

MINUTES OF THE HOUSE COMMERCE AND LABOR COMMITTEE

The meeting was called to order by Chairman Don Dahl at 9:00 A.M. on February 17, 2005 in Room 241-N of the Capitol.

All members were present except:

Delia Garcia- excused
Kevin Yoder- excused

Committee staff present: Jerry Ann Donaldson, Kansas Legislative Research Department
Norm Furse, Office of Revisor of Statutes
Renaë Jefferies, Office of Revisor of Statutes
June Evans, Committee Secretary

Conferees appearing before the committee:

Jay Angoff, Kansas Coalition for Workplace Safety
Terri Robinson, National Council on Compensation Insurance

Others attending:

See attached list.

The Chairman opened the hearing on **HB 2447 - Workers compensation; reforming the residual insurance market structure.**

Staff gave a briefing on **HB 2447**, stating there needs to be a technical change on page 1, line 24, to change "director" to "commissioner". The plan of operation provides for a competitive bidding process pursuant to which the commissioner shall seek, and any insurer seeking to qualify as the residual market insurer may submit, rates at which the insurer will agree to insure any employer who is in good faith entitled to but who is unable to procure workers compensation insurance through ordinary methods. Not later than July 1, 2005, and after consultation with the workers compensation insurance industry, the commissioner shall establish an interactive internet site which shall enable any employer licensed in this state to obtain a quote from each workers compensation insurer licensed to write the coverage sought by the employer.

Jay Angoff, Roger Brown & Associates, Jefferson City, Missouri, testified as a proponent to **HB 2447**, stating that Kansas currently has a good system of property/casualty insurance. During the first six months of 2004, the property/casualty insurance industry made more money than in any other six-month period in history. It had a record profit of \$23.5 billion, which is more than the industry has made in all but four 12-month periods. The industry also had an all-time-high surplus. Surplus is the amount of money insurers hold in addition to the amount they have set aside to pay future claims. This record \$370 billion in surplus was the result of a record increase of \$85 billion, or 30%, in only 18 months.

Workers compensation insurance is a type of property/casualty insurance. Like the property/casualty industry as a whole, workers compensation was extremely profitable in 2003. The countrywide loss ratio for workers compensation for 2003 was the lowest it has been since 1997; and even the residual market, the market created by the industry as a whole for employers who insurers refuse to voluntarily insure, which almost always produces a loss, came close to breaking even, with its best performance since 1997.

The most significant reason workers compensation insurance profitability has been increasing appears to be that injured workers are filing fewer claims. Claims filed have been declining substantially for all types of cases, against all types of employers, and in all regions of the country.

As profitable as the workers compensation insurance industry has been nationally in recent years, in Kansas it has been even more profitable. For example, the loss ratio for Kansas workers compensation insurance has steadily declined since 1995, both for indemnity payments and medical payments. Specifically, the medical loss ratio, the ratio of projected claims payments to premiums collected, dropped from .71 to .54, or by 24%, while the indemnity loss ratio dropped from .63 to .42, or by 33%. A loss ratio of .54 means that 46 cents of every premium dollar is available for profit and expenses. With loss ratios that low, even the most inefficient companies, companies with higher-than-average expenses, enjoy substantial profits (Attachment 1).

CONTINUATION SHEET

MINUTES OF THE House Commerce and Labor Committee at 9:00 A.M. on February 17, 2005 in Room 241-N of the Capitol.

Terri Robinson, National Council on Compensation Insurance (NCCI), gave information on workers compensation data collection. NCCI provides impact analysis of proposed and enacted system changes. Earlier this year the Workers Compensation Advisory Council asked NCCI to evaluate the changes to the benefit structure that has been included in this bill.

NCCI estimates that the benefit changes in **HB 2447** could result in an increase in Kansas workers compensation costs in the range of +1.8 (\$27M) to +8.9% (\$42). The provision to increase the maximum benefit level for all injury types from 75% to 100% of the state average weekly wage would increase system costs. While this language proposes a change to the maximum benefits for temporary total (TT) and permanent total (PT) injuries as shown in Section 44-510c, other injury types also reference Section 44-510c for determination of their maximum benefits; thus the changes to this section impact the maximum allowable benefits for all injury types. Under current statute, workers compensation benefits generally equal two-thirds of the claimant's pre-injury average weekly wage subject to a maximum of 75% of the state average weekly wage (SAWW) and a minimum of \$25 per week. The estimated impact of increasing the maximum benefit amount to 100% of SAWW would be an increase of approximately 4.0% (\$19.0 million) of total system costs.

