

REPORT TO
UTAH STATE LEGISLATURE

Report No. 98-02

An Audit of Worker's Compensation Fund
Marketing Practices
and
Performance Indicators

February 1998

Audit Performed by:

Audit Manager

John M. Schaff

Audit Supervisor

Angela T. Smart

Audit Staff

John C. Darrow

Table of Contents

	Page
Digest	i
Chapter I	
Introduction	1
Methodology	2
Audit Scope and Objectives	2
Chapter II	
WCFU Marketing and Advertising Efforts Have Expanded	5
WCFU Marketing Efforts and Expenses Have Escalated	6
WCFU Media Campaigns Have Broadened	11
Similar Organizations Have Mixed Marketing and Advertising Programs	12
Chapter III	
WCFU Mirrors Industry Improvements	15
Industry has Rallied Since Near Collapse	15
WCFU Performance Data Seems Valid	18
Conclusion	23
Response	25

Digest of An Audit of Worker's Compensation Fund Marketing Practices and Performance Indicators

We have completed a survey of the marketing and advertising practices of Worker's Compensation Fund of Utah (WCFU). Also, in response to legislative interest that came after we issued our report on **Compensation Practices of Quasi-governmental Organizations (Report #97-01)**, we have verified some selected performance indicators of WCFU. WCFU, in defense of their compensation practices, cited their outstanding financial performance as a justification for their executives' salaries. Although WCFU has generally cooperated with our auditing efforts, the Office of the Legislative Auditor General did not have open access to primary data held by WCFU. All information that we requested from WCFU was first edited and cleared through the executive office, therefore we had very little contact with the data in its original state. The information contained in this report is, to the best of our knowledge, valid—as we only included information that we were able to independently verify. Our primary objectives in this report are to:

- Review the marketing and promotional activities of WCFU, and
- Validate selected performance indicators of WCFU.

Below is a synopsis of the most significant issues found in this report:

- ❑ **WCFU Marketing, Advertising and Agent Expenses Have Expanded.** In the course of this audit we determined that since 1993, WCFU has emphasized and increased spending in the areas of printed, radio and television media campaigns. The organization has moved in the direction of advertising in an effort to remain competitive and retain its market share. Overall, expenses in the areas of advertising, marketing and independent agent incentive expenses have increased an average of 43% annually from 1994 to 1996. Specifically, advertising expenses have increased 58% annually, agent incentive expenses have increased 31% annually, and marketing has increased 22% annually. The four-year total for expenses in these three categories is \$4,074,133; with 1997 only partially completed. (See Chapter II for more details.)
- ❑ **WCFU Leased Delta Center Suite Accounts for 87% of Marketing Expenses.** WCFU marketing expenses are primarily aimed at current and prospective customers, although the organization also uses these resources to lobby legislators. These expenses include tickets to sporting and performing arts events, golf outings, food and other entertainment resources. The most notable expense in this category is the lease on the Delta Center Suite and accompanying Jazz basketball tickets which totaled \$416,698 from 1993 to 1997. This expense, which includes Grizzly hockey tickets, food and other events in addition to the Jazz tickets, accounts for approximately 87% of WCFU's entertainment expenses over a five-year history. Other private, local workers compensation insurance writers we spoke with do not lease a suite at the Delta Center. (See Chapter II for more details)
- ❑ **WCFU Independent Agent Incentive Expenses are Significant.** Besides a standard sales commission, WCFU independent agents also receive incentives such as luxury trips, event tickets, agency bonuses and golf outings. Since 1994, WCFU has sponsored three different trips in which selected agents and a guest were invited. The total cost of these trips is \$348,948. In addition, a yearly golf tournament and bonus commissions for exceptional agency sales bring total expenses for agents to \$1 million over that same time period. This excludes sales commissions that total \$1.2 million. For this, the independent agents have signed new business for WCFU totaling more than \$10 million in premiums and total earned premiums of over \$25 million from 1994 to 1996. We spoke to other workers compensation insurance writers, both locally and nationally, and did not encounter another organization that awards incentives to the extent that WCFU does. (See Chapter II for more details)
- ❑ **Economy and Industry Have Greatly Influenced WCFU's Performance Indicators.** We believe that there were economic and industry-wide forces that helped improve the financial situations of WCFU and other insurance organizations across the nation. In the mid to late 1980's, the workers compensation industry as a whole experienced some serious problems that left some state funds insolvent. Fortunately, Utah did not sustain the damage that many other funds did, and over subsequent years the state has become a profitable market for workers compensation insurance writers. Contributing to these

improvements are industry-wide emphasis on cost controlling measures, workplace safety, anti-fraud programs and managed care programs. WCFU has adopted these initiatives and have greatly improved their financial standing, as have other workers compensation organizations in the private and state markets. (See Chapter III for more details.)

- ❑ **WCFU Claims Have Decreased at a Higher Rate Than Competitors.** WCFU claims have decreased 26% since 1992, which reflects an average annual decrease of 9% over the past five years. This decrease can be attributed to more aggressive claims management, safety programs, managed care and fraud awareness. In 1992, WCFU's claims accounted for about 59% of all claims in Utah, but in 1996, only 38% of all Utah claims were attributed to this organization. Primarily, WCFU officials believe that the emphasis on safety has had the greatest impact. We also looked at other private workers compensation insurers and found that their claims reductions were not as dramatic as WCFU's decreases. (See Chapter III for more details.)
- ❑ **WCFU was not Declared Insolvent, Despite Recent Statements.** Some WCFU officers and board members have recently alleged that the WCFU was, in 1986, insolvent or bankrupt. These statements were made during various legislative committees. After examining State Auditor reports spanning 16 years, we concluded that the WCFU was never bankrupt, and thus, these statements are an inaccurate depiction of the history of the organization. Indeed, the WCFU experienced a significant net loss in 1986, but at no time did the WCFU become insolvent. We believe that the WCFU has overstated their situation during this time, which additionally has overstated improvements they have made since. (See Chapter III for more details.)

