INITIAL STATEMENT OF REASONS
TITLE 8, CHAPTER 8, SUBCHAPTER 2
ARTICLES 1, 3, 5, 6, 9, 11 AND 13
SECTIONS 15201, 15214, 15300, 15400.2, 15251, 15405, 15430.1, 15478, 15481 and 15484

INTRODUCTION

California Labor Code Section 3700 requires every employer except the state to secure the payment of compensation by either being insured against liability to pay compensation by one or more insurers duly authorized to write workers' compensation insurance in this state, or by securing from the Department of Industrial Relations a certificate of consent to self insure either as an individual employer, or as one employer in a group of employers, which may be given upon furnishing proof satisfactory to the Director of Industrial Relations of ability to self-insure and to pay any compensation that may become due to his or her employees.

Although private individual employers have been allowed to secure certificates of consent to self insure by giving proof satisfactory to the Director of Industrial Relations of the ability to self-insure and pay compensation since 1918, it was not until Labor Code Section 3700 was amended in December of 1993 that employers were permitted to qualify to self-insure as members of groups of employers - that is, beginning in 1993, employers that could not meet financial requirements to self-insure individually could form groups to meet the financial and other requirements to self insure in aggregate. Allowing private group self insurance was intended as an alternative to the high cost of workers' compensation insurance so that employers that were not large enough to self-insure could gain the benefits of self insurance and reduce their costs.

In June of 1994, amendments to Title 8, California Code of Regulations were promulgated to implement the amendment to Labor Code Section 3700. Various sections of Articles 1, 2, 3, 5, 8, and 9 were amended to add new definitions, provide new application forms, and specify group self insurers to be subject to the same requirements as individual self insurers. In addition, a new Article 13 was promulgated to address requirements specific to group self-insurance only.

Soon after regulations were amended to address private group self-insurance in 1994, changes in law de-regulated insurance rates, resulting in substantial decreases in the cost of workers' compensation insurance. Requirements to self-insure as members of groups were somewhat burdensome, including requirements for groups to obtain excess

insurance policies with low retention levels that were costlier than higher retention level policies, and requiring even the smallest employers applying to self insure to obtain costly reviewed financial statements to qualify as members. At the same time, the cost of insurance was decreasing substantially because of deregulation, and so even though group self insurance was allowed in 1993, no private groups applied to become self insured until 2002. At that time, the cost of insurance again had begun to rise following several statutory increases in benefit levels, the failure of a number of insurers because of under-pricing, and the departure from California of many other insurers.

Because rates for workers' compensation were increasing substantially for a number of years, group self insurance became the best alternative for small to medium sized employers in certain industries. At the beginning of 2003 there was one approved private group self insurer - by the end of 2006, thirty groups with over 2,000 employer-members had been granted certificates of consent to self-insure.

In 2004, the enactment of SB 899 ushered in substantial workers' compensation reform, which is now resulting in reduced workers' compensation insurance costs. As could be expected, the reduction in insurance costs together with the burdensome requirements to qualify as members of self-insured groups have resulted in a dramatic slow down in the rush to self insure in groups, and existing groups are losing some members, as employers return to insurance. Because of these factors, there is the potential for the financial strength of group self insurers to weaken, not because of weakened financial stability of specific group members, but because of a reduced ability to spread the risk as members return to insurance and the groups decrease in size.

Because California had no experience with group self-insurance in 1993, many of the initial regulatory requirements to self insure were modeled after regulatory requirements for self-insurance for subsidiaries and affiliates of individual private self insured employers, requirements that existed long before group self insurance was permitted. However, there are basic differences between the principles of individual self insurance and group self insurance, and many of those requirements for individual self-insurers do not logically apply to group self insurance. For instance, with individual private self insurance, the financial strength of the parent company, as evidenced by the parent's certified, independently audited financial statement, documents the company's fiscal ability to self insure. The parent company's balance sheet does not consist of restricted funds that can be used only for workers' compensation expenses, and the financial strength of the company is best ascertained by evaluating the company's overall financial strength. In private group self insurance, however, the initial members of the group document financial eligibility in aggregate, as shown by their combined financial statements, but once a group has been established, the group's balance sheet (as opposed to combined members' balance sheets) consists of assets and liabilities that belong to the group as a whole (the group is a private, not-for-profit, mutual benefit corporation that exists solely to cover the workers' compensation requirements of its member). The assets consist of contributions paid by group members to operate the group and are *restricted* – that is, they may only be used to pay workers' compensation benefits and expenses associated with maintaining the group self insurance program. Thus the group's financial

strength is documented by the group's financial statement, not by financial statements for its members.