Payment of temporary partial benefits for scheduled permanent partial injuries seeks to provide incentives for injured employees to return to work by providing temporary partial benefits for claimants receiving scheduled benefits. This proposal is expected to result in a minimum overall system cost impact.

The estimated impacts of the various provisions to adjust or remove the aggregate caps on indemnity benefits are increased dramatically.

Under current Kansas statute, a claimant would qualify as Permanent Totally Disabled when the employee, on account of the injury, has been rendered completely and permanently incapable of engaging in any type of substantial and gainful employment. Currently the cap on permanent total disability awards is \$125,000, which is very close to the \$100,000 permanent partial disability (PPD) cap. As a result, there is not significant incentive (as in many other states) to be classified as "permanent total". This proposal increases the difference in maximums from \$25,000 (\$125k-\$100k) to \$125,000 (\$250k-\$1125k). NCCI estimates that this proposal would increase direct system costs by 0.6% to 0.9%.

The current Temporary Total Disability (TTD) cap of \$100,000 is rarely triggered. At the maximum weekly benefit of \$449 per week, it would take 222 weeks to reach \$100,000. It is more likely that the claimant would a) return to work at a full or reduced wage, b) reach maximum medical improvement, or c) be awarded permanent partial disability benefits prior to 222 weeks. It is felt that the increase in the TTD cap to \$125 would not have a measurable impact on the system.

Eliminating the \$50,000 cap on functional impairment awards would have minimal impact on the system costs as this \$50,000 cap is triggered only in rare instances (Attachment 2).

The meeting adjourned at 10:15 a.m. The Chairman stated the hearing on **HB 2447** would be continued on February 18.

COMMERCE AND LABOR COMMITTEE

Date February 17, 2005

NAME	AGENCY
John Ostranski	KS AFL-CIO
Lana Nicol	WCDivision KDOL
Dick Cook	KS Ins. Dept.
Jamie Gayer	Emporia State University Newman Div. Nursing
Amy Seimears	Emporia State University NDN
Sarah Hess	Emporia State University NDN
Karen Chaffin	Emporia State University Newman Div of Nursing
Jay Angoff	Roger Brown Assoc., Jeff City, MO 65101
TERRI ROBERTS	KS State Nurses Assn.
Jennifer Lynn	Sen. Emler
Joshua R Welch	Emporia State University Newman Division Nursing
Alyson M. Weiser	Emporia State University NDN
Eunise E. Cornejo	Emporia State University, NDN
Christina M. Blanton	Emporia State University-NDN
Alan Seiber	Horn Law Firm
Jeff Bo Henby	Bo Henby & Associates
JOHN C. BOTTENBERG	N.C.C.F.
GARY RICKER	BPRC
CYNTHIA NAZE	GOODYEAR TIRE & RUBBER
Andy Shaw	Goodyear Tire & Rubber Co.
Scott Heidner	KSIA
Day Hollandsworth	DofA
Ashley Sherard	Lenexa Chamber of Commerce
Michelle Burhenn	KC Star
Caryn Carter Gomar	Intern - Rep. Pauls
LARRY MAGILL	KS ASSN OF INS AGENTS
Jeff Cooper	COOPER & Lee LLC.

Report
on the
Profitability and Performance
of the
Kansas Workers Compensation Insurance System

February 17, 2005

Jay Angoff
Roger Brown & Associates
216 East McCarty Street
Jefferson City, MO 65101

Comm & Labor
2-17-05
Atch # 1

Introduction

This report first describes the current state of the property/casualty insurance industry countrywide. Second, it explains the current state of the countrywide workers compensation industry. Third, it analyzes the Kansas workers compensation market in general. Fourth, it discusses the Kansas residual workers compensation market--the means by which Kansas employers who insurers refuse to voluntarily insure obtain coverage. Finally, it explains how the Kansas residual market might be reformed so as to reduce Kansas workers compensation insurance system costs across the board--thus enabling workers compensation benefits to be increased while maintaining today's low workers compensation rates.

