Risk of Public Agency Default Discussed

More needs to be done to protect public employees and the taxpayers that fund the public sector workers' comp system in California, according to a new report required by the SB 863 reforms. No public agency, so far, has defaulted on their self-insured workers' compensation obligations. The report also finds that these agencies suffer from the same systemic dysfunction that impacts private self-insured and insured employers in Southern California.

The drafters of SB 863 included the mandate for the study amid concerns about recent municipal bankruptcies in Stockton, Vallejo and elsewhere. There's no evidence that workers' comp benefits for injured workers were impacted by any of these declared insolvencies, but with so many other local governments in bad financial condition, there is concern for what could happen in the future.

No Backstop for public agencies.

"If an insurer defaults, [the California Insurance Guarantee Association] is there to pick up the pieces and make sure that all the correct benefits and medical care are are paid for the injured workers. If a private self-insured defaults then there is the Self-Insured Security Fund," says Mark Priven, a researcher with Bickmore. "But public self-insurers really don't have a backstop in that same way – there is no one entity there to pay." This leaves taxpayers on the hook.

Priven presented his preliminary findings and recommendations to the Commission on Health, Safety and Workers' Compensation, which is now seeking community feedback on the report. The findings could be a precursor to new regulations and solvency standards for public agencies, such as counties, cities and various local agencies that self-insure directly or through a joint-powers authority (JPA).

> ***"But public self-insurers really don't have a backstop in that same way – there is no one entity there to pay," --- Bickmore's Mark Priven***

Priven points out that public sector injured workers have always gotten their benefits even when their employer has declared bankruptcy, but notes that public entities pose different levels of risk. Many obtain coverage through JPAs, which are viewed as relatively low risk due to their joint and several liability structures and the fact that they lack any history of bankruptcies. Others, such as counties and school districts are closely aligned with the state and Priven questions whether the state would allow workers' comp benefits to be interrupted.

Cities, Special Districts Are Biggest Threats

"The biggest exposures are individually self-insured cities and special districts," says Priven, maintaining that "If there is going to be a solution or some collection that protects against insolvency, against default, then it needs to recognize that not all public entities are the same both in the type of entity and whether it is in a JPA or individually self-insured."

Priven says a survey of public entities revealed that they are in many ways acting much like private self-insureds. The entities are using actuarial studies to evaluate their workers' comp liabilities, which is the standard for private self-insurers, and they are including an estimate of what it will cost to administer the claims moving forward. Overall financially, about 30% of the respondents have reported a deficit sometime within the last 10 years, but none have filed bankruptcy.

In terms of recommendations he notes that the Department of Industrial Relations' Office of Self Insurance Plans (OSIP) does have the authority to collect relevant data from the public entities, but currently lacks the tools to effectively evaluate a public entity's solvency risk. "The Office of Self-Insurance needs to collect different information – they need to at least collect financial and actuarial information," he says.

OSIP has been criticized in the past for lacking the financial analysis ability to properly evaluate self-insured's actuarial or financial reports.

Claims Characteristics

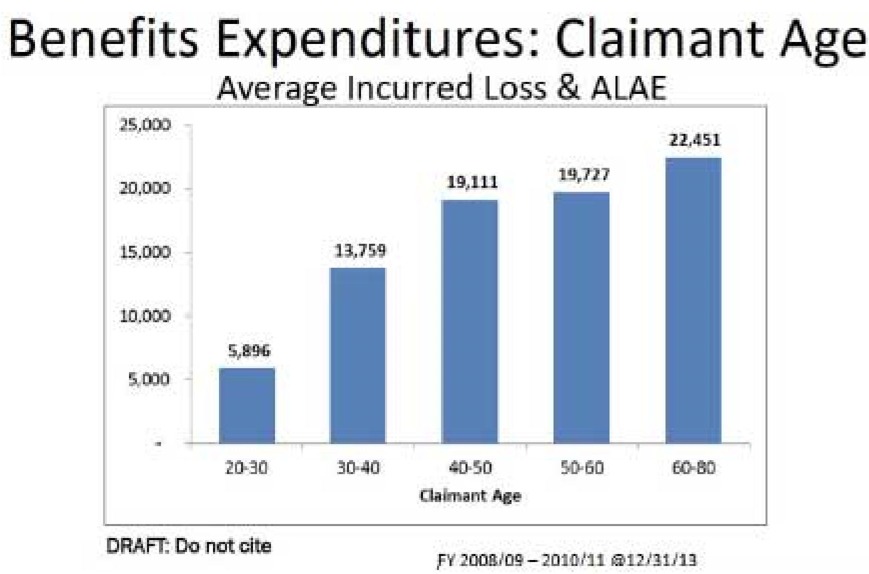
The report also examined claims costs and claims handling experience for the public entities and just like the rest of the claims paying industry, Southern California is a problem.

"Typical to what we have seen in the insurance world the loss rates in Northern California are lower than average and in the South they're higher than average," says Priven. "That's both due to average claim size and frequency."

Other sources have noted a correlation between location and overall claims costs. Industry studies find that increasing claim counts and costs coming from the Los Angeles region are driving nearly all of the recent uptick in claims frequency in the insured market.

Bickmore's data shows Southern California losses for public entities that self-insure are about 12% above the statewide average compared to Northern California where loss rates are 21% below that average. Similarly the average workers' comp claim for these entities are 9% above the average in the South compared to 12% below average in Northern California.

One claim characteristic that is significant for public entities, which tend to have an older workforce, is the high correlation between age and claim cost. Bickmore's review found that claims for older workers cost significantly more and included a higher proportion of indemnity benefits for both temporary and permanent disability. Average benefit expenditures for workers 50 to 60 years of age was $19,727 compared to $13,759 for workers in their 30's. The average cost for workers in their 40s was $19,111, while workers in their 20s racked up only $5,896 in workers' comp benefits on average. Roughly 25% to 30% of the benefit costs for the older workers are for indemnity benefits compared to just 15% for the younger workers (see chart below).



Claims administration in Southern California also seems to be more problematic with claims shops in the Los Angeles region showing poorer performance than claims adjusting locations in other regions of the state. But this isn't just a public entity phenomenon. Bickmore's review of data from the Division of Workers' Compensation's Audit Unit shows that claims shops in the Los Angeles Region score worse than the rest of the state regardless of the entity be it an insurer or a self-insured, self-administered or a third party administrator.

"My takeaway from this is that we often talk about the impact a region has on claims costs...this shows it has an impact on a claims adjuster's ability to handle claims well," says Priven. "The fact that there's a difference between Northern and Southern California tells me that there is something sort of systemic going on that makes it harder to do these things in Southern California well compared to Northern California."

Copies of the full report are available in our resources section or by clickking here. Comments can be submitted to CHSWC via e-mail at chswc@dir.ca.gov or by mail to CHSWC, 1515 Clay Street, 17th Floor, Oakland, CA 94612.