Before private group self insurance regulations were introduced in 1994, self insurance regulations consisted of 12 articles in Chapter 8, Subchapter 2 of Title 8, California Code of Regulations. These articles addressed specific subcategories of subject matters, such as certificates of consent to self-insure, application, security deposits, audits, and others. Amendments dealing specifically with private group self insurance (but not individual self insurance) were introduced in a new Article 13, but amendments related to group self insurance in some of the other subcategories of subjects were also made in the pre-existing articles.

Labor Code Section 3701 requires a private self insured company to secure incurred worker's compensation liabilities. The intent of this section is to protect the rights of the injured workers and the other self insured companies in case of bankruptcy or other non payment of claims by a self insurer.

The self insurer is required to post a security deposit in the amount determined by the Director. The security deposits are held in trust by the Director of Industrial Relations for the self insurer. If the company defaults on payment of their workers compensation liabilities or files bankruptcy, the deposit will be utilized to pay their employees worker's compensation claims.

In order to benefit the injured workers, the security deposit needs to be issued by an institution that can make payment of the entire amount on demand. This makes it critical that the security deposit be issued by a financially secure institution.

In addition to the necessity for the amendment of regulations related to group self insurance, other areas related to self insurance in general need to be addressed, such as the need to revise for the reporting of the expenses of medical cost containment programs applicable to self insured employers. Clarifying maintenance of records which can be electronically stored instead of microfilmed and cash in trust.

Article 1, Definitions

Existing Section 15201 provides definitions for commonly used terminology related to workers' compensation self-insurance.

Amendment to 15201(x) will clarify the definition of an indemnity claim as it pertains to self-insurance reserving and reporting requirements.

Amendment to 15201(cc) will clarify the definition of a medical-only claim.

With changes in the law as a result of SB899, the amount of compensation benefits due to the injured worker decreased dramatically. Injuries that resulted in some form of permanent disability prior to SB899 now often results in no permanent disability. In addition, there are incentives for the employers to return injured workers to modified

duties. As a result, temporary disability benefits are more often not due. However, the medical expense costs remain the same for the same period of time.

Self-insured employers are required to report the total estimated future liabilities (reserves) on all claims. Only the claims defined as indemnity claims are listed on the annual report and are routinely subject to an audit to verify accuracy of the reported reserves.

Prior to the changes that decreased compensation benefits to injured workers, the medical cost for the medical-only claims were nominal and under-reserving for such claims were insignificant. Therefore, the Office of Self-Insurance Plans did not scrutinize these claims when reviewing for reserves. Now, with the changes and with the strict interpretation of the definitions of indemnity and medical-only claims, audit of reserving on these claims becomes more important, as under-reserving on medical-only claims can become costly.

Amendment of the definitions of indemnity claim and medical-only claim insures that certain types of injuries that incur significant medical costs are reported in the annual report and are subject to audit to verify that they are reserved for adequately.

Article 3, Security Deposit Requirements

Existing Section 15214 provides that a self insured employer can post cash in the form of a corporate check, cashier's check certificate check or money order, made payable to Department of Industrial Relations In Trust for, the legal name of the self insured employer.

One of the methods of security deposit a self-insured employer can post to secure their self-insured workers' compensation liabilities is with cash which could then be placed into an interest bearing savings account or into a Certificate of Deposit (CD) not to exceed a one (1) year term. If in form of CD, the original CD is held at the bank or financial institution in which the CD was purchased. A receipt showing evidence of the CD, its terms and amount is provided to the OSIP. After the CD receipt is received from the bank by OSIP an Approval of Certificate of Deposit and Authorization to State Treasurer is prepared (which basically shows the self-insured employer's name, the terms of the certificate and the amount) and sent to the State Treasurer's Office (STO) wherein it is recorded and a receipt is then generated by the STO and sent back to the OSIP.

The STO bills OSIP for being the "custodian" of the CD even though the Treasurer does not actually hold a certificate. The charges to the OSIP are determined by the number of CD documents created during a quarter for each account which is then divided by the number of documents created by all accounts to arrive at a weighted percentage. This weighted percentage is then multiplied by ¼ of the treasurer's section yearly budget to arrive at the quarterly amount invoiced to the OSIP. The average yearly cost is approximately $45,000.

Existing regulations require the State Treasurers' Office to be the custodian of CD's even though they do not hold the original certificate. The proposed amendment provides that

the bank or financial institution issuing the certificate and holding the original certificate to be the custodian at the expense of the self-insurer and not at the expense of the Office of Self-Insurance Plans, thereby eliminating unnecessary expense incurred by OSIP for the STO to be the custodian. The Office of Self-Insurance Plans will continue to maintain internal documentary evidence of such deposits as was done when such deposits were held by the STO.