I. The profitability of the property/casualty insurance industry nationally

During the first six months of 2004, the property/casualty insurance industry made more money than in any other six-month period in history: it had a record profit of \$23.5 billion¹, which is more than the industry has made in all but four 12-month periods.² The industry also had an all-time-high surplus--surplus is the amount of money insurers hold in addition to the amount they have set aside to pay future claims--of \$370 billion.³ This record \$370 billion in surplus is the result of a record increase of \$85 billion, or 30%, in only 18 months.⁴

¹ Business Insurance, "P/C industry's first-half profits top \$23 billion," Oct. 18, 2004 (hereinafter "First Half Profits").

² Insurance Information Institute, What's Keeping Insurance CEO's Awake at Night?, May 6, 2004 (Presentation of III Senior Vice President Robert P. Hartwig at NCCI Annual Issues Symposium) (hereinafter "Awake at Night").

³ Business Insurance, First Half Profits, supra note 1.

⁴ Id.; Business Insurance, "Insurer profits soar in 2003," Apr. 14, 2004.

The reinsurance industry--reinsurance is insurance that insurance companies buy to cover claims above a certain level--has also been enjoying record profits. In 2003 (data has not yet been released for 2004) the ratio of projected losses to premiums collected in the reinsurance industry was the lowest it has been since before 1991.⁵ In addition, reinsurance capacity has increased: for example, the capacity of Lloyds of London, perhaps the best-known reinsurer in the world, has risen by 50% in only three years, from \$10 billion to \$15 billion pounds⁶--almost \$30 billion at today's exchange rate.

The record profitability and record surplus of both the insurance industry and the reinsurance industry is obviously good news for the insurers and reinsurers who receive those profits and hold that surplus. But it is also good news for buyers of insurance throughout the United States: record profits in the insurance business means that insurance rates will soon be falling, and that new companies will be entering the industry seeking to obtain some of those record profits for themselves.

II. The profitability of the workers compensation insurance industry nationally

Workers compensation insurance is a type of property/casualty insurance. Like the property/casualty industry as a whole, workers compensation was extremely profitable in 2003. The countrywide loss ratio for workers compensation for 2003 was the lowest it has been since 1997⁷; and even the residual market—the market created by

⁵ Awake at Night, *supra* note 2.

⁶ *Id.*

⁷ National Council on Compensation Insurance, Kansas Workers Compensation State Advisory Forum, Oct. 28, 2004, at 11 (hereinafter "State Advisory Forum").

the industry as a whole for employers who insurers refuse to voluntarily insure, which almost always produces a loss—came close to breaking even, with its best performance since 1997.⁸

The most significant reason workers compensation insurance profitability has been increasing appears to be that injured workers are filing fewer claims: claims filed have been declining substantially for all types of cases, against all types of employers, and in all regions of the country.⁹ For example, between 1997 and 2002, the following decreases in workers compensation claims occurred:

I. Decreases in Workers Compensation Claims by Type of Injury¹⁰

<u>Type of Claim</u>	<u>Decrease</u>
Fatality	21%
Permanent Total	14%
Permanent Partial	19%
Temporary Total	30%
Medical Only	25%

II. Decrease in Workers Compensation Lost Time Claims by Size of Claim¹¹

<u>Size of Claim</u>	<u>Decrease</u>
> \$50,000	4%

⁸ NCCI Holdings, Inc., Workers Compensation Update, Nov. 16, 2004, at 12 (presentation of NCCI Chief Actuary Dennis Mealy) (hereinafter “Workers Compensation Update”).

⁹ State Advisory Forum, supra note 7, at 17.

¹⁰ Id. at 19.

¹¹ Id. at 18.

\$10,000-\$50,000	11%
\$2,000-\$10,000	26%
< \$2,000	51%

III. Decrease in Workers Compensation Claims by Size of Employer ¹²

Size of Employer (by payroll)	<u>Decrease</u>
< \$250,000	21%
\$250,000-\$1 million	30%
\$1 million-\$5 million	27%
\$5 million-\$20 million	34%
\$20 million-\$100 million	31%
> \$100 million	31%

As a result of all these decreases, workers compensation costs nationally now account for just 1.8% of payroll.¹³

III. The profitability of the workers compensation insurance industry in Kansas

As profitable as the workers compensation insurance industry has been nationally in recent years, in Kansas it has been even more profitable. For example, the loss ratio for Kansas workers compensation insurance has steadily declined since 1995, both for

¹² NCCI Research Update, Research Breakout Session, Annual Issues Symposium, May 7, 2004.

