California has high utilization, high cost low benefits in the areas of temporary disability, permanent partial disability, permanent total disability and fatality. Figures represent a mixture of completely realized (closed) costs and reserve costs and
could change, although change is expected to be minimal as figures show a policy year.

Comments by the Commission requesting further clarification of data included:

Is it possible to indicate a "mean line" on graphs?

Is it possible to show cost drivers/exclusions/rehabilitation data on graphs?

Commissioner Powell raised the question of whether or not "stress" can result in permanent total disability. Commissioner Cheshier responded affirmatively that, currently in California, "stress" can result in 100% disability. Note was taken that definitions of "stress" with respect to Workers' Compensation benefit provisions vary widely from state to state.

Dr. Shor presented a discussion draft of a questionnaire intended to be used by the consulting team for individual state surveys (Project Completion Strategy Item S-4, Page 4 of 18). The seven (7) primary topics developed and reviewed by him are:

1. Cost
2. Process of regulation
3. Regulation
4. Safety programs/incentives/penalties
5. Market structure
6. Financial stability
7. Request studies of Workers' Compensation system made within each state as well as any reports due to be published shortly

Commission comments regarding the questionnaire draft included:

It would be helpful in evaluating the collected data for the staff to indicate why these particular fifteen (15) states had been chosen for study as well as how it was decided who traveled to each state. Do only staff members make these trips?

Commissioner Van Horne voiced concern that the staff may "bog down" in this effort - the time element being so short for Commission Report development.

Strong concern for the small employer was voiced along with the desire for statistics concerning the small employer and how he fares within the system.

Commissioner Long would like to hear testimony from claimants/buyers - how do they perceive market/what are their impressions of the Workers' Compensation market?

Mr. Soper presented a discussion draft of the Workers' Compensation Rating Bureau survey analysis task assignment (Project Consulting Strategy Item S-14, Page 7 of 18). The presentation encompassed the following seven (7) topics:

1. Management operations and responsibilities
2. Audit analysis task
3. Analysis of Bureau functions
4. Interaction with Department of Insurance
5. Issues or concerns about the Bureau
6. Identify solutions to the issues and/or problems
7. Review research and development activities

Resulting Commission discussion:

Does Workers' Compensation Rating Bureau work/should it be under Department of Insurance?

Chairman Aigner wants progress report/examples: Can staff find similar situations in other states? What are implications for the Workers' Compensation Rating

Bureau operating within the Department of Insurance?

What are the pros/cons for Rating Bureau as part of Department of Insurance?

Susan Wright, J. D. reported on efforts to locate focus within witness testimony and questions asked by the Commission (Project Consulting Strategy item S-15, Page 7 of 18). Mrs. Wright has reviewed the testimony and has placed the issues in two (2) categories:

1. Issues identified by the Commission
2. Issues identified by witness.

Resulting Commission discussion:

Commission requested concise narrative summary by witness indicating if there are holes in testimonies.

In September, Mrs. Wright will have completed a review of more employers of all categories, large, medium, high risk, medical and plaintiff testimony. How many are in each category?

Other issues to be addressed by Mrs. Wright, using such possible data sources as the League of Cities and County Supervisors:

More information needed from employers who are not adequately represented

Using market structure, what role does self-insurance play?

What are other states doing?

Who can self-insure?

Provide a cross comparison with other states.

Safety incentives for small employers - what are other states doing?

Does minimum rate law make a difference?

How can this concept be promulgated and/or pushed in California?

Jim Stickels of the American Alliance of Insurers asked whether it would be helpful if he/we indicated what was thought to be most important concerning testimony received? The answer to Mr. Stickel's question being "yes", Mrs. Wright was directed to send her data through organizations for their input.

The issue of aggregate excess insurance was briefly discussed. An attendee pointed out that current law is based on a decision of the Attorney General's Office in the 1935-1937 era which stated that sale of aggregate excess means the employer has no incentive to reduce problems once limit is reached.

Chairman Aigner requests progress reports on all activities for the Commission. Requests materials at least one week before meetings for study and formation of questions.

COMMISSION REPORT

Mr. Soper presented a status report concerning the planning associated with the Commission Report formulation, review, production and distribution. He reviewed the identified items in the "Project Completion Strategy" relating to Division Three, Commission Report Completion and Production Tasks found on Page 11 through 13 of 18.

Commissioner Aigner stated that the Report development procedures are as follows:

> Commission members will write Volume I - making recommendations as result of the findings developed by the Executive Director and his staff.
>
> The consulting team staff will produce Volume II containing the technical and statistical information on which the recommendations are based.

Mr. Soper stated he would develop a topical outline encompassing Commission Report format, organizational procedures, draft review, printing, binding, production and distribution for the next meeting. Mrs. Wright is developing a glossary for the purpose of obtaining consistency. No decision was reached on whether to entertain peer reviews. It was recommended by several Commissioners that the item of "Peer Review" remain open for further discussion.

> Commissioner Van Horne pointed out that truncating the schedule of gathering background information must be considered in order to allow for writing and review of the Commission Report.
>
> Commissioner Cheshier pointed out the need to identify three (3) or four (4) primary topics for discussion with a meeting being devoted to discussion of each one.

GUEST SPEAKERS/INTERVIEW SESSIONS

The Director of NAIC is a strong possibility. The Chairman indicated he would entertain proposals from the floor. It was suggested that a sub-committee be established to develop appropriate resources for future guest speaker/interview sessions.

ACTUARY/ECONOMIST PANEL

Mr. Soper suggested there be three reports focused on the rate study system and that these reports originate with an economist and two (2) actuaries, one with a principal client base and experience serving the casualty insurance company industry segment and the other with a focus and client base of state Departments of Insurance, regulatory agencies and other public sector activities.

Commission comments:

An economist is helpful only if he/she is part of the process of deciding what kinds of analysis might be useful for the purposed of this study. The use of "dueling actuaries" versus only one was discussed: consensus was to use two with differing backgrounds thus able to provide different perspectives.

A panel for the September meeting will be established from the sub-contractor actuaries/economists to be considered. Mr. Soper will put together the list within the next week.

There is a possibility more meetings may be needed when resource people are brought in. Resource people must be able to attend all Commission meetings and must bring substantive data.

Dr. Shor suggested a sub-group of Commissioners for the purpose of developing questions for use during to the panel discussion and later, for use in interviews. Chairman Aigner will provide the meeting facilities and participating Commissioners are Aigner, Cheshier, Long, Neeley, and Powell. Participating staff are Dr. Shor and Mr. Soper.

The Commission will clearly state what it believes is important. Can the sub-contractors frame the data? The Commission will provide the direction for the economist/actuaries in addressing:

market structures
safety
retrospective v. prospective pricing
financial stability
solvency

Ultimately, the question to be addressed is: If California changed its Workers' Compensation system, what would be the outcome?

Chairman Aigner directed that the consulting team status report for the September meeting of the Commission include:

1. Consulting assignment for Mrs. Wright:
   Status report concerning testimony matrix analysis survey

2. Consulting assignments for Dr. Shor and Mrs. Solberg:
   Concise progress reports concerning the various State benefits

3. Consulting assignment for Mr. Soper and Dr. Shor:
   Report concerning rationale for selection of the various states selected for survey purposes

4. Consulting assignment for Mr. Soper:
   Coordinate and serve as moderator for panel of actuaries and economists

There being no further business, the meeting was adjourned at 4:35 PM.

Richard H. Soper
Executive Director

RHS/VRS/ld

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APPENDIX A.9

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
SEPTEMBER 20, 1991
SAN FRANCISCO AIRPORT HILTON HOTEL
SAN FRANCISCO INTERNATIONAL AIRPORT

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 1:12 PM by Commissioner Susan D. Schaefer in the absence of the Chairman. Dennis J. Aigner, Chairman, briefly delayed in flight, took charge of the meeting upon his arrival. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- Melchior D. Powell
- Susan D. Schaefer

Members absent:

- William E. Neeley
- James C. Van Horne

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members Glenn M. Shor, Virginia R. Sundt and Susan M. Wright. The meeting was open to the public.

MINUTES

The minutes of the previous Commission meeting held on August 21, 1991 were approved as distributed.

COMMISSION MEETING SCHEDULE

The Commission meeting schedule, previously revised on request of the Commissioners for the months of October and November, was approved.

PANEL PRESENTATION

Mr. Soper introduced Glenn M. Shor to act as moderator for the formal panel presentations by actuaries and economists. Each presentation lasted thirty (30) minutes and afforded each panelist the opportunity of making a "Position Statement" apropos previously agreed upon topics as well as reviewing his curriculum vitae. Each participant provided Commissioners and attendees with "Position Statement" report representative of his panel presentation. Additional copies of the reports are available upon request from Mr. Soper, Executive Director.

