Office of the
Legislative Fiscal Analyst

FY 2005 Budget Review

Joint Appropriations Subcommittee for
Commerce and Revenue

Workers Compensation Fund

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**Summary**

The Workers Compensation Fund (the Company) provides employers with low cost workers’ compensation and employer liability insurance. All funding comes from premiums paid by policyholders. The Company receives no funding from the State. The State is a policyholder and does pay premiums to the Company. Premiums paid by the State accounted for $6,248,615, or 3.46 percent and $6,992,047 or 3.13 percent of total 2002 and 2003 premium respectively. Although this analysis concentrates on the administrative portion of the Company’s budget, the success of the Company in meeting its statutorily created objectives is better evidenced by a review of the other key operating statistics.

The Legislature established the workers’ compensation system in 1917. Employers have the option of obtaining workers’ compensation coverage through the Company or another private carrier or self insuring (with the approval of the Industrial Commission). The Company insures over 29,000 Utah employers.

The Legislature has designated the Company as an independent entity. [UCA 63E-1-102] As such it is organized as a quasi-public corporation, a type of independent corporation. [63E-2-106] In connection with this designation, the budgetary control was shifted from the Legislature to the Company’s Board of Directors. The budget presented herein is for Legislative review and not for approval.

The Company is not a component unit of the State of Utah. Statute indicates that the State is not liable for the expenses, liabilities, or debts of the Workers’ Compensation Fund, and may not use any assets of the Injury Fund for any purpose. [UCA 31A-33-105(2)]
3.0 Programs: Workers Compensation Fund   -   Administration

Recommendation  No recommendation is needed. The budget is for review only.

Organizational Summary

The Workers Compensation Fund is organized as follows:

**Administration** includes accounting, financial analysis, budgeting, investments, human resources, and information systems.

**Claims** includes claims administration, medical management, special investigations, third-party administration of self-funded entities, and oversees recoveries and reimbursements from third parties.

**Marketing and Underwriting** includes oversight of independent agents as well as internal marketing representatives, the Company’s regional offices, customer service, loss prevention, review of policyholder risk for premium pricing, premium rate and rate adjustment filings, and policyholder dividend filings.

**Legal Services** adjudicates cases before the Labor Commission.

Personnel Change  The Company anticipates increasing its staff by 10 FTEs during 2004, primarily to accommodate the growth in its policyholder base.
| Key Objectives | Key objectives of the Company are to promote workplace safety, efficiently adjudicate claims, and enable appropriate care to injured workers while minimizing the cost to employers. The Company has been successful in achieving these objectives by investing in quality systems and personnel. The Company’s combined ratio (claims and operating expenses divided by earned premium revenue), after several years of increases, is projected to decrease to 100.7% for 2003, due to improved rate adequacy and fewer catastrophic claims losses. Although the Utah Insurance Department approved no loss cost rate increases for either 2001 or 2002, and approved a loss cost rate decrease for 2003, the Company improved its combined ratio by increasing premiums where justified and appropriate. For 2004, a loss cost rate increase of 5.9% was approved. For 2003 and 2004, operating costs increased due to growth in the Company’s policyholder base, which in large part was due to absorbing policies from competitors that withdrew from the market. |
| Company Initiatives | The Company has implemented the following initiatives aimed at lowering claims costs and premiums, and providing improved service to policyholders and injured workers: • Increased the number and expertise of safety/loss control professionals to make such services readily available to policyholders. • Established a medical case management and utilization review group with registered nurses to oversee medical treatment. • Contracted with hospital and physician groups to provide medical care at discounted rates. • Assisted employers in establishing drug and alcohol testing programs. • Utilized vocational rehabilitation specialists to assist injured workers in returning to work. • Reduced per adjuster caseloads to 111 by hiring additional adjusters. • Utilized sophisticated software to track the effectiveness of various physicians and treatments. • Aggressively investigates and assists in the prosecution of policyholder, claimant and provider fraud. The Company’s special investigations unit has saved nearly $52.4 million since its inception in 1992. • Established branch offices in Ogden and St. George to increase service in outlying areas. • Hired Spanish-speaking adjusters and rehabilitation specialists to assist non-English speaking workers. |
| Business Practices | The Company has developed new products, services and delivery methods to better meet the needs of its customers. |
The Company operates as a non-profit, mutual insurance company. Premium rates for the Company, and all other private carriers, are based on statistical data supplied to the National Council on Compensation Insurance, Inc. (NCCI), which makes premium rate recommendations to the Utah Insurance Department for their review and approval.