¹³ NCCI Holdings, Inc., State of the Line, May 6-7, 2004, at 36 (presentation of NCCI Chief Actuary Dennis Mealy) (hereinafter "State of the Line").

indemnity payments and medical payments. Specifically, the medical loss ratio--the ratio of projected claims payments to premiums collected--dropped from .71 to .54, or by 24%, while the indemnity loss ratio dropped from .63 to .42, or by 33%.¹⁴ A loss ratio of .54 means that 46 cents of every premium dollar is available for profit and expenses; a loss ratio of .42 means that 58 cents of each premium dollar is available for profit and expenses. With loss ratios that low, even the most inefficient companies—companies with higher-than-average expenses—enjoy substantial profits.

Not surprisingly in view of these extraordinarily low loss ratios, Kansas is one of the most profitable states in the nation for workers compensation insurance. In 2003, for example, Kansas ranked 6th in profitability among all the state¹⁵, and in 2002 it ranked 3rd.¹⁶ Perhaps most impressive, Kansas is one of only 6 states in the nation in which in both 2002 and 2003 workers compensation insurers booked a profit even before adding in their investment income.¹⁷ Like most insurers, workers compensation insurers expect to pay out more in claims and expenses than they take in in premiums because they make such a substantial profit from the investment income that accrues on the premiums they collect. Kansas workers compensation insurers, in contrast, had a net gain due to their premiums exceeding their projected claims in addition to their investment income.

Happily for Kansas employers, however, high profits for workers compensation insurers have not translated into high workers compensation insurance rates for

¹⁴ State Advisory forum, supra note 7, at 29.

¹⁵ National Council on Compensation Insurance, NCCI Calendar-Accident Year Results by State Using Data Valued as of Dec. 31, 2003, at 18 (2004) (hereinafter “Results by State”).

¹⁶ Docking Institute of Public Affairs, Workers Compensation in Kansas, at 13 (Jan. 2004) (hereinafter “Docking Institute”).

¹⁷ Results by State, supra note 15, at 8-18.

employers. To the contrary, Kansas workers compensation rates have remained essentially flat since 2000, except for a 17% increase in 2001 in the residual market.¹⁸ In line with its recommendations for recent years, the National Council on Compensation Insurance--the insurance industry organization that publishes "advisory" rates and projects future claims payments for the industry¹⁹--has recommended negligible increases for 2005: a 1.7% increase in the voluntary market, and a .4% increase in the residual market.²⁰

Moreover, workers compensation rates in Kansas are far lower than both the countrywide and regional averages. Specifically, on the NCCI's index of state-by-state workers compensation rates, Kansas workers compensation loss costs are 1.17, compared to a countrywide average of 1.60 and an average in the five-state KS-OK-MO-NE-CO-region of 1.70.²¹

The reason Kansas workers compensation insurers have enjoyed substantially above average profits while at the same time Kansas employers have paid substantially-below-average rates is that Kansas workers file relatively few compensation claims, and when they do file claims they receive relatively little compensation. For example, claim frequency dropped substantially in Kansas between 1995 and 2002—from 45 to 33 per \$1 million in premium.²² Similarly, between 1992 and 2002, lost time cases dropped

¹⁸ State Advisory Forum, supra note 7, at 22.

¹⁹See *Amundson & Assoc. v. Nat'l Council on Comp. Ins.*, 988 P.2d 1208, 1210 (Kan. App. 1999).

²⁰ State Advisory Forum, supra note 7, at 22.

²¹ *Id.* at 24.

²² *Id.* at 32.

from 4.3 per 100 workers to 3.0 per 100 workers, or by 30%.²³ The decline in such claims in manufacturing and construction was particularly dramatic: in manufacturing they dropped by 42%--from 7.3 to 4.2—and in the construction industry by 39%--from 6.7 to 4.1.²⁴

Even more significant, the compensation Kansas workers receive on those infrequent occasions when they do file a claim is by far the lowest in the 5-state region that includes Kansas: according to the NCCI, injured workers in Kansas receive an average of approximately \$13,000 in Kansas, but an average of between \$16,000 and \$23,000 in Missouri, Colorado, Nebraska and Oklahoma.²⁵

Finally, 364 insurers are today writing workers compensation business in Kansas.²⁶ This is not surprising in view of the high profits available in Kansas to workers compensation insurers, including those insurers with very high cost structures.

IV. Can the operation of the Kansas workers compensation insurance market be improved?

The Kansas workers compensation insurance market appears to be functioning to benefit both the insurers who write the insurance and the employers who buy it: insurance company profits are high, and insurance rates are low.