Participating panelists were:

David Appel, Ph.D.
Michael McMurray, FCAS
Firm: Milliman & Robertson, Inc.
New York, New York

Allan I. Schwartz, FCAS, ASA, MAAA, FCA
Firm: AIS Risk Consultants
Freehold, New Jersey

Blaine F. Nye, Ph.D.
Firm: Stanford Consulting Group
Menlo Park, California

Each panelist previously had been provided with a summary criteria for his development of the "Position Statement" as follows:

How would you envision the State of California Workers' Compensation system operating under an alternative rating plan such as:

- competitive rating system
- exclusive state fund system

Optional Response:

- concerning either a recommended proposed alternative or modification of existing rating system

What would you anticipate to be the major effects concerning the following takeholders:

- covered employees
- insured business
- insurance carrier
- service providers (medical, legal, etc.)
- regulator

How would you propose to complete a study regarding a comparative analysis of the State of California Workers' Compensation rating system? What would your proposed strategic plan encompass?

In addition, please indicate what existing data is readily available to support this project research. What significant factors should be identified and considered in the comparative analysis of various state Workers' Compensation plans utilizing different rating systems?
What analytical methods would you recommend to provide a concise uniform comparative analysis of the several states which utilize various different rating systems?

Following the formal presentations, Mr. Soper served as moderator during the question and answer session. The purpose of the question and answer session was to address the concerns of the Commission members, to clarify each participant's completion strategy for the proposed study and to determine further the panelists' qualifications.

Dennis Aigner, Chairman, thanked the panelists for their participation.

EXECUTIVE DIRECTOR REPORT

Mr. Soper suggested the participation of Commissioner and consulting team members in six (6) condensed briefing sessions prior to the October Commission meeting in order to disseminate information concerning:

Selection of future speakers to address a representative cross section of Workers' Compensation system stakeholders' interests with the principal focus on rating systems.

Selection of the states Workers' Compensation in which programs are to be analyzed.

Refinement of the questionnaire discussion draft to be utilized in development of data concerning Workers' Compensation programs in selected states.

Development of Commission Report formulation, production and distribution strategies.

Formulation of project criteria, scope of work and completion strategy concerning contract resources (actuary and economist).

Status report concerning testimony matrix project including recommended testimony concerning areas not currently addressed in existing Commission testimony.

Mr. Soper suggested that each subcommittee then return to the full Commission with recommendations for consideration at the public meeting.

Mr. Soper suggested that appropriate stakeholder groups be invited to testify before the Commission at future meetings.

Commissioner Cheshier suggested the Commission consider use of subcommittees and/or two day meetings since time is becoming closer to the deadline for the report to be distributed.

Mr. Soper indicated that he would begin an audit of the Workers' Compensation Insurance Rating Bureau of California at 9:00 AM Monday, September 23, 1991.

CLOSED SESSION

At this time, the Commissioners adopted a motion to adjourn to a fifteen minute Executive Session for further deliberation as to the choice of panelist, actuary or economist resources. No action was taken.

OPEN SESSION RESUMED

The Workers' Compensation Rate Study Commission public meeting was resumed and called to order by Chairman Aigner. A decision to select the panelist/subcontractor(s) was agreed upon by the Commissioners.

Commissioner Long moved that the Commission employ Milliman & Robertson, Inc. to do a series of quantitative studies along the lines of their proposal and to employ AIS Risk Consultants to do a policy analysis: details of both contracts to be worked out by the Executive Director who will report said details to the Commission at its next meeting. It was further moved that the Executive Director be asked to consult with Stanford Consulting Group concerning a possible update of its 1986 study and that he report back to the Commission on this matter at the next Commission meeting as well.

The motion made by Commissioner Long was passed unanimously.

ADJOURNMENT

There being no further business, the meeting was adjourned at 5:15 PM.

The next public meeting of the Workers' Compensation Rate Study Commission will be held at 11:00 AM on Friday, October 25th at the Chamber of Commerce in Sacramento.

Richard H. Soper
Executive Director

RHS/VRS/vrs

APPENDIX A.10

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
OCTOBER 25, 1991
CHAMBER OF COMMERCE OFFICES
SACRAMENTO, CALIFORNIA

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 11:10 PM by Commissioner James Van Horne in the absence of the Chairman who was delayed en route. Members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- William E. Neeley
- Melchior D. Powell
- Susan D. Schaefer
- James C. Van Horne

Members absent: None

MINUTES

The minutes of the previous Commission meeting held on September 20, 1991 were approved as distributed.

COMMISSION MEETING SCHEDULE

Details of future Commission meetings for the months of November and December, 1991 as well as January and February, 1992 were announced. Printed schedules were available to those who requested them.

TESTIMONY

Due to the proposed length of the meeting and needs of those businessmen who were testifying, Item #5 on the agenda was taken next in order.

Susan Wright opened this segment of the meeting with her sub-committee report:

Format of narrative with matrices attached approved in sub-committee
Areas requiring further sub-committee study:
- aggregate excess insurance
- cost of actual operations
- safety incentives
- JPA pools
- profitability - better definition

Slides shown indicating format of narrative and matrix pages.

Testimony germane to the Workers' Compensation system was given by the following witnesses:

1. John Rush, General Manager
   XL Manufacturing Company
   product: wheelchairs

2. Mark Gerlach
   Northern California Franchise Association

   Richard Brenning
   Association of Burger King Franchises
   owner 11 restaurants in greater Sacramento area

3. Allen Toy, President
   Round Table Pizza Restaurants Franchise with 9 restaurants in the greater Sacramento area

4. Donna Moseley
   Corporate Risk Management Department
   Claims Manager for Western Region (west of Mississippi River)
   J. C. Penney Co.

5. Lee Landry, Executive Vice President
   Landry Temps of Sacramento

Commissioner Van Horne thanked Ms. Wright for making arrangements for the above speakers. He suggested that future testimony involve more manufacturers having national operations as well as those just in California.

REPORT OF ACTUARIES AND ECONOMIST

Mr. Soper introduced Allan Schwartz of AIS Risk Inc. Mr. Schwartz provided a handout of previously performed study for the State of North Carolina and a status report concerning his labors to date. Five major points were emphasized:

1. Technical aspects of manual rate calculation

2. Procedural aspects of rate filing analysis
   kinds of personnel used to compile study
   how much review by Rating Bureau

3. Type of date available in setting rates
   Is data sufficient to decide fair assessment? asked by Commissioner Van Horne

4. Rating systems and safety concerns

5. Profitability
   Is ratemaking allowing a reasonable profit to insurance companies

It being 1:00PM, a lunch break was declared with the status report prepared by Milliman & Robertson, Inc. to be given following the break. The Commission Meeting resumed at 1:35PM.

Dr. Van Horne raised some questions as to what is to be covered in these studies.

Commissioner Long stated that a look should be taken at what California would be like under different systems and what if self-insurance with aggregate excess were available. What would California be like under a monopolistic state fund?

Dr. David Appel and Mr. Michael McMurray presented the Milliman & Robertson, Inc. status report. Four questionnaires prepared by them were handed out: (1) Insured Business, (2) Insurance Regulator, (3) Industrial Accident Board and (4) Service Provider. A fifth handout concerned: (1) "M&R a priori rankings", (2) a 1982 AIA Report, "Workers' Compensation Insurance Rate Regulation Study/Five Special Needs for Workers' Compensation" and (3) Key Ancillary Considerations for a Workers' Compensation Rating System.

Four studies agreed to by Milliman & Robertson, Inc. are:

1. Initial review of rate making systems and how they affect stakeholders interests
   Review of alternative systems

2. Net cost of coverage - actual adjusted employer cost

3. Historical rate of return

4. Experience rating evaluation
   Factors giving rise to differences

Statutory benefits and actual benefits paid differ widely.

Commissioner Aigner: stakeholders / employer/ employee
Insurance company profits as lead indicators for stability of insurance company.

Commissioner Van Horne stated he needed to know more about the employee: cost of inconvenience, i.e., claim settlement time: how much is bureaucracy slowing it up? In other words, transaction costs.

Commissioner Van Horne indicated that Mr. Soper should "help address the transaction cost issue".

Commissioner Long asked, "What is the total cost? What proportion of total premium goes to premium benefits?"

Commissioner Van Horne observed that none of the Milliman & Robertson, Inc. questionnaires addressed the employee standpoint.

Commissioner Schaefer stated she wished to hear about affects on employees.

Commissioner Aigner stated Employee benefits not the function of ratemaking system: may have other concerns besides size of benefits and speed of settlement.

Commissioner Van Horne: Would like to see questionnaire addressed to those who have filed claims.

Mr. McMurray questioned how to identify a list of injured

Dr. Shor thinks this matter more appropriate for consulting staff attention.
2 issues
within California
outside California

He stated that the California Workers' Compensation Institute had done a study of 1,000 workers and what happened to them in course of settling claims.

Mr. Schwartz stated that there is a National Board dealing with just this kind of statistics.

Dr. Appel stated that the Department of Labor puts out statistics. He suggested a confidential survey and dialogue with the Department of Industrial Relations.

Commissioner Powell stated that this kind of information surely had to be available but that he was not sure a survey questionnaire to claimants was "the way to go."

Commissioner Van Horne: Can we charge the staff with investigation of this issue/identification of sources of information. However, the Dr. Appel and Mr. Schwartz should not exclude this issue from their reports.