Chapter I

Introduction

We have completed a survey of the marketing and advertising practices of Workers' Compensation Fund of Utah (WCFU). In addition, we have examined several performance indicators of WCFU as requested, following the report of our earlier audit of **Compensation Practices of Quasi-governmental Organizations** (#97-01). We have also collected limited data on other workers' compensation insurance organizations both locally and nationally in order to provide a comparative perspective on these issues. Overall, WCFU has continually improved its financial performance in the last five years. This positive trend can be attributed to a number of factors, including industry-wide cost saving efforts which the WCFU has pro-actively adopted, satisfactory premium rates and increased marketing and advertising campaigns by the WCFU.

Because the make-up of quasi-governmental organizations is different than that of state agencies, they are allowed to adopt some practices that are more typical of a private business than that of government. The WCFU was designated as a quasi-public corporation in 1988 and since that time the company's operations and management have taken on private sector practices. The decision to grant this quasi-governmental status to WCFU, according to Senate records, was in response to the thrift crisis during the mid 1980's. The state became concerned with the issue of liability and, in an effort to reduce this threat, WCFU was exempted from certain sections of the **Utah Code**, which allowed the company more managerial flexibility. Even with these exemptions, the question of state liability remains an issue.

This flexibility has enabled WCFU to more aggressively compete for business in the open market with other private insurance carriers. Being a quasi-governmental organization that is in direct competition with other private companies is a unique situation for WCFU. However, this situation also provides at least one rationale used by WCFU executives to justify the marketing and advertising of their products and services. Nevertheless, a portion of WCFU's market share is captive by virtue of the State Risk Management contract and other agencies of the state, including the universities and colleges, which private companies are not granted. These are contracts guaranteed to WCFU for which private carriers cannot compete. However, a recommendation was recently adopted by the Blue Ribbon Commission on the Worker's Compensation Fund of Utah that, if passed by the Legislature, would allow private insurers to compete for state contracts. Still, WCFU retains other ties to the state (i.e., federal tax exemption). Because issues involving the operation of the quasi-governmental organizations continue to be of interest to Legislators, this report will answer questions concerning the marketing and advertising practices of this organization.

Methodology

The data presented in the following chapters will illustrate the marketing, advertising and some performance indicators of Worker's Compensation Fund of Utah. In addition, we have included historical market information, as well as data from similar organizations, for comparison. Our reason for doing this was that the financial trends of the workers compensation insurance market, on a national level, have made some dramatic adjustments over the past decade. Understanding the impetus of these changes was important to our analysis of the performance data of WCFU because it allowed us to view the organization in perspective with the rest of the industry. Additionally, this information on the industry helps to illustrate the magnitude of WCFU's improvements during this same time frame. It is difficult to estimate the effect of the economy on the financial performance of WCFU, versus the organization's own initiatives. We believe that there were economic and industry-wide forces that helped improve the financial situations of the WCFU and other insurance organizations across the nation.

Most of the WCFU data requested was provided through WCFU's internal auditor, under the direction of the organization's executive office. Although WCFU has generally cooperated with our auditing efforts, the Office of the Legislative Auditor General did not have open access to primary data held by WCFU. All information that we requested from WCFU was first edited and cleared through the executive office, therefore we had very little contact with the data in its original state. This created a difficult auditing situation. In addition, WCFU delayed in providing us with some requested information, which ultimately held up the audit process for several months. This delay stemmed from WCFU executives who were concerned about the confidentiality of the data and our right to have access to it. These issues were eventually resolved. Nevertheless, we were unable to test the validity of some original data. The information contained in this report is, to the best of our knowledge, valid) as we only included information that we were able to independently verify.

Audit Scope and Objectives

This audit was originally part of the request to examine four quasi-governmental organizations' compensation practices. Because of the size of the original request and time constraints, we issued the compensation report when those issues were completed and are now finishing the remaining issues, which are contained in this report. The chapter on WCFU's performance data was written in response to legislative interest that came after the compensation report was issued. WCFU, in defense of their compensation practices, cited their outstanding financial performance as a justification for their executives' salaries. As requested, we have chosen some of their performance data to validate.

Because this audit is a survey of the issues, we have presented the requested data in an informational format and no formal recommendations have been made. As mentioned earlier, we have provided some comparative data, but in doing so we have reached only general conclusions about the data sets. Specifically, this report is designed to:

- Review the marketing and promotional activities of WCFU, and
- Validate selected performance indicators of WCFU.

This report is organized into two sections. In Chapter II we will discuss Workers' Compensation Fund of Utah's marketing and advertising practices. We have primarily focused on the organization's expenses for these two areas, although we have also collected some data on the organization's incentives for independent agents. Following this analysis, Chapter III will review the economic trends and changes that have shaped the workers' compensation insurance industry on a national and state level and review some selected performance data of the WCFU.

This Page Left Blank Intentionally

Chapter II WCFU Marketing and Advertising Efforts Have Expanded

Since 1993, Workers' Compensation Fund of Utah has significantly increased its marketing and advertising efforts. Before this time, WCFU did not advertise or market its products and services in a competitive manner. But over the past five years, with increased competition from the private sector, organization management has more assertively promoted the organization and its products in the open market. Although WCFU is a quasi-governmental organization, the organization utilizes private sector management and organizational practices. This mix of private and public elements produces some difficulties when evaluating and determining the effectiveness of a organization's marketing and advertising programs.

Taking these concerns into consideration, it is our opinion that WCFU's marketing and advertising practices have been effective in acquiring and retaining business for the organization. Further, WCFU reflects the marketing and advertising practices of the private market and even exceeds their private competitors marketing efforts in the Utah market. Currently, WCFU employs marketing resources such as entertainment tickets, meals, independent agents and media programs in an effort to retain existing business and acquire new clients. We obtained data on several private and quasi-governmental workers' compensation companies to measure against WCFU. These efforts seem to have been successful as WCFU has maintained a relatively stable market share percentage, despite the increasingly competitive marketplace. In addition, WCFU enjoys high name recognition with both customers and non-customers alike.

The following figure is a summary of the organization's advertising, marketing and agent expenses since 1994. Expenses have been broken into the following three categories: advertising, marketing and agent expenses. Advertising expenses include printed, radio and television campaigns. Marketing expenses primarily include tickets to sporting and performing arts events, food and other entertainment items given to current or prospective customers. Finally, agent expenses include bonuses, luxury trips, event tickets and golf outings given to independent agents as sales incentives.