Both insurers and employers, therefore, can reasonably be expected to be extremely satisfied with the Kansas workers compensation system.

²³ Id. at 37.

²⁴ Id. at 38.

²⁵ Id. at 45.

²⁶ Kansas Insurance Department, Workers Compensation Loss Cost Multipliers, last updated September 5, 2003.

Kansas workers, on the other hand, are not as well-served by the Kansas workers compensation system: the reason the Kansas workers compensation system produces both high profits for insurers and low rates for employers is that workers compensation benefits in Kansas are extremely limited. For example, the maximum weekly benefit in Kansas is the seventh lowest in the nation.²⁷ In particular, it is much lower than in any of the four states bordering on Kansas: Kansas' \$440 compares to \$528 in Oklahoma, \$542 in Nebraska, \$659 in Colorado, and \$663 in Missouri.²⁸ Moreover, Kansas workers compensation benefits are far lower than workers compensation benefits countrywide for every injury type, and for both medical and indemnity benefits.²⁹ Specifically, for medical and indemnity benefits combined, Kansas benefits are just 72% of the national average.³⁰

It would be possible to raise benefit levels, while at the same time retaining workers compensation rates at their current low levels, by reforming the one element of the Kansas workers compensation insurance system that is not working well: a residual market structured to increase costs rather than to constrain them. The residual market is the means by which employers who workers compensation insurers refuse to voluntarily insure can—and must—obtain insurance, since the law requires employers to have workers compensation insurance,³¹ but does not require insurers to sell workers

²⁷ Docking Institute, *supra* note 16, at 17-18.

²⁸ *Id.* at 17.

²⁹ *Id.* at 20.

³⁰ *Id.*

³¹ KSA 44-532(b).

compensation insurance to any particular employer.³² In Kansas, the insurance industry and the government agree on the rates to be charged in the residual market, which are higher than voluntary market rates, and all workers compensation insurers share in the results of that market: whether the market has a profit or loss, each carrier is responsible for that profit or loss in proportion to its market share.³³

Because each insurer is responsible for the results of the residual market only in proportion to its market share, no single insurer has a substantial incentive to control residual market costs. On the other hand, one or more of the largest insurers typically receive a fee for functioning as so-called “servicing carriers”--collecting the premiums and paying out claims for the residual market -- and because this fee is calculated as a percentage of either the premium they collect or the claims they pay, the bigger the residual market the higher a servicing carrier’s compensation. Thus, while no insurer has a significant interest in restraining costs in the residual market, servicing carriers have an interest in increasing those costs. This system not only drives up residual market rates, but also drives up voluntary market rates, since the increased costs of the residual market are passed through to employers in the voluntary market

The manner in which the residual market is structured in Kansas has had the following adverse effects:

³² KSA 40-2108.

³³ Amundson, supra note 19, at 1210.

1. The Kansas residual market loses money.

On \$66 million³⁴ in residual market premium written in 2003, the Kansas residual market had an underwriting loss of \$24 million.³⁵ Notwithstanding Kansas's low workers compensation rates this underwriting loss has the effect of raising Kansas's voluntary market rates, since the voluntary market carriers pay for the loss in proportion to their market share, and they pass that loss though to their voluntary market policyholders. At the same time, a loss in the residual market doesn't mean a loss for the servicing carrier. To the contrary, it means higher fees to the servicing carrier.

2. Whether measured by premium volume or number of policies, more workers compensation business is in the residual market in Kansas than virtually any other state.

For example, of the 19 states in which the NCCI administers the residual market, Kansas had the 2nd highest premium volume in the residual market--19.4%--in 2003, and the highest percentage--20.3%--in 2002.³⁶ Moreover, the percentage of policies in the residual market almost doubled between 2001 and 2003, increasing from 17.65% in 2001 to 33.4% in 2003.³⁷ Whether measured by premium volume or number of policies, the amount of workers compensation business in the residual market in Kansas is now approximately twice the national average. Notably, employers in the residual market are adversely affected not just because they pay the higher residual market rate, but also because they generally receive less and lower-quality services--including loss-control services--than do employers in the voluntary market.

³⁴ State Advisory Forum, supra note 7, at 92.

³⁵ National Council on Compensation Insurance, Residual Market Management Summary 2003, at 20 (hereinafter "Residual Market").

³⁶ Id. at 18-19.