Appel & McMurray status report on three projects:

Experience rating
obtained from other states
have requested from WCIRB
have developed computer programs to calculate average weight/credibility of experience rating
developed ? data for last three (3) years

Mr. McMurray addressed the questionnaire development.

Showed slide: "M&R Appriori Rankings"
defined column headings:

- Rate promulgations responsibility
- Rate regulation type
  two specific types
  prior approval - need regulatory body
  non restrictive

Each of these have eight (8) important characteristics for stakeholders, i.e., rate competition, dividend competition, reasonable rate of return, solvency, equitable distribution of costs, coverage availability, safety incentives and claims service

At this point there was a vigorous discussion of the construction of the studies to be undertaken by Milliman & Robertson, Inc. and AIS.
Cover:
self insurance
employees/transaction costs
amount of benefits received
What is role of centralized Rating Bureau in a ratesetting system?

What RB can/cannot do.
Brief review of residual market.

Commissioner Neeley asked: What proportion of state fund is residual market/insurer of last resort?

Commissioner Van Horne: It is recommendation of the Commission and staff that we employ Milliman & Robertson, Inc. and AIS Risk Consultants as consultants. Fees to Milliman & Robertson, Inc. to be in the amount of $125,000 and fees to AIS to be in the amount of $70,000. It is further recommended that the MAC Group study not be commissioned for update, but that the feasibility of including this study in the Commission Report be approached.

The motion was moved, seconded and carried.

Mr. Soper stated that in compliance with AB 971 the above fees were within the budget: would be treated as a "straight pass through", made in three payments with ten percent retention and that these were "fixed fees not to be exceeded."

There being no further business, the meeting was adjourned at 5:21 PM.

The next meeting of the Workers' Compensation Rate Study Commission will be at 1:00 PM on November 15, 1991 at the Holiday Inn Crowne Plaza, Los Angeles International Airport.

Richard H. Soper
Executive Director

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APPENDIX A.11

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
NOVEMBER 15, 1991
HOLIDAY INN CROWNE PLAZA
LOS ANGELES INTERNATIONAL AIRPORT
LOS ANGELES, CALIFORNIA

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 1:15 PM by Commissioner D. J. Aigner, Chairman. Members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- William E. Neeley
- Melchior D. Powell
- Susan D. Schaefer
- James C. Van Horne

Members absent: None

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members Glenn M. Shor, Ph.D, Susan M. Wright, J.D. and Virginia R. Sundt. The meeting was open to the public.

MINUTES

The minutes of the previous Commission meeting held October 25, 1991 were approved as distributed.

COMMISSION MEETING SCHEDULE

Commissioner Van Horne suggested that Commission meetings be scheduled on an every two week basis during January and February. The published Commission meeting schedule

was amended to include this suggestion. Meeting dates, times and locations for the month or January and February, 1992 are as follows:

January 10, 1992 in Los Angeles 1:00 PM
Holiday Inn Crowne Plaza, Los Angeles International Airport

January 24, 1992 in San Francisco 1:00 PM
Airport Hilton Hotel, San Francisco International Airport

February 7, 1992 in Los Angeles 1:00 PM
Hyatt Hotel, Los Angeles International Airport

February 21, 1992 in San Francisco 1:00 PM
Airport Hilton Hotel, San Francisco International Hotel

TESTIMONY:

Susan M. Wright reported she is receiving additional written materials from many who have previously testified. A motion to end receipt of testimony, both oral and written, as of December 31, 1991 was adopted. Mrs. Wright will send written notification of this date to all who have testified before the Commission.

In December, the Commission is scheduled to hear testimony to including, but not limited to the following:

Acting Director for Benefit Assistance & Enforcement

Safety coordinators for small employers

Workers' Compensation stakeholder testimony concerning:
Claimant medical treatment
Aggregate excess workers' compensation insurance availability

Mr. Casey Young, Administrative Director of Workers' Compensation
Department of Industrial Relations
State of California

Mrs. Wright introduced those who would testify before the Commission today:

1. Mr. Steven Kelen, President
California Webbing Industries
Only company of its kind west of the Mississippi RiverManufacturer of seat belts, child car seats, tie downs for aircraft and trucking industries, etc.

2. Mr. Mark Ashcraft, Director
Self Insurance Plans
State of California

Informative presentation on self-insurance, aggregate excess insurance, Joint Powers Authorities and "leasing" of employees.

Mr. Ashcraft recommends that Workers' Compensation Rate Study Commission endorse repeal of the California State law prohibiting aggregate excess workers' compensation insurance.

3. Mr. Wilfred Godbold, President & Chief Executive Officer
Zero Corporation

Member: Small Business Task Force, California Chamber of Commerce
Business Round Table

Some statistics presented concerning California businesses:
23% plan to leave the State or move some operations from California 37% of manufacturers plan to leave California Workers' Compensation costs are considered the single most important reason for exodus of business

Following the testimony, there was a discussion amoung the Commissioners concerning the type of testimony that should be heard on December 13, 1991: Commission can take some latitude in setting up the problem. Cost drivers situation must be solved by the legislature. Commissioner Long wants to hear from someone representing the medical community. He does not wish to wrap up the testimony without hearing from "cost drivers". Commissioner Neeley want to hear from the League of California Cities. The Executive Director is to find medical "cost drivers": he has someone in mind to testify in December.

STATUS REPORT: ECONOMISTS AND ACTUARIES

The Executive Director reviewed the proposed scope of the resource sub-contract concerning Dr. Appel and Mr. Schwartz. The refinements of the sub-contracts scope were reviewed and it was requested that approval be voted on by the Commission.

Dr. Shor reviewed the scope of and specific changes to the contract with Dr. Appel.

Dr. Appel is sending out a questionnaire along with a letter concerning the maintenance of confidentiality. The Commission instructions are that the records be "sanitized" so as to protect the confidentiality of records.

Dr. Cheshier would like to have a summary of assumptions in the data base of the questionnaire. Dr. Appel indicated that the data used is that of Dr. John Burton now

at Rutgers University, formally at Cornell University. Dr. Appel will describe the variables affecting states in his report.

Status of items covered by the study:

1. Rate of return for thirteen (13) states (finished)
2. Employer costs (in preliminary state of completion)
3. Experience rating (not done)

Commissioner Van Horne requested that the "bulk" of the study be submitted by January 15, 1992 even if it is in draft form.

Dr. Shor reviewed the scope of and specific changes to the contract with Mr. Schwartz.

Mr. Schwartz has sent questionnaire to those states using the "Exclusive State Fund" for Workers' Compensation.

A completion date of January 15, 1992 is expected by Dr. Appel and Mr. Schwartz for the submittal of their project reports to the Commission.

A motion to accept both of these statements of contract scope was made by Commissioner Powell, seconded by Commissioner Schaefer and carried unanimously.

Commissioner Cheshier raised a question concerning a possible conflict of interest on Dr. Appel's concerning his assignments with both the Workers' Compensation Insurance Rating Bureau and the Commission. Commissioner Aigner and Mr. Soper had both reviewed the situation: neither thought there was a problem.

Chairman Aigner raised the question of whether Dr. Appel and Mr. Schwartz would attend the December meeting: if so, what would be their presentation? Commissioner Van Horne would like to have them available for questions and answers. Commissioner Aigner and Commissioner Van Horne discussed the "question and answer v. formal presentation". December meeting looks like mostly testimony. Therefore, Dr. Appel and Mr. Schwartz will not appear in December.

Commissioner Van Horne believes the Commission ought to have one draft available for consideration at the January 10th meeting. Therefore, he volunteered to make the draft available concerning the "second of his two assignments", Workers' Compensation Insurance Rating Bureau, and to make recommendations of items to be discussed.

Commissioner Long wanted to know when the Commission would work with the sub-contractors. The Executive Director would serve as a focal point and funnel information to sub-committees
What about working sessions? It is possible to have an open working session that is not

necessarily a quorum. The third contracted appearance by Dr. Appel and Mr. Schwartz will be a working visit but posted as a public meeting. Chairman Aigner noted that the budget was sufficient that augmented appearances by Dr. Appel and Mr. Schwartz were possible.

COMMISSION REPORT CONTENT AND TOPIC ASSIGNMENTS

Chairman Aigner explained the strategy of sub-committee working sessions to the public in attendance.

Additional copies of the preliminary Table of Contents - Topical Outline for the Commission Report were made and passed out to the meeting attendees for discussion.

Chairman Aigner raised the issue of an "upfront" agreement to include the MAC Report in Volume II of the Commission Report as Stanford Consulting Group and Tom Brown, Chairman and Chief Executive Officer of California Casualty, have been attempting to negotiate.

Commissioner Schaefer voiced considerable concern about a promise made in advance to include in the Commission Report a document not requested by the Commission. Commissioner Van Horne indicated that the Commission has access to the "Mac Report", it being a public record. He also shares the concern expressed by Dr. Schaefer. Commissioner Long stated that he believes such a promise would open the Commission to similar demands from other interest groups. Commissioner Powell agreed.

The response Mr. Soper was directed to give Stanford Consulting Group, Tom Brown et al was: We have considered your proposal. Please be advised that the Commission is unable to guarantee in advance that the Mac Report will be part of the Commission Report. However, if you wish to submit your work by January 15th and there is no commitment concerning review or expense required on the part of the Commission, it will be considered.