The proposed amendment to the regulation replaces the term "passbooks" with "savings account", allows for certificates of deposit to be issued by credit unions that meet the standards contained in Section 15215, and changes the current manner on how cash is processed by the Department of Industrial Relations, Office of Self-Insurance Plans when received from private self-insured private employers for their security deposit posting. The bank or financial institution holding the Certificate of Deposit will be the "custodian" instead of the STO, and the OSIP will maintain documentary evidence of the deposit. The proposed changes also allow for "brokered" Certificates of Deposit" as another form of security deposit, in addition to regular Certificates of Deposit (referenced by banks and financial institutions as "callable" Certificates of Deposit).

Article 5 Self Insurer's Annual Report

Existing Section 15251 specifies the reporting requirements and when public and private self insured employers are required to file with the Office of Self Insurance Plans (SIP) within Department of Industrial Relations.

Existing Section 15251(b)(1)(f) provides that employment and wages paid in calendar in the calendar year as reported on the Employment Development Department on the employers Form DE-6 be reported on the Self Insurer's Annual Report.

Existing Section 15251(c)(1)(f) provides that employment and wages paid in calendar in the fiscal year as reported on the Employment Development Department on the employers Form DE-6 be reported on the Self Insurer's Annual Report.

The proposed amendments would also permit the use of any other equivalent EDD employment and wage reporting document applicable to the self insured employer. This clarification is necessary as all public self insurers and some private self insurers do not utilize the DE-6 form and must utilize other EDD required reporting forms. In addition, some larger public agencies and joint powers authority (JPA) self insurers submit required employment and wage information to EDD by downloading specified information electronically, so that technically no "form" is filed in hard copy at all. Subsection (c)(1)(F) is therefore being editorially revised to correct this oversight and allows the annual report information on employment and wages to come from whatever EDD reporting is utilized or required of the self insured by EDD.

Article 6, Estimating Work Injury Claims and Medical Reports

Existing Article 6 contains four regulatory sections, Section 15300 – 15303, which addresses estimating and reporting of work injury claims; revision of estimates; medical reports; and medical, surgical hospital contracts, respectively, by self insured employers.

On the Self Insurer's Annual Report filed by each self insurer annually with the Director, liabilities to be reported are broken into an "indemnity" component and a "medical" component. The Workers' Compensation Insurance Rating Bureau has proposed changes in the medical component reporting requirements for workers' compensation insurance carriers with respect to the reporting of medical cost containment programs expenses effective January 1, 2011, that would be applicable to all workers' compensation insurance carriers, but would not be applicable to self insured employers. The proposed amendment to Article 6 would essentially adopt the same reporting requirements for the cost of medical cost containment programs as proposed by the WCIRB applicable to self insured employers in reporting the medical component of self insured claims. By making the proposed changes, both workers' compensation insurance carriers and self insured employers would report the medical cost containment program expenses as an allocated cost of work injury claims effective July 1, 2010, providing consistency and clarity in the reporting of these costs within the workers' compensation system in California.

Section 15300(b)(7) specifies the manner in which the life expectancy of injured workers must be estimated and to provide claims administrators with information on how to obtain life expectancy information. It also states the website address where the chart can be found. The proposed amendment to this section is changing the website address for the vendor to Self Insurance Plans because when the charts get updated the website will display a message indicating Internet Explore cannot display the page therefore by Self Insurance Plans updates the charts on an annual basis.

Article 9. Recordkeeping and Audits

Article 9, dealing with recordkeeping and audits, is amended to eliminate the requirement that inactive or closed claim files be microfilmed, and to make available financial information to the Self Insurer's Security Fund.

In order for the Office of Self Insurance Plans to determine whether estimates of future liability of self insured employers are adequate, each workers' compensation claim file must contain documentation of all factors involving the handling of the claim that affect the amount of benefits due or potentially due. Documentation in the claim files must be maintained in a manner that can be readily accessed by auditors, and, to ensure that claims are adequately reserved, it must be clear that estimates of future liability may not be eliminated until there is no reasonable expectation of future costs.

Section 15400.2 addresses that inactive and closed claim files may be microfilmed and original paper files shall be maintained for at least two years after the claim has been closed or becomes inactive. The proposed amendment to this section would allow for claims files to include electronic storage.

Section 15405 addresses the confidentiality of self insurance records. The amendment to subsection (a)(2)is necessary to add the financial information including actuarial reports of participants in the Alternative Security Fund as being available to the Security Fund. This amendment is necessary to comply with Labor Code Section 3701.8(b).