³⁷ NCCI, Kansas Residual Market Annual 2003 Status Report, as of Jan. 8, 2004, at 8 (hereinafter "Status Report").

3. The Kansas residual market contains a higher percentage of businesses who are there not because they are unsafe but because they are small.

It appears that in Kansas a disproportionate number of small businesses are placed in the residual market not because of any adverse claims experience but solely because they are small. For example, in Kansas 74.16% of the policies in the residual market are for \$2,500 or less; they account for 14.74% of residual market premium volume.³⁸ Only three of the 23 states for which the NCCI collects data have a higher percentage of policies with \$2,500 or less in premium; and in only three other states do such policies account for a higher percentage of premium volume than they do in Kansas.³⁹ To the extent small businesses are placed in the residual market despite good claims experience, they are unfairly required to pay higher rates, and to receive lower levels of service, than they would in the voluntary market.

4. The claims experience of the business in the residual market in Kansas is much more favorable than is the experience of the residual market countrywide.

While the number of policies in the residual market in Kansas increased in 2003, the average experience mod of all policies in the pool decreased, to approximately 1.06, which was substantially below the national average of 1.10.⁴⁰ This means that substantially more business with good claims experience is placed in the Kansas residual market than is placed in the average state's residual market. Such businesses are unfairly required to pay higher rates, and to receive lower levels of service, than they would in the voluntary market.

³⁸ Residual Market, *supra* note 34, at 26.

³⁹ *Id.* at 22-28.

⁴⁰ Status Report, *supra* note 37, at 9.

Replacing the existing residual market with a competitive bidding process which forces insurers to compete for the residual market business on a “winner-take-all” basis could ameliorate the problems outlined above. Under such a process, the insurer offering the lowest rates for residual market business would obtain all that business, and would be on the risk for the results of that business: unlike servicing carriers in the present system, it would earn a profit only if the residual market earned a profit. It would therefore have an incentive to contain costs in the residual market to the greatest extent possible.

Moreover, because other carriers will no longer pay for any losses in the residual market and will therefore not include the cost of any such losses in their voluntary market rates, a competitively-bid residual market should also reduce voluntary market rates. And finally, a competitively-bid residual market should maximize safety—since maximizing safety reduces workers compensation losses, and reducing losses will increase the residual market carrier’s profits.

Conclusion

From a business or insurer perspective, any change in the Kansas workers compensation system may appear to be gilding the lily, since insurance profits are high and insurance rates are low. Nevertheless, the structure of the residual market in Kansas has caused both residual and voluntary market rates to be higher than they would be if the residual market were structured to create incentives to limit costs rather than increase them. If the residual market were structured to create such incentives, benefit levels could be increased while retaining today’s low workers’ compensation rates, or those already low workers’ compensation rates could be further reduced while retaining current benefit levels.

Testimony
Before the House Commerce & Labor Committee
On House Bill 2447
By Terri Robinson
National Council on Compensation Insurance
February 17, 2005

Good morning Chairman Dahl and committee members. Thank you for the opportunity to speak to you today about proposed HB 2447. My name is Terri Robinson, and I am here representing the National Council on Compensation Insurance, which is the largest workers compensation data collection organization in the nation.

As part of our services, we provide impact analysis of proposed and enacted system changes. Earlier this year the Workers Compensation Advisory Council asked us to evaluate the changes to the benefit structure that have been included in this bill. Although we have not had the opportunity to present it to the Council, we did complete the analysis, and I will provide a summary at this time. The complete analysis is included in my written testimony.

NCCI estimates that the benefit changes in this bill, if enacted, could result in an increase in Kansas' workers compensation costs in the range of +1.8% (\$27M) to +8.9% (\$42M).

The following components of HB 2447 are expected to impact overall costs as follows:

<u>Provision</u>	<u>Impact</u>
• Increase the maximum benefit level for all injury types from 75% to 100% of the state average weekly wage -	From +4.0% to 6.0%
• Payment of Temporary Partial benefits for Scheduled Permanent Partial claims -	Minimal savings
• Adjust /Remove Aggregate Caps -	From +1.7% to 2.8%
• Annual Adjustments to Maximum Benefits -	+0.1%
Total Cost Impact	From +5.8% to 8.9%

Analysis of Provisions of HB 2447

- **Increase the maximum benefit level for all injury types from 75% to 100% of the state average weekly wage (SAWW)**

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This provision would increase system costs. While this language proposes a change to the maximum benefits for temporary total (TT) and permanent total (PT) injuries as shown in Section 44-510c, other injury types also reference Section 44-510c for determination of their maximum benefits; thus the changes to this section impact the maximum allowable benefits for *all* injury types.