EXECUTIVE DIRECTOR REPORT

Questionnaire:

Dr. Shor stated that there was a person within each state to act as "Advisor" who could be "walked through" the questionnaire: that much of the data had already been compiled and that he was negotiating with the National Conference of State Legislatures for data.

Procedural Manual:

Mr. Soper briefly covered the procedural manual for the Commission Report. He indicated that he was developing a three ring binder system to contain preliminary segments of Volume II for use by both the Commission and consulting team as a primary reference in drafting Volume I. It was indicated that this partially completed Volume II draft report binder would be distributed during December.

Topic Assignments:

Various segments of the work being done by Dr. Appel and Mr. Schwartz will be included in the Topical Outline of the Commission Report, Volume II.

Commissioner Powell stated that report sections should be kept to ten pages maximum plus graphics, thereby emphasizing the need for brevity.

The Commission discussed its decision and recommendation making process concerning the report applicable to the following questions:

Make sure all charges of legislative mandate are being met.

How are we to agree? Are we to strive for consensus or majority vote/minority dissent?

There is a need to indicate more substantive discussion is taking place. Need to have shown process of general discussion and analysis.

In December, determine what the main items are and lay them out in January and February.

Need something by March 1st for effect in legislature but could legally go 90 days beyond that date.

Some discussions of impressions without any commitment or final decisions - interactive discussions.

Address issues that interrelate v. doing separately and then trying to blend.

Commissioner Aigner stated, "Let me work with Glenn Shor, in particular, and take a crack at setting stage for December meeting: setting out five or six primary issues and brief summary of what have heard and know. It is reasonable to say we are stopping to analyze what we've got but not precluded from adding more."

Dr. Shor expressed the opinion that the subject of exclusive state funds has not been adequately addressed from the point of view of change.

The Executive Director will contact Bill White, Actuary, in Olympia, Washington for presentation materials. Mrs. Wright was directed to add Mr. White to the list of people who testified before the Commission.

Commissioner Aigner directed that, at the December meeting of the Commission, two hours only be allotted for the meeting and receipt of testimony and two hours be allotted for discussion concerning the Commission Report materials.

Also at his direction, the following agenda for the December meeting was set:

1. Approval of Minutes
2. Testimony
3. Discussion
4. Assignments

There being no further business, the meeting was adjourned at 5:10 PM.

The next meeting of the Workers' Compensation Rate Study Commission will be at 1:00 PM on December 13, 1991 at the Holiday Inn Crowne Plaza, San Francisco International Airport.

Richard H. Soper
Executive Director

/vrs

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APPENDIX A.12

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
DECEMBER 13, 1991
HOLIDAY INN CROWNE PLAZA
SAN FRANCISCO INTERNATIONAL AIRPORT

BURLINGAME, CALIFORNIA

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 1:15 PM by Commissioner D. J. Aigner, Chairman. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- William E. Neeley
- Melchior D. Powell
- Susan D. Schaefer
- James C. Van Horne

Members absent:

- Stewart L. Long

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members Glenn M. Shor, Ph.D, Susan M. Wright, J.D. and Virginia R. Sundt. The meeting was open to the public.

MINUTES

The minutes of the previous Commission meeting held November 15, 1991 were approved as distributed.

COMMISSION MEETING SCHEDULE

The Commission will hold meetings twice during the months of January and February, 1992. Meeting dates, times and locations for these meetings are as follows:

January 10, 1992 in Los Angeles 1:00 PM
Holiday Inn Crowne Plaza Hotel, Los Angeles International Airport

January 24, 1992 in San Francisco 1:00 PM
Airport Hilton Hotel, San Francisco International Airport

February 7, 1992 1:00 PM
Airport Hyatt Hotel in Los Angeles, Los Angeles International Airport

February 20, 1992 1:00 PM and
February 21, 1992 9:00 AM - 5:00 PM
Airport Hilton Hotel, San Francisco International Airport
(Commission Report Volume One working session)

Commission Report topic assignments to be discussed at the meetings are as indicated:

January 10, 1992

D. J. Aigner	Economics of Workers' Compensation, Section 3.0
J. C. Van Horne	Rating Bureau, Section 7.0
R. H. Soper	Aggregate Excess Coverage, Section 8.0

January 24, 1992

S. L. Long	Section 5.0, Sub-section 5.4, with/Cheshier/Powell/Neeley
S. D. Schaefer	Quality of Service, Section 6.0
G. M. Shor	Analysis of California System Ratesetting Law as Compared to Systems Utilized by Other States, Section 9.0

February 7, 1992

J. C. Van Horne	Broader Issues Affecting Rate Making Process, Section 4.0
	Prospective v Retrospective Pricing, Section 5.0
P. A. Cheshier	Sub-section 5.1
M. L. Powell	Sub-section 5.3

February 20 - 21, 1992

W. E. Neeley — Prospective v Retrospective Pricing, Section 5.0 Sub-section 5.2

TESTIMONY

Mrs. Wright introduced those individuals who testified before the Commission. Testimony concerning Workers' Compensation was given by the following individuals all of whom also answered questions from the Commission members and staff as well as from the floor.

1. Mr. John C. Wilson, Executive Director
   Schools Excess Liability Fund
   Sacramento, California
   a Joint Powers Authority

2. Ms. Christine Baker, Acting Deputy Administrator
   Office of Benefit Assistance and Enforcement
   Department of Industrial Relations
   State of California

3. Mr. Brad Richmund, Manager, Safety & Health Services Department
   Mr. Norm Hanson, Vice President
   State Compensation Insurance Fund
   San Francisco, California

4. Mr. Casey Young, Administrative Director of Workers' Compensation
   Department of Industrial Relations
   State of California
   San Francisco, California

5. Mr. Russell Leatherby, Chairman & Chief Executive Officer
   Unicare, a California Workers' Compensation specialty company
   Irvine, California

6. Ms. Wendy Johnson, Actuary
   Pacific Actuarial Consultants
   Los Altos, California

7. Dr. Ira Monnosson, M. D., Chairman, Industrial Medical Council
   Assistant Professor of Clinical Medicine
   University of California Los Angeles
   Los Angeles, California
   Private consulting practice in the field of occupational medicine and internal medicine.

SUB-CONTRACTOR RESOURCES

Dr. Shor stated that Dr. Appel, et al. of Milliman & Robertson, Inc. and Mr. Allan Schwartz of AIS Risk Consultants appeared to be on target for the completion date of January 15th for the Commission sub-contracts.

The mechanics of receiving information and disseminating to the appropriate persons or group of persons were discussed. Mr. Soper is serving as coordinator.

There being no further business, the meeting was adjourned at 5:28 PM. The next meeting of the Workers' Compensation Rate Study Commission will be held on January 10, 1992 in Los Angeles.

Richard H. Soper
Executive Director

/vrs

APPENDIX A.13

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
JANUARY 10, 1992
HOLIDAY INN CROWNE PLAZA
LOS ANGELES INTERNATIONAL AIRPORT

LOS ANGELES, CALIFORNIA

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 1:10 PM by Commissioner D. J. Aigner, Chairman. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- Melchior D. Powell
- Susan D. Schaefer
- James C. Van Horne

Member absent:

- William E. Neeley

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members Glenn M. Shor, Ph.D, Susan M. Wright, J.D., Benjamin Davis, LeRoy A. Loseke, Lori R. Daniels and Virginia R. Sundt. The meeting was open to the public.

MINUTES

The minutes of the previous meeting held on December 13, 1991 were approved as distributed.

WORKERS' COMPENSATION RATE STUDY COMMISSION REPORT

Commissioner James C. Van Horne reviewed the draft Section 7.0 concerning the Workers' Compensation Rating Bureau. Following an extensive discussion among Commission members and by members of the audience, modifications as to format and content were suggested. The document will be modified accordingly and available at the next meeting of the Commission.

Commissioner Van Horne presented four (4) recommendations concerning the Rating Bureau: recommendations one (1) and two (2) were endorsed at this time; voting on number three (3) was deferred until the next meeting; voting on recommendation number four (4) was deferred until February 20 - 21, 1992.

A five minute recess was declared to allow Mr. Soper and Commissioner Aigner to confer with Masako T. Dolan, Deputy Insurance Commissioner.

Richard H. Soper, Executive Director of the Commission reviewed draft Section 8.0 concerning Aggregate Excess Insurance. Following discussion among the Commission members and by members of the audience, modifications as to format and content were suggested. The document will be modified accordingly and available at the next meeting of the Commission.

Mr. Soper presented two (2) recommendations regarding excess aggregate insurance: recommendation number one (1) was endorsed. Editorial modifications were suggested for recommendation number two (2) - make it part of recommendation number one (1). Revised Section 8.0 will be available to the Commission of January 24, 1992.

Dr. Shor will present the next version of Section 9.0, "Analysis of California System Rate Setting Law as Compared to Systems Utilized by Other States" at the January 24th meeting. In response to Dr. Shor's question concerning content, Commission members stated that this section required analysis only: no recommendations need be made.