Figure I
WCFU Total Advertising, Marketing and Agent Expenses
1994-1997*

	1994	1995	1996	1997*	Four-year Total
Advertising	\$300,577	\$687,539	\$751,629	\$800,900	\$2,549,945
Marketing	96,837	98,701	143,333	109,520	448,391
Agent Expenses	241,533	416,402	433,982	7,239	1,075,2797
Total	\$638,947	\$1,202,642	\$1,328,944	\$923,659	\$4,074,133

** Includes expenses through August 1997. Agent expenses only include the golf tournament. Commissions and incentive trips are not included in the 1997 figure.*

As Figure I illustrates, expenses for advertising, marketing and independent agents from 1994 through August of 1997 have increased dramatically. These increases represent WCFU's efforts to retain market share in a competitive industry. Overall, expenses in these three areas averaged an annual increase of 43% from 1994 to 1996, the most recently completed year. The most dramatic increase has been in advertising, which has increased 58% annually from 1994 to 1996. For this same time period, agent expenses have increased 31% annually whereas marketing has increased 22% annually. In order to understand WCFU's marketing and advertising efforts more fully, we will address each of these activities in this chapter. First, we will explain how marketing practices have increased at WCFU, and why organization executives feel it is important. Next, WCFU's advertising campaigns will be examined. Finally, we have gathered comparative information on other organizations' marketing and advertising strategies, both in and out of state.

WCFU Marketing Efforts and Expenses Have Escalated

Prior to 1993, WCFU did not actively market its products and services to current or potential customers. However, since a new management team took over in 1992, the organization has devoted approximately \$477,000 to marketing resources that are distributed to customers, legislators and other important business contacts. The main resource that WCFU employs is the organization-leased Delta Center suite and accompanying Utah Jazz basketball tickets. However, WCFU uses other resources such as college sporting events, professional performing arts events and golf tournaments to solicit large business accounts and to lobby members of the legislature. According to one industry official, these marketing practices are commonplace in the insurance business, but other state and industry officials do not agree. They contend that marketing practices of this nature in the workers compensation line of insurance are unusual. Other state workers' compensation organizations concur that their respective marketing and advertising efforts are non-existent or at the most, meager, in comparison to WCFU. In addition to these entertainment resources, the organization provides incentives to their independent agents such as luxury trips, golf tournaments and tickets to sporting events.

Delta Suite is a Marketing and Lobbying Tool

WCFU has leased a suite at the Delta Center for marketing and lobbying to clients and legislators, respectively, since 1993 and recently renewed the lease for the next five years. The suite is a key item in the WCFU's marketing program and it accounts for 87% of total marketing expenses. In 1994, the Delta Center suite was jointly leased with Blue Cross/Blue Shield of Utah, but starting in 1995, WCFU leased an entire suite alone. Along with the use of the suite, the lease entitles WCFU to 18 seats and accompanying tickets for Utah Jazz basketball games.

Refreshments, catered meals, Grizzly Hockey tickets and tickets to other events can also be purchased at the suite for an additional cost. Delta Center expenses for WCFU were approximately \$125,000 for the 1996-1997 basketball season and totaled \$416,698 from 1993 to 1997. This included tickets to Jazz games, the use of the suite and food, as well as use of the suite for other events at the Delta Center for which WCFU may have purchased additional tickets. Figure II shows Delta Center expenses for the past three completed years. Because WCFU operates on a calendar year, the \$125,000 represents the last and first halves of two different basketball and hockey seasons (1996 represents the end of 1995-1996 season and the beginning of 1996-1997 season).

Figure II			
Delta Center Expenses (Calendar Year)			
1994-1996			
	1994*	1995	1996
Expenses**	\$48,048	\$95,733	\$112,759
Value of Single Ticket	37	40	46
<p><i>* Note: Shared suite with Blue Cross/Blue Shield in 1994</i> <i>** Note: Expenses include suite usage, event tickets, catered meals and refreshments for all Delta Center activities including Jazz Basketball and Grizzly Hockey.</i></p>			

WCFU uses the suite for marketing purposes; specifically, they entertain important clients and prospective clients, agents, important contacts and legislators. To a lesser degree, they occasionally allow organization employees to purchase tickets to other events and concerts that are held at the Delta Center. According to WCFU's marketing executive, the suite is a key component of their marketing plan, and attending a sporting event with a client allows WCFU's executive officers to foster a good relationship with them. Other private, local workers compensation insurance writers we spoke with do not lease a suite at the Delta Center.

Jazz tickets are only given to WCFU's largest premium-paying customers (not less than \$20,000 in premium) and by doing so, the organization maximizes the impact of the resources by concentrating on large dollar premium accounts. According to one executive, the WCFU's goal is to have between \$500,000 to \$750,000 worth of premium dollars represented in the suite at each event. WCFU executive officers accompany the ticket holders as hosts for the events. WCFU executives believe that the suite has been an effective marketing tool that has helped to develop and build good business relationships. WCFU also occasionally gives tickets to independent agents as a new customer sales incentive.

When legislators are invited, WCFU's lobbyist also attend the games. Typically, tickets given to legislators are distributed at the time of the general legislative session which runs from mid-January to March, although some legislators have attended at other times. During the 1996-97 basketball season, 20 legislators received tickets to Jazz games. Most legislators received a pair of tickets for only one game, however four legislators received tickets for two to three games. During the 1995-96 season, 14 legislators received Jazz tickets, of which only two legislators received tickets to two games.

Other Marketing Resources Matched to Clients

WCFU also purchases tickets to other events for marketing and lobbying purposes. As a marketing practice WCFU tries to match their marketing resources to their clients, so the organization purchases tickets to professional and college sporting events and performing arts events in addition to Jazz tickets. The Figure III shows WCFU's entertainment expenses from 1993 to August of 1997. Again, according to WCFU officials, the organization did not market

entertainment resources prior to 1993.