Under current Kansas statute, workers compensation benefits generally equal two-thirds of the claimant's pre-injury average weekly wage subject to a maximum of 75% of the state average weekly wage (SAWW) and a minimum of \$25 per week.

The proposal to increase the maximum benefit amount would affect high wage earners who make more than 112% of the SAWW and are limited by the state's maximum weekly benefit of 75% of the SAWW. These high wage earners comprise approximately one third of the work force in Kansas. Half of them, those making between 112% and 150% of the SAWW, would see average benefit increases of approximately 20%, while those making more than 150% of the SAWW would experience a 33% increase in benefits. This is expected to increase indemnity costs over 10%. Since indemnity costs account for approximately 41% of total costs in Kansas, the estimated impact of increasing the maximum benefit amount to 100% of SAWW would be an increase of approximately 4.0% (\$19.0 million) of total system costs.

In estimating the final impact of this proposal, we also give consideration to behavioral changes that may result from the increased benefits provisions, such as increased claim frequency and longer claim duration; these changes would result in indirect costs to the system. For example, at the proposed higher benefit level, some workers may take longer to go back to work and some workers who previously wouldn't have filed a claim may now consider doing so. Past studies have shown that this utilization impact for this type of benefit increase could vary from 20% to over 50% of the direct impact.

Considering both the direct and indirect (utilization) effects of this proposal, the impact could increase overall system costs up to 6.0% (\$28.4 million).

- **Payment of Temporary Partial benefits for Scheduled Permanent Partial Injuries**

This provision seeks to provide incentives for injured employees to return to work by providing temporary partial benefits for claimants receiving scheduled benefits. This proposal is expected to result in a **minimal overall system cost impact.**

Under current Kansas statutes, an injured party can receive both temporary total (TT) and temporary partial (TP) benefits in cases involving *unscheduled* permanent partial disability (PPD) benefits. The final PPD award is then reduced by the total amount of such TT or TP payments. Current statutes provide for TT payments for scheduled PPD, but do not allow for TP payments in such cases. This proposal would extend TP benefits to scheduled PPD. This could provide incentives for injured claimants to return to work sooner than they would currently, and could result in savings to employers from hiring of additional workers, training new employees, or other such expenses needed to temporarily replace injured employees.

A previous proposal from the Kansas WC Advisory Council on the provision of TP benefits for scheduled permanent partial injuries had included an offset for TP benefits from scheduled PPD benefits. If such an offset were to be considered with this proposal, as is the case with TT benefits, it would result in no change in total amount of benefits received and, therefore, would result in a very minimal cost savings, if any, to the Kansas workers compensation system. This proposal does not contain a provision for such an offset.

- **Proposal to Adjust or Remove Aggregate Caps on Indemnity Benefits**

The estimated impacts of the various provisions to adjust or remove the aggregate caps on indemnity benefits are shown in the following chart:

Proposal	Overall Impact	Premium Impact
1. Increase Permanent Total Cap from \$125,000 to \$250,000	1.0% - 1.5%	\$4.7M - \$7.1M
2. Increase Temporary Total Cap from \$100,000 to \$125,000	Insignificant	-
3. Increase Permanent Partial and Temporary Partial Cap from \$100,000 to \$125,000	0.7% - 1.3%	\$3.3M - \$6.2M
4. Removal of \$50,000 cap from functional impairment	Insignificant	-
Total	1.7% - 2.8%	\$8.0M - \$13.3M

Impact of Increasing the PTD Cap from \$125k to \$250k

Under current Kansas statute, a claimant would qualify as PTD when the employee, on account of the injury, has been rendered completely and permanently incapable of engaging in any type of substantial and gainful employment. While certain injuries are listed as those that qualify for PT benefits, it is stated that in all other cases PTD shall be determined in accordance with the facts. Currently the cap on permanent total disability (PTD) awards is \$125,000, which is very close to the \$100,000 permanent partial disability (PPD) cap. As a result, there is not significant incentive (as in many other states) to be classified as "permanent total". This proposal increases the difference in maximums from \$25,000 (\$125k-\$100k) to \$125,000 (\$250k-

\$125k). NCCI estimates that this proposal will increase direct system costs by 0.6% to 0.9%.