Dr. Shor presented overhead slides of sample materials to be contained within the Commission Report:

1. Example of the State Comparison pages using Georgia as the model
2. Workers' Compensation in 1990 - pie chart demonstrating "where the money went"
3. Example of testimony pages showing matrices and text

PROCEDURAL QUESTIONS

Considerable discussion was devoted to procedural question items including, but not necessarily limited to:

Format of Public Meeting Notice

Adoption of the Commission Report Draft Sections
Mr. Soper should receive written comments on text material

Following presentation of each segment, make suggestions to the author concerning modifications and take a preliminary "straw vote' on the recommendation made therein.

If disagreeing with / modifying author's recommendations, submit written comments within one week

ITEMS TO BE DISCUSSED/AGENDA - January 24, 1992

Commissioner Aigner highlighted several items, i. e. Kruger & Burton article, "Employers' Cost of Workers' Compensation..." that had come to his attention indicating that he would like to initiate broad discussion concerning these items.

Therefore direction was given that the following items be included in the January 24th Commission meeting agenda:

1. The Kruger & Burton article
2. Certain Milliman & Robertson, Inc. studies
3. Studies by AIS Risk Consultants, Inc.
4. Draft Section 6.0 of the Commission Report - S. D. Schaefer
5. Draft Section 9.0 of the Commission Report - G. M. Shor
6. The topics of
    a. competitiveness
    b. reasonable rate of return/dividends
    c. profitability
    d. payroll v. hours worked

Commissioner Powell requested that Milliman & Robertson, Inc. and AIS Risk Consultants, Inc. studies be sent directly to the Commissioners. Mr. Soper indicated that this request had been made but would be reiterated.

There being no further business, the meeting was adjourned at 4:10 PM

The next meeting of the Workers' Compensation Rate Study Commission will be held on Friday, January 24, 1992 at the San Francisco Airport Hilton Hotel beginning at 1:00 PM.

Richard H. Soper
Executive Director

/vrs

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APPENDIX A.14

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
JANUARY 24, 1992
HILTON AIRPORT HOTEL
SAN FRANCISCO INTERNATIONAL AIRPORT

SAN FRANCISCO, CALIFORNIA

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 1:10 PM by Commissioner D. J. Aigner, Chairman. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- William E. Neeley
- Susan D. Schaefer
- James C. Van Horne

Member absent: Melchior D. Powell

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members Glenn M. Shor, Benjamin Davis, LeRoy A. Loseke, and Virginia R. Sundt. The meeting was open to the public.

MINUTES

The minutes of the previous Commission meeting held on January 10, 1992 were approved as distributed.

WORKER'S COMPENSATION RATE STUDY COMMISSION MEETINGS

The next Commission meeting will be held Friday, February 7, 1992 at the Los Angeles

International Airport Hyatt Hotel. There will be a two day meeting on February 20 and 21 at the San Francisco International Airport Hilton Hotel.

(IMPORTANT NOTE: The San Francisco Airport Hilton Hotel location has been changed to the Clarion Hotel which is located south of the airport at 401 E. Millbrae Avenue, Millbrae, California 94030. This change concerning the February 20-21 meetings was made due to extreme space limitation at the Hilton and lack of availability of any larger meeting rooms).

WORKERS' COMPENSATION RATE STUDY COMMISSION REPORT

Commissioner Schaefer discussed draft report Section 6.0, "Quality of Service".

Commissioner comments:

Are claims being settled properly and in a timely manner? Are employees getting a fair shake?

Address the audit process.

How does the system work?

What is the degree of satisfaction? If low, how is a higher degree of satisfaction to be obtained?

Commissioner Aigner questioned the rather broad statement that California is a safe place to work. Ensuing discussion focused on "determination of safety", definition of "compensable" and scope of base for industrial mix.

Report should include footnotes concerning important reference documents.

Loss Control Services:

What is the quality of these services?
Are consumers aware these services exist and are available to them?

Does the current system help or hinder safety/loss prevention activities?

Commissioners agreed to hold Section 6.0 to consider its integration with other sections now being prepared.

SUB-CONTRACTOR REPORTS

Dr. David Appel, Director of Economic Consulting with the New York firm of Milliman & Robertson, Inc. discussed the four (4) studies undertaken as authorized by the Commission sub-contract. These studies, presented with a mini description, are entitled:

1. Alternative Ratemaking Systems

   Is the California ratemaking system better or worse than other existing alternatives?

   Are there changes which would make all participants better off and none worse off. No final conclusion was reached.

   Identify and describe alternative ratemaking systems.

   Evaluate system stakeholders.

2. Net Cost to Employers

   Identify determinants of Workers' Compensation costs
   Investigate interstate differences

3. Rates of Return

   Using data derived from private insurers in thirteen (13) states and state funds in eight (8) states:

   a) determine both operating costs and rates of return
   b) calculate rates of return and identify variations across states.

   Examine underwriting result, operating return and return on net worth

   Dr. Appel stated: "Administration of the system is more important that what the system is called/named."

4. Financial Incentives for a Safe Workplace

   Identify/measure accuracy of California experience rating program

   Data base 1985-87 & 1989 loss experience for 150,000 risks

   Calculate modifier for 1985-87 and compare to actual 1989 loss

Following the presentation, discussion was held involving questions and answers on the subject materials.

COMMISSION REPORT SEGMENT DISCUSSION

Following a fifteen minute break at 3:00 PM, the Commission heard comments by Mr. Tom Rankin, a "labor member" of the Governing Board of the Workers' Compensation Insurance Rating Board. Mr. Rankin suggested that the Commission consider the system of public members, how it works and whether the Governing Board should be expanded to include more public members. Additional suggested research included possible changes in rating methodology. Further discussion regarding governance of the Workers' Compensation Insurance Rating Bureau appears to be of considerable interest to stakeholders.

SUB-CONTRACTOR REPORTS - CONTINUED

Allan I. Schwartz, President of AIS Risk Consultants, Inc. presented his research findings in seven (7) studies undertaken as authorized by the Commission sub-contract, as follows:

1. Actuarial Report on the Overall Ratemaking Methodology Used by the Workers' Compensation Insurance Rating Bureau of California

2. Actuarial Report on the Ratemaking Data Used by the Workers' Compensation Insurance Rating Bureau of California

3. Actuarial Report Regarding Workers' Compensation Rating Systems That Encourage Safety and Health

4. Actuarial Report Regarding Workers' Compensation Self-Insurance

5. Actuarial Report Regarding the Review Process for Workers' Compensation Rate Filings

6. Actuarial Report Comparing the Operations of Exclusive and Competitive Workers' Compensation State Funds

7. Analysis of California Workers' Compensation Insurance Profitability by Insurance Company Group

Following the presentation, discussion was held involving questions and answers on the subject materials.

On behalf of the Commission, Commissioner Van Horne thanked Dr. Appel and Mr. Schwartz for their excellent presentations.

It being late, the meeting was adjourned at 5:25 PM. Agenda items not discussed were deferred to February 7, 1992 when the Commission meets in Los Angeles.

Richard H. Soper
Executive Director

/vrs

WCCA1242.MIN

APPENDIX A.15

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
FEBRUARY 7, 1992
HYATT AIRPORT HOTEL
LOS ANGELES INTERNATIONAL AIRPORT

LOS ANGELES, CALIFORNIA

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 1:15 PM by Commissioner D. J. Aigner, Chairman. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- William E. Neeley
- Susan D. Schaefer
- James C. Van Horne
- Melchior D. Powell

Members Absent: None

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members Glenn M. Shor, Benjamin K. Davis, LeRoy A. Loseke, and Virginia R. Sundt. The meeting was open to the public.

MINUTES

The minutes of the previous Commission meeting held on January 24, 1992 were approved as distributed.

WORKER'S COMPENSATION RATE STUDY COMMISSION MEETINGS

The next meeting of the Workers' Compensation Rate Study Commission will be a two day work session held at the Clarion Hotel in Millbrae, California near the San Francisco Airport. Dates for the meeting are February 20 and 21, 1992.

(IMPORTANT NOTE: The San Francisco Airport Hilton Hotel location announced on previous meeting schedules has been changed to the Clarion Hotel which is located south of the airport at 401 E. Millbrae Avenue, Millbrae, California 94030. This change concerning the February 20-21 meetings was made due to extreme space limitation at the Hilton and lack of availability of any larger meeting rooms).

Further meetings of the Commission will take place on March 6, 1992 in Sacramento and on March 20, 1992 in Irvine, California. Details as to location, etc. are pending. Mr. Soper will make arrangements.