Figure III
WCFU Yearly Marketing Resource Expenses by Category
1993-1997

Event	1993	1994	1995	1996	1997*	Total
Sporting Events						
Professional	\$24,806	\$90,741	\$90,512	\$135,005	\$101,235	\$442,299
College	1,821	3,620	5,345	4,710	4,357	19,853
Performing Arts						
Music	\$ 1,772	\$ 1,900	\$ 1,956	\$ 2,236	\$ 2,016	\$ 9,880
Theater/Dance	408	576	888	1,382	1,912	5,166
Total	\$28,807	\$96,837	\$98,701	\$143,333	\$109,520	\$477,198
* <i>Note: Includes expenses through August 1997</i>						

As Figure III illustrates, the purchase of entertainment resources has dramatically increased since 1993. From 1993 to 1996, expenses increased by 71% annually, with the most notable category being the increase in professional sporting events. Sporting event tickets, including Jazz basketball, Buzz baseball and Grizzly hockey, account for 93% of total marketing resources. The next largest expense category is college sports which accounts for 4% of total resources. Finally, performing arts events account for 3% of total marketing resources.

Independent Agents Given Performance Incentives

WCFU appoints a select group of insurance agents to market their products and services. There are about 120 agents currently appointed to write insurance for WCFU, which encompasses about 30 agencies. Typically, the agents receive a 5% commission, but this varies by agent and by policy. In addition, the agency as a whole can receive a bonus commission if the agency's overall business is particularly good in a year. According to one industry expert, about 60% of all workers compensation insurance writers in the nation use agents and 40% do not. In terms of quasi-governmental workers compensation writers, there is a mix with some retaining agents and some not. This mix is partly explained by the history of the workers compensation funds in the nation. The industry expert explained that typically, older funds (like Utah's which was created in 1917), do not use agents as frequently as newer funds that have come into existence in the past 20 years. Older funds, most of which originated in state governments, have secured their market shares over time, while the newer funds have needed to be more competitive.

While the use of agents is not an unusual practice in this industry, some argue that offering incentives to agents is unusual. For the past three years, WCFU has offered luxury trips to agents and a guest to Hawaii, Ireland and Australia, respectively. In 1998, organization executives report that they plan on sending agents to Hawaii again. The agents who qualify for these trips must sell \$200,000 in net new business in a year. In 1994 and 1995, a total of 22 agents and guests qualified for and were awarded the trips; in 1996, there were 26 agents and guests. Additionally, between four and six WCFU executive officers and guests attended each of the trips as hosts. WCFU paid for airfare, lodging, food, entertainment, transportation and some spending money, as well as the taxes that the agents would have to report as a result of including the value of the trip in their taxable income. WCFU also awards trip invitations to agency directors and a guest if two or more of their agents qualify for trips. In addition to the trips, WCFU sponsors a

golf tournament for the agents each year. The organization pays for green fees, carts, meals, prizes, shirts and refreshments for the day. Agents also receive Jazz suite tickets on occasion as an incentive gift.

Workers' compensation insurance writers in Utah's private sector indicated that they do not provide incentives to their agents of the same magnitude as WCFU. Others reported to us that they do not use independent agents. One industry official we spoke with said that even in larger markets the use of incentives does not reach the level of WCFU's incentives for agents in Utah. For example, the official indicated that dinners, lunches or an occasional sporting event ticket are the most that he had experienced in the greater Chicago area for the workers compensation line of insurance. Figure IV shows the cost for each of the trips and golf tournament expenses, as well as agency bonus commissions paid for the years 1994 through 1996. Jazz basketball ticket expenses are not included in these numbers. Of the 41 regular season games in 1996-1997, we noted only two games where agents received tickets.

Figure IV			
WCFU Agent Incentive Expenses			
1994-1996			
	1994	1995	1996
Bonus Commission	\$153,853	\$298,073	\$278,428
Incentive Trip	87,680	112,550	148,718
Golf Tournament	N/A	5,779	6,836
Total	\$241,533	\$416,402	\$433,982

As the figure illustrates, WCFU agent expenses have increased over the past few years. Annually, expenses have increased an average of 34 percent. The organization paid \$1 million in incentives to independent agents over the past three years, and sales commissions of \$1.2 million (not shown in Figure IV) during the same time period. In return, these agents have brought new written premiums totaling more than \$10 million and total earned premiums of over \$25 million to WCFU from 1994 to 1996. Because of this, WCFU executives feel that the money they spend on agent incentives makes good business sense.

WCFU Media Campaigns Have Broadened

Over the past four years, WCFU has begun to develop advertising campaigns to aid in their marketing efforts. These campaigns have been in the form of paid television commercials, newspaper advertisements and radio announcements. Through these efforts, WCFU is attempting to acquire new business, retain current business, increase worker safety and increase public awareness of fraud, according to organization executives. WCFU feels that with the increased competition in the insurance market, media campaigns are vital to securing their market share. In addition, the organization has produced anti-fraud and safety commercials that they believe have benefitted the whole Utah worker's compensation market by increasing awareness of these issues.

WCFU marketing and advertising efforts have increased significantly since 1993. Overall, marketing expenses more than doubled from \$300,577 in 1994 to \$806,900 in 1997 (through August). WCFU pays a retainer to a large advertising firm which develops their media programs and interacts with the news media, newspapers and television stations. From our analysis, we found that the WCFU advertising programs in 1996 are roughly divided into thirds, with almost an equal number of television, print and radio advertisement programs. During this year, WCFU paid \$718,052 to their advertising firm for products and services.

WCFU Market Share Remains Stable

Since the early 1990's, WCFU's share of the available market, as a percentage, has remained relatively stable. WCFU maintains that advertising is vital in a competitive market in order to retain their market share. In 1992, WCFU reported its market share to be at 57 percent. From that time on, market share remained in the mid-50's range but dipped slightly to 54 percent in 1995. The most recent data indicates that WCFU's market share is at 52 percent in 1997. The organization has expressed concern at the loss of percentage points and believes that increased competition and a healthy market in Utah are partly responsible. One industry official reports that the Utah market has remained extremely competitive over the past decade.

Advertising efforts seem to have improved WCFU's name recognition. In March 1997, a Dan Jones poll showed that 88 percent of WCFU customers recognized the organization name and 89 percent of non-WCFU customers recognized the organization name from public advertising. Customers in the manufacturing and construction industries were more likely than other industries to remember WCFU media advertising.