Due to the somewhat "loose" definition of PTD in Kansas, under this proposal there would now be added incentive for claimants to have themselves categorized as permanently and totally disabled. This may cause a "utilization" effect whereby a shift in claims from serious PPD to PTD status occurs. The estimated impact could increase to as much as 1.5% due to the potential for increased utilization.

Impact of Increasing the TTD Cap from \$100,000 to \$125,000

The current TTD cap of \$100,000 is rarely triggered. At the maximum weekly benefit of \$449 per week, it would take 222 weeks to reach \$100,000. It is more likely that the claimant would a) return to work at a full or reduced wage, b) reach maximum medical improvement, or c) be awarded permanent partial disability benefits prior to 222 weeks. Further, in the case of permanent partial injuries, the healing period benefits are limited to 15 weeks (in addition to the 415 week maximum). For these reasons we do not feel that the increase in the TTD cap to \$125,000 will have a measurable impact on system costs.

Impact of Increasing the PPD/TPD Cap from \$100,000 to \$125,000

NCCI has examined a permanent partial loss distribution curve, which was calibrated to match current benefit levels in Kansas. It was determined that the direct impact of removing the cap would be an increase of between 7% and 10% in permanent partial costs. By replacing a cap of \$125,000, the impact on permanent partial costs would be approximately +3.5%. This translates to a direct increase of 0.7 to 1.3% on overall system costs.

This proposal may also impact utilization of PPD benefits in the following ways:

- 1) The proposal may affect PPD claims that are under the current \$100,000 cap. We surveyed Kansas claims adjusters at five of the largest writers of workers compensation in the state. According to the adjusters surveyed, raising the current \$100,000 ceiling could have an effect on negotiations and increase the average cost of lump sum settlements.
- 2) Also, the adjusters surveyed felt that an increase in the PPD cap could create added incentive not to return to work in order to secure the higher "general" disability benefits. The extent that this might occur would be difficult to predict and would hinge upon several factors such as attorney involvement, interpretations of the judges, etc.

Impact of Eliminating \$50,000 Cap on Functional Impairment Awards

As defined in section 44-510e of the Kansas statutes (Compensation for disabilities not covered by schedule), functional impairment means "the extent, expressed as a percentage, of the loss of a portion of the total physiological

capabilities of the human body as established by competent medical evidence and based on the fourth edition of the AMA Guides to the Evaluation of Permanent Physical Impairment, if the impairment is contained therein". NCCI estimates that this proposal to remove the \$50,000 cap on functional impairment benefits, which applies to non-scheduled PPD cases only, would have a minimal impact on system costs, as this \$50,000 cap is triggered only in rare instances.

As an example, suppose an employee who is receiving functional disability benefits is a high wage earner such that the maximum weekly benefit of \$449 (75% of the state average weekly wage) is paid. By the required formula for functional disability benefits, the AMA impairment rating would have to be greater than 26.8% in order to generate an award of \$50,000 or more: 0.268 (impairment rating) \times 415 (# of weeks) \times \$449 (weekly benefit) = \$50,000]. In most instances where the employee returns to work, the AMA impairment rating is far less than 26.8%. In fact, 5% to 15% would be more common in these cases. Further, not all claimants are at the maximum weekly benefit. Hence the vast majority of functional disability awards are under \$50,000. Thus, elimination of the \$50k cap is expected to impact system costs minimally.

Recognizing some "utilization" effects as cited above, NCCI estimates the overall impact of the proposed adjustments in the caps to be in the range of 1.7% to 2.8%. These estimates do not consider the removal of caps on fatal benefits, since these would not be changed according to the wording contained within this proposal.

- **Impact of Adjusting Caps by Changes in State Average Weekly Wage (SAWW)**

In addition to the proposed changes to the caps as discussed above, this bill also proposes annual increases to the maximum compensation benefits based on the annual percentage change in the SAWW. Historically, the SAWW has increased by 2-4% per year, though the most recent five years have had an average increase of approximately 3%. If we assume that the maximum aggregate caps for PT, PP, TT and TP would increase by 3% effective 7-1-2006, the overall impact on system cost is estimated to be approximately +0.1% (\$0.5M). Since such a change would occur annually under this proposal, this increase in system costs, or something similar, would occur each year and would likely be incorporated in the annual loss cost filing, as are the current changes in benefits that are tied to changes in the SAWW.

This completes my testimony regarding HB 2447. I will be happy to answer any questions at this time.