(NOTE: Subsequently, arrangements for the March 6, 1992 and March 20, 1992 meetings were confirmed:

March 6, 1992 - Sacramento - 11:00 AM
California Room, 12th Floor
California Chamber of Commerce
1201 K Street
Sacramento, CA 95812-1736
916/444-6670

March 20, 1992 - Irvine - 1:00 PM
Hyatt Regency Hotel
17900 Jamboree Road
Irvine, CA 92714
714/975-1234
Close to John Wayne Airport)

WORKERS' COMPENSATION RATE STUDY COMMISSION REPORT

Consulting Staff member Glenn M. Shor presented a "walk-through" of his draft Section 9.0, "Analysis of California Ratesetting Law as Compared to Systems Utilized in Other States". Topics covered include, but are not limited to:

Commission Background/Mandate
Historical Basis of Ratesetting
Legal Basis of Ratesetting
Formal Process of Ratesetting
The Workers' Compensation Insurance Rating Bureau

Ratemaking Decisions 1974-1991
Introduction to Rating Systems of Other States

Commissioner James C. Van Horne discussed his draft Section 4.0, "Broader Issues Surrounding the Rate Making Process" concerning what the Commission perceives to be the cost drivers of the Workers' Compensation system, i.e., "medical, broadened coverage, litigation costs, fraud and coverage gaps,... insurance company expenses and profits."

The "cost drivers" issue promoted vigorous discussion among Commissioners and stakeholders in attendance at the meeting.

Commissioner Aigner, Chairman proposed that Commissioner Van Horne's Section 4.0 be considered as the preface for the Commission Report. Comments from Commission members indicate they advocate a more forceful approach to this topic than that displayed by the presented draft.

Commissioner Patricia A. Cheshier addressed Section 5.0, "Prospective v. Retrospective Pricing", Sub-section 5.1, "Rate Adequacy". In preparing her report, Commissioner Cheshier considered information presented to the Commission in studies by Milliman & Robertson, Inc., AIS Risk Consultants, Inc., Stanford Consulting Group, Inc., the Workers' Compensation Insurance Rating Board and Orin Kramer. Her opinion is that Workers' Compensation rates in California are <u>not</u> inadequate; she leans toward maintaining the minimum rate law essentially as it is currently, but with a more <u>retrospective</u> rating and tightening of the administration of the law.

A stimulating discussion concerning merits of prospective v. retrospective, how to shift the costs equitably and "what am I willing to pay for stability" ensued.

Correspondence aimed at Commission members on the subject of inclusion/exclusion of State Fund Workers' Compensation loss experience in the Workers' Compensation insurance rate calculations will be brought to the February 20-21 meeting for consideration.

Further discussion by the Commission centered on the topic of "Payroll v. Hours Worked". Mr. Robert Mike, President of the Workers' Compensation Insurance Rating Bureau gave a précis of his report to the California Department of Insurance advocating a payroll orientation. Washington is the only state using hours worked.

Commissioner Aigner, Chairman requested the record to show that the Commission had reviewed the topic of payroll v. hours worked and saw no reason to effect any changes. Seconded by Commissioner Van Horne. The motion was carried with four (4) yeas and two (2) abstentions: Commissioners Long and Schaefer.

There being no further business, the meeting was adjourned at 4:07 PM.

The next meeting of the Workers' Compensation Rate Study will be held on February 20 and 21 at the Clarion Hotel south of the San Francisco International Airport.

Richard H. Soper
Executive Director

/vrs

WCCA2072.MIN

APPENDIX A.16

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
FEBRUARY 20 - 21, 1992
CLARION HOTEL
SAN FRANCISCO INTERNATIONAL AIRPORT

SAN FRANCISCO, CALIFORNIA

MINUTES

WORKERS COMPENSATION RATE STUDY COMMISSION MEETING (Initial Day)
THURSDAY, FEBRUARY 20, 1992

The Workers' Compensation Rate Study Commission meeting was called to order at 1:35 PM on February 20, 1992 by Commissioner J. C. Van Horne, acting as Chairman pro tem. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- William E. Neeley
- Melchior D. Powell
- Susan D. Schaefer
- James C. Van Horne

Members absent: None

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members Glenn M. Shor, Susan M. Wright, LeRoy A. Loseke, Benjamin K. Davis, Lori R. Daniels and Virginia R. Sundt. The meeting was open to the public.

MINUTES

The minutes of the previous Commission meeting held on February 7, 1992 were unanimously approved as distributed.

WORKER'S COMPENSATION RATE STUDY COMMISSION MEETINGS

The Workers' Compensation Rate Study Commission meeting will continue tomorrow, Friday, February 21, 1992 at the Clarion Hotel, San Francisco Airport reconvening at 9:00 AM.

Succeeding meetings of the Commission will be held on March 6, 1992 in the California Room at Chamber of Commerce, Sacramento, California and on March 20, 1992 close to John Wayne Airport, Orange County at the Hyatt Regency Irvine.

WORKERS' COMPENSATION RATE STUDY COMMISSION REPORT:

Commissioner Melchior D. Powell presented draft sub-section 5.3, "Competitiveness and Efficiency of Delivery of Insurance Product" as part of Section 5.0, "Prospective v. Retrospective Pricing".

Commissioner James C. Van Horne indicated that he found no sentiment in favor of an exclusive state fund, therefore, he proposed recommending that there not be an exclusive state fund. The Commission staff was charged with drawing together overlapping issues pertaining to this matter.

Commissioner Stewart L. Long presented Section 5.0, "Prospective v. Retrospective Pricing" draft sub-section 5.4 in which he dealt with pricing issues in relation to promotion of safety in the workplace.

Commissioner William E. Neeley presented draft sub-section 5.2, "Small Employer Considerations" as part of Section 5.0, "Prospective v. Retrospective Pricing".

Commissioner Patricia A. Cheshier indicated that she had chosen to modify recommendations previously made concerning Section 5.0, "Prospective v. Retrospective Pricing", sub-section 5.1.
She did want to keep minimum rate law but modify it so as to reflect solvency only.

Commission Chairman Dennis J. Aigner presented draft Section 3.0, "Economics of Workers' Compensation".

Each presentation provoked vigorous discussion.

Following Commissioner Aigner's presentation, Commissioner Van Horne asked, "How competitive a system do we want to recommend?"

A. No regulation as to price, but of supervisory

B. Some type of underlying manual rate

C. Retain present system

The meeting adjourned at 5:50 PM with instructions that it would resume at 9:00 AM on Friday, February 21st.

WORKERS COMPENSATION RATE STUDY COMMISSION MEETING (Resumed) FRIDAY, FEBRUARY 21, 1992

The Workers' Compensation Rate Study Commission meeting was called to order at 9:35 PM on February 21, 1992 by Commissioner D. J. Aigner, Chairman. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- William E. Neeley
- Melchior D. Powell
- Susan D. Schaefer
- James C. Van Horne

Members absent: None

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members Glenn M. Shor, Susan M. Wright, LeRoy A. Loseke, Benjamin Davis, Lori R. Daniels and Virginia R. Sundt. The meeting was open to the public.

Commissioner Aigner thanked Commissioner Van Horne for chairing the meeting on Thursday.

Commissioner Aigner suggested "revisiting" the motion made by Commissioner Cheshier. After discussion, the recommendation was further modified to read: "Open competition, but with floor rate pricing (based on loss cost) with intent that most insurance would be priced above the floor rate. The intent of floor rate pricing is to provide some element of solvency and safeguards against predatory pricing.

Commission Aigner doesn't favor protecting insurance company solvency, but does favor protecting the employee through a "guarantee fund" - premiums variant with respect to risk price options.

Commissioner Cheshier's original recommendation was restated as follows: "Minimum rate for each of the 447 occupations based on loss costs, perhaps increased for expenses. It is the intent that most insurance will be priced above that minimum rate."

Straw Vote results: In favor 4 Opposed 3

Commissioner Van Horne gave an example - loss costs + 20% (expense loading of 16 2/3%). It was felt that recommendation should include mechanism in order to remove the political aspects of rate setting.

Commission Aigner asked the staff to gather sample data to assist in determining the "floor"
Pure loss costs
Pure loss costs with "kicker"

Straw vote on recommendation #1 (open competition) :

	In favor	7	Opposed	0

Results of straw vote taken on Commissioner Neeley's recommendations:

Safety Groups	In favor	7	Opposed	0
Rebates	In favor	6	Opposed	1

Commissioner Long asked for a straw vote to put extensive discussion of "losses" on the Commission's laundry list of items to be discussed.

Results of straw vote taken on Commissioner Long's recommendations:

	In favor	7	Opposed	0

Commissioner Van Horne indicated that, contingent on passing of recommendation #1, he wanted to discuss assigned risk. His concern is that the risk pool be distributed across all insurers in California with a low threshold (minimal if really bad risk) State Fund would be one of many insurers. Most insurance would be written as to rate. Commissioner Van Horne would set a rate of say 300% above floor thereby forcing unsafe employers out of the market (business).

Recommendation:
Contingent on recommendation #1 being passed, the assigned risk pool (involuntary market) should be allocated across all workers' compensation insurers in California on a pro rata basis of market share.

Straw vote	In favor	5	Opposed	2

Commissioner Schaefer indicated that her recommendations in Section 6.0 on safety had been subsumed into Commissioner Neeley's and Commissioner Long's sub-sections, however, a monitoring system should be developed to encourage service in safety/benefit services.

Schaefer recommendation:
The audit process should be used to assure satisfactory performance of statutory duties. Provision of loss control, safety and benefit services should be explicitly evaluated and results disseminated.

	In favor	7	Opposed	0

RATING BUREAU:

Recommendation #1: wording modified
Recommendation #2: stands as is
Recommendation #3: delete
Recommendation #4: becomes #3

In determining the floor rate, State Compensation Insurance Fund data should be included in its entirety.