Part of WCFU's market share is captive. WCFU insures most state agencies through the State of Utah Division of Risk Management policy and the state higher education institutions, which is required by statute. The Division of Risk Management policy covers all executive, legislative and judicial offices, agencies and departments. Altogether, these required policies amount to about \$7.7 million dollars. It is interesting to note that the state and higher education premiums held by WCFU, including the \$4.4 million Division of Risk Management contract, account for approximately 4% of the entire Utah market (excluding the self-insured market). WCFU does not insure all governmental entities as many are insured by the private market. However, a total of 239 local governmental entities are covered by the organization which, combined with the state and higher education, accounts for about 8% of the organization's premium dollars. The total premium paid for these policies in 1996 was \$10,807,532.

Similar Organizations Have Mixed Marketing and Advertising Programs

Other state workers compensation organizations we spoke with indicated that they do not market or advertise on the same scale as WCFU. Of the eight state workers compensation funds contacted, six were quasi-public/self supporting and similar to the Worker's Compensation Fund of Utah. The other two carriers were an independent state agency and a private insurance carrier that had won a three-year contract to service the assigned risk pool. Marketing efforts of these carriers ranged from no marketing plans at all to giving away cash or trip drawings to sponsoring community activities and programs. None of these organizations give incentive-based awards to independent agents, other than drawings for prizes.

Six of the carriers we contacted utilized some form of media advertising. Although print and radio spots were the most commonly used advertising medium, one carrier is considering using television spots next year. Another carrier used advertising in trade magazines exclusively. Overall, advertising budgets varied from carrier to carrier. One carrier indicated that the organization's needs for marketing and advertising had increased, as was evidenced in budget increases from \$300,000 to \$650,000 a year ago. In response to these needs, a new marketing position is being created to network and build relationships with new clients .

While independent agents are used by most of these carriers, none of them offer incentives similar to WCFU and most agents receive only commissions for their sales. One carrier does

invite its agents and the agents' clients to golfing outings, sporting events, boat trips, and seminars, but not on extended trips.

We also contacted some of the workers compensation writers in Utah to compare marketing and advertising strategies with WCFU. Of the three companies we spoke with, one does use independent agents and provide sales incentives such as trips, but the other two do not. These two companies reported that they are not able to market to the same extent as WCFU, even though the market is extremely competitive and agent incentives might be beneficial to company sales. Overall, we did not find an organization in the private or quasi-governmental arenas that market at the same level as the WCFU. The WCFU's marketing strategies raises questions as to what extent an organization, with ties to the state, should market. However, because WCFU is competitive with the private market, and because WCFU has a healthy market share, it is reasonable to conclude that WCFU has been effective in their marketing efforts.

This Page Left Blank Intentionally

Chapter III

WCFU Mirrors Industry Improvements

The Worker's Compensation Fund of Utah is generally performing well financially, as dramatic reductions in claims have been achieved and other performance indicators show improvements since the late 1980's. Nationally, the worker's compensation insurance market has revitalized since a near collapse in the late 1980's and early 1990's. Spiraling medical costs and inadequate rates produced serious problems that left some state funds insolvent. Utah, along with the rest of the nation, struggled through this period but did not sustain as much damage as many other states did. Fortunately, Utah has rallied to become a viable market for this line of insurance. As a significant part of the Utah insurance market, WCFU has been both a contributor to reform efforts as well as a beneficiary to an increasingly healthy economy.

In order to illustrate these market forces, reforms and how WCFU has been affected by these changes, we have provided background information and some limited comparative performance data in this chapter. Although the industry as a whole was in trouble during the late 1980's, Utah fared quite well due to legislative action and a strong state economy. And, since the industry turnaround, WCFU and other private carriers have reported strengthened performance indicators. Specifically, in terms of WCFU, the performance data that they have presented to the legislature in committee testimony seems accurate; however, executives and board members have repeatedly stated that the WCFU was, at one point, insolvent. During the course of this audit we found evidence to the contrary, and therefore we cannot concur with these statements. Nevertheless, to WCFU's credit, claims have significantly decreased along with premium rates. Finally, WCFU has received favorable performance ratings by outside evaluators.

Industry has Rallied Since Near Collapse

The workers compensation industry has made dramatic improvements in the past five years that have salvaged the industry as a whole and strengthened individual states and funds as well. Some of the main reasons for this positive trend can be attributed to industry reforms, including cost controlling initiatives and state-based legislative reforms nation-wide. The economy has also improved since the beginning of the 1990's, which has helped to revitalize this and other markets. Utah's economy, on a more local level, has also posted record low unemployment rates. Additionally, while the workforce in Utah continues to grow, the number of injuries occurring on the job is increasing at a slower rate. Finally, Utah businesses are benefitting from lower insurance premium rates because of increased safety and fraud prevention programs.

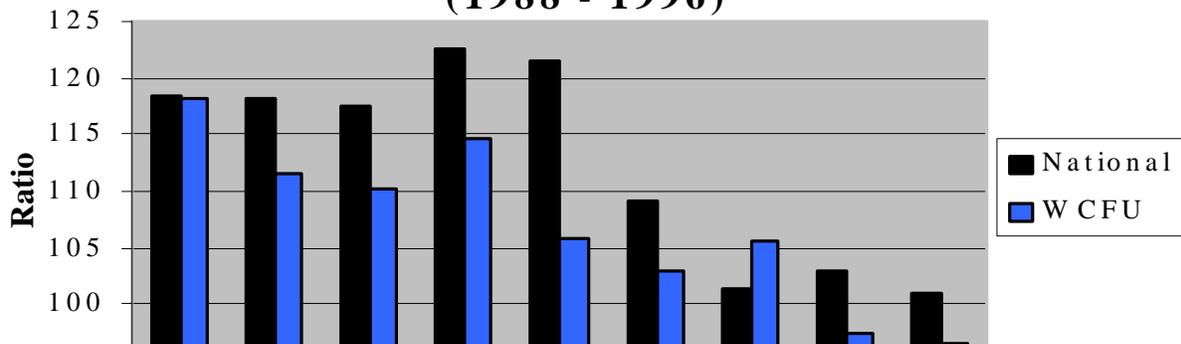
These statistics not only signal that the State of Utah is still a competitive market for the workers compensation insurance industry, but also that Utah businesses and insurance companies are taking safety and cost controls seriously. According to one industry official, Utah is a good place to be if your product is workers compensation insurance. These industry-wide cost controlling efforts were necessary to restore the ailing workers compensation systems according to the NCCI (National Council on Compensation Insurance, Inc.).