Discounts and Rebates

Programs that provide adjustments to standard rates may be granted by carriers with approval of the Utah Insurance Department. The Company offers a variety of adjustment programs that are dependent on historical or projected claims data. The Company may also return excess income to the policyholders in the form of dividends.

History

Originally, the Company operated as a division of the Industrial Commission and then the Department of Finance. In 1981, the Legislature reorganized the Company under the Department of Administrative Services. In 1988, the Legislature ended the Company’s status as an agency, shifted the oversight of expenditures from the Legislature to a Governor-appointed Board of Directors and made the Company independent from direct State oversight. In accordance with Governmental Accounting Standards, the Company was designated an enterprise fund from 1988 to 1990 and as a discrete component unit from 1991 to 2000. In 2001, the Division of Finance determined that the Company was no longer a component unit of the state and excluded it from the state of Utah’s Comprehensive Annual Financial Report. The legislature codified this change. In 1997, the Legislature removed the State Auditor’s direct responsibility to audit the Company. The Governor appoints six of the seven-member board. Current board members are listed below.

Current Board

<table>
<thead>
<tr>
<th>Name</th>
<th>Title and Affiliation</th>
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<tbody>
<tr>
<td>Melvin C. Green</td>
<td>Chairman, Founder and partner of Galbraith and Green (retired),</td>
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<tr>
<td>Judd A. Turner</td>
<td>Insurance Broker, Fred A. Morton &amp; Company</td>
</tr>
<tr>
<td>Dallas H. Bradford</td>
<td>Managing Partner, Arthur Andersen, LLP (retired)</td>
</tr>
<tr>
<td>S. Camille Anthony</td>
<td>Executive Director of Department of Administrative Services, State of Utah</td>
</tr>
<tr>
<td>Robert D. Myrick</td>
<td>President of Morgan Stanley Bank</td>
</tr>
<tr>
<td>Howard E. Dransfield</td>
<td>Senior Executive, Mobil Corporation (retired)</td>
</tr>
<tr>
<td>Lane A. Summerhays</td>
<td>President and Chief Executive Officer of Workers Compensation Fund</td>
</tr>
</tbody>
</table>
Premium revenue declined in 1995, 1996, 1997 and 1998 as the benefit of overall cost reductions were passed on to policyholders, primarily through rate reductions, discounts, and dividends. Net earned premiums increased 0.7%, 23.0%, 16.3%, 30.8%, and 25.6% for years 1999, 2000, 2001, 2002, and 2003, respectively, due to new business, improved customer retention, tightening of safety record adjustment discounts, and increased market share. For 2004, it is anticipated that earned premium revenue will decrease 1.5%, due primarily to the divestiture of affiliated Advantage Workers Compensation Insurance Company. The Company’s market share (per A.M. Best) was 51.5%, 57.8%, and 65.0% for 2000, 2001, and 2002, respectively. The increases over the historical market-share average of approximately 50% were due to other carriers withdrawing from the market due to rate inadequacy and insolvencies.

Premium revenue is used to pay benefit expenses and administrative expenses. Benefit expenses declined from 1994 to 1999 due to the Company’s successful loss control and medical management efforts but have increased from 2000 to 2003 due primarily to growth in insured risk, medical inflation, wage inflation, and increased claim severity.

The Company pays premium taxes to the State in accordance with Utah Code Annotated 31A-33-114 and 59-9-101. Premium taxes for 2001 and 2002 were $9,901,000 and $18,997,000, respectively.

The success of the Company’s programs has strengthened its investment portfolio and increased investment income. In turn, policyholder equity has grown significantly since 1993 and remains strong. Investment income is used to offset expenses and enable further premium reductions. Utah’s workers compensation premiums are consistently ranked among the lowest in the nation.

In the past, the Company priced premium for policies based on loss cost rates submitted by NCCI and approved by the Utah Insurance Department. Policyholders received refunds of excess premiums in the form of dividends. Between 1994 and 1999, the Company’s Board of Directors approved dividends totaling $130,522,000. The Company has adopted additional pricing strategies, including loss-sensitive accounts, where a minimum premium is charged to the policyholder and subsequent settlement of premium is made based on the policyholders’ claim experiences. As a result, the year-end variance between premiums paid and policyholder experience is smaller and fewer dividends will be paid. Dividends for 2000, which were paid during 2001 and later, totaled $8,000,000, and dividends for 2001 paid during 2002 and later totaled $2,442,000. Dividends for 2002, paid during 2003 and later are projected to total approximately $3,000,000.

The 2004 budget for the Company was approved by the Board of Directors on December 18, 2003, and is presented to the Governor and Legislature for information purposes. The 1990 Legislature allowed the Company to report its operating results on a calendar year rather than the State’s fiscal year.
Performance Measures
4.0 Tables