Straw vote: In favor 7 Opposed 0

WCIRB President Robert Mike and Commission staff member Glenn Shor will provide information on "floor" and how computed.

R. H. Soper will formulate strategy for coordinating references to Volume II supporting documentation. G. M. Shor is to assist with editing.

Commissioner Aigner: On 3/6 modify Subsection 3.5.1 as pertains to WCIRB

Recommendation by Commissioner Aigner:

Commissioner of Insurance shall issue an annual evaluation of the state of competition in the workers' compensation insurance market.

Straw vote: In favor 6 Opposed 0

Draft a new Section 7.0, Volume I concerning Exclusive State Funds. Place near aggregate excess section.

Commissioner Schaefer cannot attend the Commission meeting on March 6, 1992. Since she wants to vote on the issues, she will provide a Commission member with her proxy vote. Previously unexamined issues raised on March 6th, will not be voted by her proxy.

The issue of dissenting opinions was raised: Commission response was that any Commissioner should be able to write a signed statement in dissent and be prepared to have it submitted as part of the Commission Report.

Resulting from two days working sessions, the following recommendations concerning workers' compensation insurance ratesetting system were made:

1. Open competition, but with floor rate pricing (based on the loss cost or primarily loss cost) with the intent that most insurance will be priced above the floor rate. The intent of the floor pricing is to provide some element of solvency and protection against predatory pricing.

   Straw vote: Yes 7 No 0

2. The availability of safety groups which provide group purchasing power to small firms should be expanded and publicized by the Department of Insurance. Insurers should be encouraged to develop and promote such safety groups.

   Straw vote: Yes 7 No 0

3. To provide safety incentives, the Commission recommends the institution of a system of premium rebates for small firms.

   Straw vote: Yes 6 No 1

4. The premium level required for participation in the experience rating and retrospective rating plans should be lowered to allow more employers to participate.

   Straw vote: Yes 7 No 0

5. Contingent on recommendation #1 being passed, assigned risk pool (involuntary pool) should be allocated across all workers' compensation insurers in California on the basis of pro rata market share.

   Straw vote: Yes 5 No 2

6. With respect to quality of service, the auditing process should be used to assure satisfactory performance of statutory duties. Provision of loss control, safety and benefit services should be explicitly evaluated and results disseminated.

   Straw vote: Yes 7 No 0

7. The Rating Bureau should continue in its role as a quasi independent organization for determining rating classifications, experience modifiers and floor rates. The Commission believes that there would be no advantage to siting this function within the Department of Insurance.

   Endorsed by WCRSC at 1/10/92 Commission Meeting.

8. The Bureau should instigate a more systematic approach to handling employer complaints. Direct contact people should be designated to handle the various types of inquiries. Systematic records should be kept on each inquiry, particularly as to type, disposition and the speed with which the disposition is made. Consideration should be given by the Bureau to designating an ombudsman to help employers of all sorts having a problem.

   Endorsed by WCRSC at 1/10/92 Commission Meeting.

9. In determining the floor rate, the State Compensation Insurance Fund data should

be included in its entirety.

Straw vote: Yes 7 No 0

10. The Commission recommends against establishment of an exclusive state fund for California, but recommends continuation of the California State Insurance Compensation Fund as a competitive state insurance fund.

Straw vote: Yes 4 No 3

11. The Commission recommends that the workers' compensation system be re-evaluated on terms broader than the ratemaking mechanism. (See Preface)
Straw vote: Yes 7 No 0

12. It is recommended that the insurance code be modified to allow all workers' compensation self-insured employers (public and private) to purchase workers' compensation aggregate excess insurance and that

a. those insurance carriers permitted (admitted) to transact workers' compensation insurance in the State of California subject to the review of the Department of Insurance and benefits of the California Insurance Guarantee Associate (CIGA)

b. a study might be undertaken to consider requiring workers' compensation aggregate excess insurance for certain categories and designated sized of workers' self-insured employers.

Endorsed by WCRSC at 1/10/92 Commission Meeting

13. The Commission recommends that the Commissioner of Insurance issue an annual report evaluating the state of competition in the workers' compensation insurance market.

Straw vote: Yes 6 No 0

There being no further business, the meeting was adjourned at 3:25 PM.

Richard H. Soper
Executive Director

/vrs
Corrected
3/9/92

WCCA2202.CMN

APPENDIX A.17

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
MARCH 6, 1992
CALIFORNIA ROOM
CALIFORNIA CHAMBER OF COMMERCE OFFICES
SACRAMENTO, CALIFORNIA

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 11:00 AM on Friday, March 6, 1992 by Commissioner Dennis J. Aigner, Chairman. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- William E. Neeley
- Melchior D. Powell
- James C. Van Horne

Members absent: Susan D. Schaefer

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members Glenn M. Shor, LeRoy A. Loseke, Benjamin K. Davis, Lori R. Daniels and Virginia R. Sundt. The meeting was open to the public.

MINUTES

The minutes of the previous Commission meeting held February 20-21, 1992 were approved as corrected.

WORKER'S COMPENSATION RATE STUDY COMMISSION MEETINGS

The next meeting of the Workers' Compensation Rate Study Commission will be held at 1:00 PM on Friday, March 20, 1992 at the Hyatt Regency Irvine, 17900 Jamboree Boulevard, Irvine, California, close to the Orange County John Wayne Airport.

WORKERS' COMPENSATION RATE STUDY COMMISSION REPORT:

Commissioner Aigner indicated that the purpose of today's meeting is to review and discuss the recommendations made at the last meeting and to take a final vote. The Executive Director will revise the report to the Legislature accordingly.

Having considered the testimony and research documents presented to it, the Commissioners discussed the issues of "open competition", maintenance of a "floor rate", loss costs, safeguards against "predatory pricing", discriminatory pricing, a uniform classification system without experience modification, safety incentives, assigned risk pools, the State Fund and the role of the Rating Bureau.

Glenn Shor briefly discussed his paper on loss ratios, loss ratios adjusted for inclusion of expenses and all expenses + loss adjusted expenses.

Willie Washington of the California Manufacturers' Association and John Wilson, Executive Director of the Schools Excess Liability Fund spoke to the Commission about assigned risk pools.

RECOMMENDATIONS MADE BY THE COMMISSION:

The following recommendations have been developed and are endorsed by the Commission. In each case, the recommendation was reviewed and voted on by individual Commissioners: each recommendation listed obtained, at minimum, a simple majority of votes.

Recommendations:

1. The Commission recommends abolition of the existing minimum rate law, replacing it by open competition with floor rates approved by the Insurance Commissioner based on loss costs provided by the Workers' Compensation Insurance Rating Bureau. Prior approval from the Insurance Commissioner would be necessary to price below the floor rate.

   The Commission also recommends:

   a. Reliance on a uniform classification system
   b. The Insurance Code provisions applying to unfair discrimination be extended to workers' compensation insurance.
   c. In determining floor rates, the State Compensation Insurance Fund be included in their entirety.

   Vote: Yes 6 No 0

2. Contingent upon recommendation number one being passed by the Legislature, the Commission recommends the establishment of an assigned

risk pool. The costs would be allocated across all workers' compensation insurance insurers in California on the basis of a pro rata market share.

a. It is the intent of the Commission that requirements for admission to and rates for the assigned risk pool be designed so that the percentage of total premium volume in this category is very low.

b. The Commissioners recommends that the level and extent of self-insurers' contribution to cost of the assigned risk pool should be studied and an appropriate decision reached.

c. The Commission recommends a tiered assigned risk plan, similar to that used in the State of Michigan.

Vote: Yes 6 No 0

3. If recommendation number one is not passed by the Legislature, the premium level required for participation in experience and retrospective rating plans should be lowered to allow more employers to participate.

Vote: Yes 6 No 0

4. The Workers' Compensation Insurance Rating Bureau should continue in its role as a quasi independent organization for determining rating classifications and loss costs. The Commission believes that there would be no advantage to siting this function within the Department of Insurance.

The Workers' Compensation Rating Bureau should instigate a more systematic approach to handling employer complaints. Direct contact staff should be designated to handle the various types of inquiries. Systematic records should be kept on each inquiry, particularly as to type, disposition and the speed with which the disposition is made. Particular attention should be paid to the responsiveness to small employers. Consideration should be given by the Bureau to designating an ombudsman to help employers of all sorts having a problem.

Vote: Yes 6 No 0

5. It is recommended that the insurance code be modified to allow all workers' compensation self-insured employers (public and private) to purchase workers' compensation aggregate excess insurance and that

a. Those insurance carriers permitted (admitted) to transact workers' compensation insurance in the State of California be subject to review of the Department of Insurance and benefits of the California

Insurance Guarantee Association (CIGA).

b. Study might be undertaken to consider requiring workers' compensation aggregate excess insurance for certain categories and designated sizes of workers' compensation self-insured employers.

Reaffirmed previous endorsement/adoption.

6. The Commission recommends against establishment of an exclusive state fund in California.

Vote: Yes 5 No 1

7. The availability of safety groups which provide group purchasing power to small firms should be expanded and publicized by the Department of Insurance. Insurers should be encouraged to develop and promote such safety groups.