To illustrate the condition of the workers compensation industry, a report by the Alliance of American Insurers states that in 1984 all 19 state funds reported that they were solvent, meaning that their assets exceeded their liabilities. This included the Utah state fund. However, at the end of 1990, six of these funds reported that they were insolvent and two more were considered statutorily insolvent. In other words, almost half of the funds were unsound. For six of the other state funds (including Utah), the period between 1984 and 1990 meant their financial strength was diminished. During this same time period, the Utah state fund reported a weakening financial condition but relatively strong financial ratios.

The following figure illustrates market forces through the late 1980's to present. We have included the WCFU and national figures for comparison. The combined ratio statistic that is shown is the ratio of insurer costs to revenues. More specifically, it is the sum of losses, loss adjustment expenses, underwriting expenses and dividends to policyholders divided by premiums. For example, a combined ratio of 120 means that for every \$1.00 of premium, there is \$1.20 in

costs. Hence, lower combined ratios are generally more profitable for insurance companies. A combined ratio of 100 is considered the industry standard, and according to one NCCI official, anything under 110 is usually profitable and ratios over 110 can signal problems. Profitability is also conditional on other factors, such as investment income, which can make up for shortfalls. He also stated that Utah fared very well through the most devastating period in the industry. Utah, overall, posted low combined ratios, which is indicative of the more profitable conditions in this state, in comparison to the rest of the nation.

Figure V
Combined Ratios for the Nation and WCFU
(1988 - 1996)



Generally, WCFU has stayed beneath the national figures. This is indicative of the Utah market overall as well as the organization in particular. Only once, in 1994, did WCFU's combined ratio reach a higher level than the national figures. Nationally, the most dramatic relief came between 1992 and 1994 when the combined ratio dropped over 20 points. This relief coincided with administrative changes at WCFU in 1992, which resulted in the installation of the current WCFU management team. It was at this same time that current management began implementing marketing and advertising programs, as well as cost control, safety and fraud prevention programs. According to industry officials, by 1993 the workers compensation system had begun to benefit from the reforms that had been implemented years earlier. Figure V illustrates how the industry was suffering as well as the progress that was made to remedy the situation.

Utah Fared Better Than Most States

Generally, Utah did not realize the workers compensation insurance crisis or declare the state fund insolvent, as did other states. In fact, the Utah State Legislature was one of the more proactive legislative bodies in the nation, implementing many safeguards to repair the workers compensation system before it reached disaster. For example, reform efforts on the cost side of the workers compensation equation were matched by increased premium rates on the income side. According to one official at the National Commission on Compensation Insurance (NCCI), substantial rate increases ultimately helped many states in crisis to make gains, but other state funds were eventually declared insolvent. The reasoning for this is that many states, including Utah, were more inclined to raise rates if a rate increase could be substantiated by actuarial reports. Other states, however, were more inclined to alter rates based on political reasons. Intuitively, an actuarially based rate increase makes more sense, but according to this official, many states did not have the political will to raise the rates adequately. Fortunately, Utah was willing to raise rates, which supported increases in benefit pay-outs to injured workers; thus enabling insurance companies to make a profit.

Utah Insurance Writers Realized Gains

Other insurance writers were also experiencing losses during the late 1980's; however, when reforms and rates caught up in the 1990's, these companies made considerable gains along with WCFU. We spoke with some private company officials who noted that the industry-wide

emphasis on managed care, safety programs and fraud detection were all effective in controlling costs. In addition, as the economy improved and rates increased, the workers compensation insurance market as a whole became profitable again. Some national insurance writers we spoke with indicated that the Utah market has become very profitable within the last five years which has resulted in increased competition as new companies have entered the market. National companies are interested in the Utah market because it has improved so significantly.

WCFU Performance Data Seems Valid

The Workers' Compensation Fund of Utah's performance data seems valid and the organization has made significant performance improvements in the last decade. Although the market and economy improved, WCFU has also made additional strides as an organization. Although other companies in the workers' compensation market have also experienced improvements in claims filed, WCFU decreases seem to be more dramatic. Still, it is difficult to determine which forces produced the positive outcomes at WCFU. Ultimately, the market and WCFU management teams, both past and present, can take joint credit.

WCFU and other private insurance carriers have adopted industry-wide managed care initiatives and other claims cost-controlling measures which seem to have been beneficial. WCFU has also implemented safety and accident prevention measures, as well as anti-fraud efforts directed at reducing costs which also seem to have had an impact. Overall, state premium rates have declined in response to WCFU and private companies making these changes. Finally, WCFU has been given a high performance rating by A.M. Best, an independent evaluating organization. These changes have improved the financial integrity of the organization. However, WCFU's management have overstated the impact of these improvements by claiming that WCFU was at one time bankrupt. Through our examination, we found evidence to the contrary; therefore, we do not agree with this contention.

WCFU Claims Have Significantly Decreased

Since 1992 the number of claims filed at the Workers' Compensation Fund of Utah have decreased from 41,767 to 30,874 for a total decrease of 26 percent. This reflects an average annual decrease over the past five years of 9 percent. The WCFU attributes this decrease to more aggressive claims management, safety programs, managed care and fraud awareness. In addition, WCFU's portion of actual claims as a portion of the state total, has decreased over the past five years. In 1992, the WCFU's claims accounted for about 59% of all claims in Utah, but in 1996 only 38% of all Utah claims were attributed to this organization. These decreases are significant, given that the state injury rate and the state employment rate have not fluctuated. These rates are currently running parallel to each other with the employment rate increasing at a slightly higher rate than the injury rate.

According to WCFU officials, these dramatic decreases in claims were due to increases in WCFU's safety programs, including drug and alcohol testing, safety seminars and an increase in safety inspectors. In addition, in 1988 each claims adjuster managed an average of 368 claims. With such a high caseload, adjusters often could not fully investigate claims to determine whether or not they were justified. Many unnecessary and fraudulent claims were probably paid by WCFU because adjusters did not have adequate resources to investigate them. By 1996 the organization had increased the number of claims adjusters so that now each adjuster manages approximately 109 claims. Organization executives contend that this has significantly reduced the rate of claims paid because invalid claims are more easily detected and denied. In addition, the organization believes that with more adjusters their customer service has improved and payments are more timely.