Article 11. Hearings and Appeal Procedures

Existing Section 15430 is the first section in Article 11 of self insurance regulations that discusses self insurance matters that the Director may investigate or that may result in hearings.

Existing Section 15430.1 addresses definitions used in Article 11. This subsection is amended to clarify the definition of who the custodian for cash deposits and approved securities are, to clarify the definition of an aggrieved party and to typographically fix Appeal a Board to read as Appeals Board.

Article 13. Group Self Insurance

Existing subsection 15478 addresses the requirements for excess insurance for group self insurers. Existing Subsection (b) allows the Manager to permit a group self insurer to maintain specific excess coverage with a Self Insurer's Retention as high as $1,000,000 if the group self insurer can support doing so. There is no requirement for individual self-insured employers to maintain specific excess coverage, and many do not maintain specific excess coverage or maintain coverage with retention at much higher levels. One very large California employer has specific excess coverage with a Self Insurer's Retention of $100 million, meaning that the specific excess carrier will not become liable to reimburse the employer for any costs until the employer has paid out over $100 million on a claim. $500,000 retention level is proposed to be raised to $1,000,000. Self insured groups may also reach a size where they are adequately funded to easily pay claims that exceed $500,000 in lifetime costs without reimbursement. The amendment is necessary to help these large group self insurer's reduce costs by paying less for excess coverage than they would for a policy with a lower retention when the group is able to pay claims up to $1,000.000 in cost with leading to financial weakening of the group that would affect its ability to continue as a group self insurer. The amendment is also necessary to allow the Manager to take market conditions into account when and if policies with $500,000 retention become unavailable or too costly for the level of protection provided.

The subsection (b) is amended to include the word "no" which was inadvertently left out because the upper limit of the policy requirement is no less than twenty-five million ($25,000,000).

A new subsection (i) is added to require that the Group Administrator on March 1st of each year to file with Office of Self Insurance Plans the budget plan for the group's current year along with the rates of contribution And a new subsection (j) is added to require any change in the rates of contribution from members as indicated in section (i) (1) through (3) be filed within 30 days of such change. This change is necessary in order to allow a prospective view of the financial capacity of a group. Financial reports are retrospective. The larger problem with groups in deficit is not having sufficient contribution. These documents will allow SIP to monitor groups earlier and be more proactive in preventing deficits.

Existing Section 15481(a) requires each group self insurer "… at least annually …" to "… have an actuarial analysis done of its historical loss development at the 80% actuarial confidence level and at the expected confident level…." The section also specifies requirements for the actuary performing the study.

Existing Subsection (b) requires the deadline for the commencement of the study. The subsection (b) is amended to change the requirement that the study be provided to the Board of Trustees by 75 days after the end of the group self insurer's program year. This change is necessary in order to allow sufficient time after the end of the program year to complete the study.

Section 15484 provides for continuing financial capacity requirements for group self insurers.

Existing Section 15484(a) requires that the certified, independently financial statement be prepared according to Generally Accepting Auditing Standards (GAAP), that the report be submitted by July 1 following the end of the program year, that if it cannot meet that deadline that it immediately advise the Manager in writing of the reasons and submit an un-audited financial statement, and follow up by submitting an audited financial statement within 60 days. It is crucial that the Manager be able to ascertain the financial stability of the group self insurer at least annually in order to determine if assets exceed liabilities so that surplus funds may be released pursuant to Section 15477. In order to make that determination, the Manager must be able to look at a financial statement that is guaranteed to be conducted independently, and is according to standard audit procedures. Since the group self insurer's program year ends at the end of the calendar year, March 1, three months after the end of the program year, gives the group self insurer adequate time to conduct review claims data for the year (required to be submitted to the Manager by March 1 pursuant to Section 15251), and obtain the audit report following the actual audit. Since it is imperative that the manager be able to review a certified, independently audited financial statement, no other option is provided in this section.

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TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS OR DOCUMENTS

The Department did not rely upon any technical, theoretical, or empirical studies, reports or documents in proposing the adoption of this regulation.

ALTERNATIVES TO THE REGULATION CONSIDERED BY THE AGENCY AND THE AGENCY'S REASONS FOR REJECTING THOSE ALTERNATIVES

No other reasonable alternatives were presented or considered by the Department.

ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESS

The Department has not identified any reasonable alternatives or that have otherwise been identified and brought to the attention of the agency that would lessen any adverse impact on small businesses.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT ADVERSE ECONOMIC IMPACT ON ANY BUSINESS

SIP is not aware that there will be any significant adverse economic impact on business.