Vote: Yes 6 No 0

8. If recommendation number 1 is not adopted by the Legislature, then the Commission recommends the institution of a system of premium rebates and/or deductible plans for small firms.

Vote: Yes 6 No 0

9. With respect to quality of service, the auditing process should be used to assure satisfactory performance of statutory duties. Provision of loss control, safety and benefit services should be explicitly evaluated and results disseminated.

Vote: Yes 6 No 0

10. The Commission recommends that the Commissioner of Insurance issue an annual report evaluating the state of competition in the workers' compensation insurance market.

Vote: Yes 6 No 0

11. Because the important cost savings in workers' compensation are beyond the ratemaking process, the Commission recommends that the workers' compensation system be re-evaluated on terms broader than the ratemaking mechanism.

Vote:	Yes	4	Abstain	2
	Yes	1	(by proxy)	

OTHER BUSINESS:

Commissioner Aigner and the Executive Director will write the Executive Summary and send it out this week. Commissioner Aigner requested that each Commissioner read Volume I carefully for consistency of language across the board and that annotated copies be faxed to him by March 6, 1992 for assembly.

Stakeholders should fax their additions/deletions/comments to the Executive Director.

At the next meeting on March 20th, Commission needs to agree on Commission Report Volume I, as modified, as well as on contents of the Executive Summary. Comments/criticisms from stakeholders will be fielded at this meeting as well.

There being no further business the meeting was adjourned at 5:15 PM.

Richard H. Soper
Executive Director

/vrs

WCCA3062.CMN

APPENDIX A.18

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

MEETING OF COMMISSIONERS
MARCH 20, 1992
HYATT REGENCY IRVINE
IRVINE, CALIFORNIA

MINUTES

The Workers' Compensation Rate Study Commission meeting was called to order at 1:06 PM on Friday, March 20, 1992 by Commissioner Dennis J. Aigner, Chairman. Commission members present and constituting a quorum were:

- Dennis J. Aigner, Chairman
- Patricia A. Cheshier
- Stewart L. Long
- William E. Neeley
- Melchior D. Powell
- Susan D. Schaefer

Member absent: James C. Van Horne

Also present were Richard H. Soper, Executive Director of the Commission and consulting team members Glenn M. Shor, LeRoy A. Loseke, Benjamin K. Davis and Virginia R. Sundt. The meeting was open to the public.

MINUTES

The minutes of the previous Commission meeting held March 6, 1992 were approved as corrected.

EXECUTIVE DIRECTOR BUSINESS

The Commission voted to endorse the following Resolution:

ITEM ONE:

RESOLUTION
March 20, 1992 Public Commission Meeting

Be it resolved that the Workers' Compensation Rate Study Commission authorizes Commissioner Dennis J. Aigner, Chairman, to represent the Commission as the Executive Officer having authority to act as the Contracting Officer.

Be it further resolved that the Commission approved the existing contract number CC-915001 (01) with Richard H. Soper, (Richard H. Soper, Inc., dba Soper & Associates) Executive Director, and that the Commission hereby approves the contract with Amendment No. 1 (Amendment No. 1 contemplates assignment of the contract to the Commission) and Amendment No. 2 (Amendment No. 2, among other things, authorizes increase of the contract to an amount not to exceed $862,650.00.)

It is further resolved that Commissioner Dennis J. Aigner, Chairman is authorized to execute the contract and its amendments on behalf of the Commission.

Approval of this Resolution is confirmed by the majority of Commissioners' signatures hereunder. In addition, approval of the Resolution is further documented by the minutes the March 20, 1992 Public Commission meeting.

COMMISSIONERS	SIGNATURE
Dennis J. Aigner, Chairman	_____
Patricia A. Cheshier	_____
Stewart L. Long	_____
William E. Neeley	_____
Melchior D. Powell	_____
Susan D. Schaefer	_____
James C. Van Horne	_____

The Resolution was adopted by a vote of 6 in favor, none opposed.

(Copies of the above Commissioner signed Resolution were forwarded to the State of California, General Services Department.)

ITEM TWO:

The Commission agreed that the studies/reports provided by the actuarial and economic subcontractor firms of Milliman & Robertson, Inc. and AIS Risk Consultants, Inc. were satisfactory and that the ten percent of their fees held in abeyance should be paid.

The Commission vote was 5 in favor, none opposed.

ITEM THREE:

Commission Report Distribution:

Commissioner Aigner entertained the following motion:

> Soper & Associates shall assume responsibility for distribution of requested copies of the Commission Report by those individuals and organizations which would not normally be on the distribution list within the scope of the contract. Furthermore, Soper & Associates may recover reasonable expenses associated with printing, distribution related costs.

The Commission vote was 5 in favor, none opposed.

WORKERS' COMPENSATION RATE STUDY COMMISSION REPORT:

Chairman Aigner indicated he had received letters concerning the recommendations and the specific language employed in the recommendations. Commission Aigner proposed that the Commission "walk through" the draft of Volume I of the Commission Report to make revisions as deemed appropriate. The correspondence received would be given consideration during the course of Volume I review.

Section 1.0 Preface:
Leave paragraph 2, benefits/costs as is.
Modify last sentence word order in last paragraph of Section.

Section 2.0 Executive Summary:
Commissioner Schaefer had several corrections she wished to insert.
Commission Cheshier had several corrections she wished to insert.

Additional corrections were made to the Executive Summary according to Commissioners and stakeholders pertinent comments.

The question of whether to indicate the Commission vote (number) on its recommendations was resolved. The following statement will be inserted into the introductory remarks just prior to the Recommendations:

> "Every recommendation with the exception of numbers 6 and 11 was passed unanimously. The vote on Recommendation number 6 was 5 in favor and 1

not in favor and 1 member absent. The vote on Recommendation number 11 was 5 in favor with 2 abstentions."

It was decided that the Recommendations would not be revisited for the purpose of change although there was a modification to Recommendation 1b.

Section 3.0 Competition, Regulation & Ratemaking in the Workers' Compensation Insurance Industry in California

The ACIC comments concerning this section were considered on their merit. There was a discussion concerning retrospective pricing.

It is the sense of the Commission that it is sympathetic to having "loss costs" defined as being fully trended but not loss cost adjustment expenses.

Senator Green, in his correspondence, asked the Commission to be sure that the assigned risk pool is self sufficient.

ACIC's point, in its correspondence concerning the assigned risk pool, is that it is a public policy matter to create the pool - should it be funded in some other way than taxing the insurers.

There was considerable discussion relative to assigned risk pools.

Commissioner Aigner, along with Commissioners Cheshier and Neeley will draft a letter to Senator Green concerning the assigned risk pool topic. It will be circulated to the other Commissioners.

In connection with Recommendation 5 concerning aggregate excess insurance, it was the intent that the phase "all workers' compensation self-insured employers (public & private) be all qualified .... self insured employers (public & private).

The subject of file and use/use and file caused considerable discussion.
Intent of the Commission - insurance companies can do as they want but make it public.

The Commissioners voted 6 in favor, none opposed to adding the following sentence to Recommendation 1b. **All insurers shall report any individual risk rating plans and the rates used to the Insurance Commissioner.**

Section 4.0 Prospective versus Retrospective Pricing
Modify last sentence pertaining to deductibles in the first paragraph.

Section 5.0 Quality of Workers' Compensation Service
This section was discussed and corrections made as to wording/sentence construction.

Section 6.0 Workers' Compensation Insurance Rating Bureau
This section was discussed and corrections made as to wording/sentence construction.

Section 7.0 Exclusive State Funds
This section was discussed and corrections made as to wording/sentence construction.

Section 8.0 Workers' Compensation Aggregate Excess Insurance
This section was discussed and corrections made as to wording/sentence construction.

Commission Aigner called for a motion to accept Volume I of the Commission Report in its entirety as modified. Commissioner Neeley made the motion which was seconded by Commissioner Powell. Volume I was accepted unanimously by a vote of 6 in favor and none opposed.

There being no further business, the meeting was adjourned at 6:45 PM.

Richard H. Soper
Executive Director

/vrs

(**SPECIAL NOTE:** These Minutes are considered to be unanimously approved by the Commission as a result of individual review by each Commissioner with neither corrections nor modifications rendered. The March 20, 1992 Minutes, therefore, are considered approved as distributed.)

STATE OF CALIFORNIA
WORKERS' COMPENSATION RATE STUDY COMMISSION

- NOTES -

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The Workers' Compensation Rate Study Commission Report is organized as follows:

	Pages	Sections	Exhibits
Volume I Executive Summary	152	11	23
Volume II Commission Staff Report Soper & Associates	426	15	197
Volume III Commission Staff Report Soper & Associates	426	4	17
Volume IV Sub-Contract Resource Report Milliman & Robertson, Inc.	256	7	71
Volume V Sub-Contract Resource Report AIS Risk Consultants, Inc.	524	10	269
Total	1,784	47	577

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Richard H. Soper, CMC, Executive Director
Workers' Compensation Rate Study Commission
Soper & Associates
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