We looked at three other insurance companies in Utah to compare claim experiences and found that their respective portions of total Utah claims had increased slightly. All of the companies we received performance data from had average claims increases of 4% or less. In addition, these competitors hold market shares that are a fraction of WCFU's, so claim increases do not have a significant impact on the state totals. Overall, workers compensation insurance writers in this state indicate that they have made financial gains since the early 1990's. As stated earlier, all of the companies we spoke with including WCFU have instituted workplace safety programs and even given premium incentives to reduce accidents. Labor Commission officials contend that these programs have benefitted the whole system by helping to prevent accidents and thus, claims.

WCFU was not Declared Insolvent

The executive officers and board members of WCFU have alleged on many occasions that the organization was insolvent or near bankruptcy around 1986. After reviewing audited financial statements and speaking with state and industry officials, we have concluded that these statements are inaccurate and that the organization was never bankrupt or in danger of becoming insolvent. Although WCFU has made improvements, the organization was not as close to insolvency as some WCFU officials have depicted in the public forum. Certainly, WCFU experienced financial hardships, as did other workers compensation insurance writers. However, we believe that WCFU has overstated their situation in 1986 and 1987 and therefore have inaccurately represented their improvements since that time.

In testimony to legislative committees, WCFU officials have repeatedly charged that the organization was insolvent, to justify the granting of quasi-governmental status. As mentioned in Chapter I, this is an inaccurate assumption. In addition, WCFU officials have used the argument that the organization was insolvent to exaggerate their current financial performance. During the April 28, 1997 meeting of the Audit Subcommittee, WCFU board members stated that "*in 1986...the fund was found to be actuarially unsound*" and that it was "*on the verge of bankruptcy and it showed all the earmarks of becoming a very large financial liability to the state.*" In the Political Subdivisions Interim Study Committee meeting on July 16, 1997, board members stated that "*the Fund became actuarially unsound within the State*", and that it "*...was bankrupt.*" In the October 14, 1997 meeting of the Blue Ribbon Commission on the WCFU, the organization's chief executive officer stated that "*in 1986 we were bankrupt.*" Neither we nor WCFU were able to document or justify these statements.

In 1986 WCFU did experience a net loss, due in part to a \$24 million increase in estimated

liability for claims. This adjustment was a result of upward trends in total anticipated costs of claims, especially in the medical payments area. During this time, court decisions regarding what constitutes a compensable accident, increases in medical provider costs and various other factors caused the independent actuary to reevaluate the estimate of liability for Incurred but Unpaid Claims for the year 1985 and earlier. This new adjustment in estimated liability for claims was reflected on the 1986 income statement. Figure VI shows the organization's assets and liabilities from 1986 to 1990. WCFU was granted quasi-governmental status in 1988.

Figure VI					
WCFU Assets and Liabilities (in 000's)					
1986-1990					
	1986	1987	1988	1989	1990
Assets	\$152,015	\$174,536	\$194,818	\$224,152	\$255,802
Liabilities	137,839	139,423	157,688	178,906	204,255
Policyholder Equity	\$ 14,176	\$ 35,113	\$ 37,130	\$ 45,246	\$ 51,547
<i>Source: Utah State Auditor's Reports (1986-1990)</i>					

Even with the net loss in 1986, our analysis shows that WCFU was financially sound. The State Auditor concurs with our conclusion based on the annual audit reports by the Office of the State Auditor, spanning the 1980 to 1996 time period, which demonstrate that the fund was never in danger of insolvency. Insurance Department officials also stated that at no time did they ever understand that the WCFU was financially unsound. Finally, documented statements from WCFU's own board meeting minutes, during this period, indicate that from 1986 to 1988 board members believed the fund to be sound. WCFU was unable to provide documentation to us indicating that the organization was ever actuarially unsound.

Industry Reforms Adopted by WCFU

WCFU, as well as other private insurance carriers in the state, took steps to control costs through managed care and put tighter controls on the claims payment process; which has benefitted the industry as a whole and the companies individually. In addition, safety programs, drug awareness and fraud prevention measures have also been implemented across the country. WCFU uses their marketing and advertising resources to promote fraud prevention and safety awareness. At least two of their advertising campaigns targeted these issues.

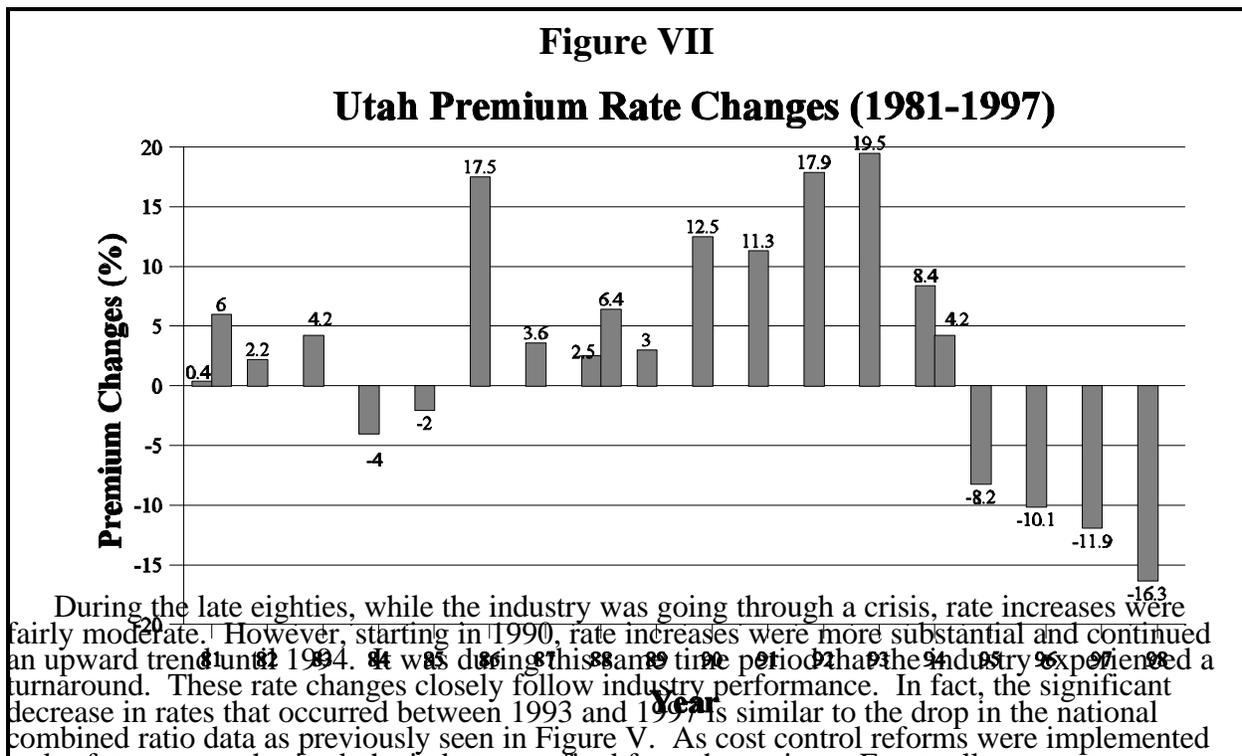
The WCFU's safety programs have increased the number of safety visits from 1,426 in 1992 to 5,054 in 1996. Additionally, organization sponsored safety seminars have also increased. Drug program consultations have also increased 73% from 56 in 1993 to 97 in 1996. The organization also cites savings from managed care efforts.

The workers compensation insurance writers that we spoke to, including WCFU, are currently employing all of these efforts. One of these companies provided us with data on their managed care efforts. This data showed that from 1992 to 1996, this company estimates saving \$5.4 million dollars due to managed care. Further, officials at the Labor Commission agree that the workers' compensation line of insurance has improved through the adoption of cost control initiatives with Workers' compensation premium rates having decreased in Utah as a result. While the "grossly unprofitable results of the last decade" are not expected to reoccur, according to NCCI, the workers compensation system is in better shape today because of the rigorous reforms and loss control efforts of the 1990's.

State Premium Rates Have Substantially Declined

Premiums in the state have declined and WCFU is a part of that. As the financial state of the industry has improved, premium rates in Utah have declined. The companies we spoke with, including WCFU, have employed many cost saving programs such as managed care, anti-fraud units and safety programs that have lowered the costs to the respective companies and decreased accident claims. Because of these improvements, the NCCI has recommended rate reductions for the workers' compensation line of insurance for the past three years. Overall, a 46.5% rate reduction has taken place since 1995. Although this has helped business owners to lower their costs, the insurance companies are experiencing a loss of premium dollars. In addition, the market has become very competitive so companies, including WCFU, are offering businesses preferred rates if they meet certain criteria. Some of these preferred rates are extremely low and according to some industry officials, are driving the rates down so low that the profit margin is disappearing. Still another industry official says that this is the nature of the business—rates drop, but eventually they will increase again in response to the market (i.e., unemployment rates).

Utah workers compensation premium rate levels have fluctuated somewhat over the last 16 years, but a few trends have become evident. After a variation in the level of rates from 1981 to 1988 (including a spike of a 17.5% increase in 1986), rates followed an upward trend from 1987 to 1993. Following this trend was a downward adjustment of rates, with an actual decrease in rates from 1995 to the most recent decrease of 16.3% in September of 1997. In Figure VII, the years 1981, 1988 and 1994 all experienced two rate adjustments. Each year's adjustments are applied to the rate of the previous year.



During the late eighties, while the industry was going through a crisis, rate increases were fairly moderate. However, starting in 1990, rate increases were more substantial and continued an upward trend until 1994. It was during this same time period that the industry experienced a turnaround. These rate changes closely follow industry performance. In fact, the significant decrease in rates that occurred between 1993 and 1997 is similar to the drop in the national combined ratio data as previously seen in Figure V. As cost control reforms were implemented and safety was emphasized, the industry profited from the savings. Eventually, premium rates decreased which has benefitted consumers and businesses. As evidence of these decreases, in October of 1997 Utah was ranked third lowest in workers compensation premiums in the manufacturing sector by Actuarial & Technical Solutions, Inc.

WCFU Given High Performance Rating

The WCFU receives an annual evaluation from the A.M. Best Company, an independent insurance rating system, which looks at other medium sized workers compensation insurance

writers for comparison. In 1997, WCFU received a rating of A-, which is considered excellent. Best uses a capital adequacy ratio to determine how financially stable and fit an organization is by looking at quality of investments, claims reserves, assets, underwriting risks and surplus. The WCFU's ratio, as of December 1996, was 205%, whereas the industry average is about 124 percent. According to this analysis, the organization is well prepared to cover their risks. Organization surpluses have also increased significantly over the past 5 years. Surplus growth has averaged almost 26% since 1992, with substantial growth of 55% in 1995.

Conclusion

Both the workers' compensation insurance industry and WCFU have made significant improvements over the past five to ten years. These positive trends are due to industry-wide reforms, rate increases that match benefit levels, cost controlling measures such as managed care, safety and fraud programs, and a healthy economy. These factors cannot be discounted when measuring the significant gains WCFU has made since the late 1980's. Throughout this time, the organization was financially stable and was at no time threatening insolvency—in fact, the state as a whole fared better than the nation.

This audit has covered some selected performance data of WCFU. As a result, we cannot accurately compare this organization's financial fitness to similar organizations in other states or other comparable workers compensation insurance writers. We have heard statements from other organizations that they experienced financial difficulties and have recovered, as did WCFU. In order to fill in as many details as possible about the state of the workers compensation system, we have provided national, state and industry data. However, because we do not have comparative performance data, it is not possible to rank or qualify the success of WCFU. In other words, the information in this report is only a piece of the story.

WCFU has made improvements in terms of claims and cost controlling programs. Claims for WCFU have decreased at a higher rate than any competitor we spoke with. This, along with excellent ratings from independent evaluators, indicates that the organization is in good financial standing and prepared to handle their risks. With these positive outcomes, the organization should be careful to not overstate these improvements. In terms of marketing, WCFU sees these efforts as necessary in an increasingly competitive market. Their marketing efforts seem to surpass any other organization that we interviewed and the benefits of their extensive advertising has evidently been paying off. WCFU enjoys a majority of the market share and although that has decreased slightly in recent years their next largest competitor is still 40 percentage points away. In addition, the organization enjoys high name recognition both with customers and non-customers alike.

Agency Response