



25 Chamberlain St.
P.O. Box 997
Glenmont, NY
12077-0997
(518) 434-3111

**LEGISLATIVE
REPRESENTATIVES**

Patricia Lynch
Allison Lee

**ASSISTANT
EXECUTIVE DIRECTOR
for Government/Industry
Affairs**

Ellen D. Kiehl, Ph.D., CAE

**EXECUTIVE
DIRECTOR**

Diane F. Kattrein, CAE

LEGISLATIVE POSITION

Professional Insurance Agents of New York State Inc.

PIANY supports legislation and additional regulatory steps to further the goals of the 2007 New York workers' compensation reforms and fairly compensate the work that licensed insurance producers perform for clients insured by the State Insurance Fund.

The purpose of this position statement by the Professional Insurance Agents of New York State, Inc. is to comment on the recommendations of the New York State Insurance Department in its Sept. 4, 2007 report to the governor and the legislature ("the Report").

Executive Summary: PIANY position statement on workers' compensation rating

- 1) **Essential legislation to provide a ratemaking system.** PIANY supports essential legislation to provide continuity for the collection and dissemination of New York workers' compensation data, to enable the development of workers' compensation rates on an actuarially sound basis.
- 2) **Designation of CIRB as the state's RSO.** PIANY understands the decision to recommend designating a restructured Compensation Insurance Rating Board as New York's Rating Service Organization for the short term. However, PIANY believes that in making this recommendation and amending CIRB's governance structure to place the Insurance Department at the head of CIRB's Governing Committee, the Department needs to take strong steps to correct the shortcomings of CIRB's performance in the past, and will be responsible for effecting corrective action. In the longer term, PIANY recommends that a closer integration of the rating service function into the Insurance Department itself will continue to be considered.
- 3) **Move to loss cost based rate filings for WC carriers.** PIANY supports a move toward loss cost based rate filings, provided the Insurance Department maintains prior approval authority over the final rate, remains on guard against predatory pricing and takes steps to ensure that rates are adequate to prevent financial impairment. However, PIANY has concerns about the ability of the commercial market to compete successfully with the State Insurance Fund, which enjoys a privileged position as a state-sanctioned competitor. PIANY believes this opportunity should be taken to amend SIF's statutory mandate to include a rate factor to compensate the insured's broker of record for SIF-related services.

Discussion

As required by the Act, the Report addressed issues related to the collection, analysis, and dissemination of data and information in connection with workers' compensation rate development. As required, it analyzes the performance of the current body charged with these responsibilities, the New York Compensation Insurance Rating Board; looks at alternatives to CIRB, whose powers "sunset" as of Feb. 1, 2008; and recommends continuing to authorize CIRB in a somewhat altered form as well as moving to a different method for preparing and filing proposed rate changes for workers' compensation. The Report also provides much useful background information on the process by which rates are set for the industry as a whole and for individual employers and explains how the rating system is designed to promote workplace safety.

The framework for this analysis rests on the recommendations made by PIANY in May, 2006, which set forth a broad outline for workers' compensation reform. The Report takes into consideration a number of points made by PIANY in developing recommendations for reform. We will look at these points and how they would be addressed by the recommendations of the Insurance Department as outlined in the Report.

Each numbered recommendation taken from the Report is followed by PIANY's comments.

1) Amend the statute to allow for Rate Service Organizations ("RSOs") to function in New York and for the exchange of data fundamental to ratemaking to take place.

PIANY, along with all other parties involved in the reforms, understood that the Act deliberately took a very strong step when it not only abolished CIRB but prohibited all similar entities from operating in New York as of Feb. 1, 2008. This step effectively foreclosed the collection and sharing of the data that is necessary to develop workers' compensation rates, going forward.

In effect, that decision committed the parties to taking a second legislative step—enacting changes to ensure continuity, even in the context of reform. In the collaborative effort that led to successful reform legislation, the decision to set a drop-dead date for addressing these issues after more study doubtless seemed sensible. It will be incumbent on all parties to maintain the collaborative spirit and resolve to develop and enact legislation on a timely basis addressing the vacuum left by the "sunset." In the absence of such legislation, we agree with Superintendent Dinallo that a totally unacceptable situation for the New York workers' compensation market would ensue as of Feb. 1, 2008.

2) Designate "in the short term" a "restructured CIRB" to collect and analyze industry wide data.

Marking CIRB for a "sunset" after nearly a century of operations was understood as a strong comment on this body's performance and the propriety of its basic structure. The present opportunity to improve the transparency and responsiveness of the state's rate development

system must not be wasted. PIANY, in its 2006 recommendations, cited a number of problems affecting CIRB's operations in the past. While we recognize that retaining CIRB (and we stress that it should be a significantly "restructured" CIRB) may be the most feasible option at this time, we recommend that these problems be aggressively addressed if CIRB's authority is to be extended for an additional period.

Specifically, our 2006 report identified as problems:

- a. the seeming inability of CIRB to ensure the accuracy of data filed by its member companies, for example the premium data on which carriers' assessments are based;
- b. the need to protect employers against carrier actions that may result in overcharges;
- c. shortcomings in the data collected and maintained by CIRB, so that it reportedly cannot respond to questions about New York's entire spectrum of workers' compensation experience and readily compare New York data on an "apples to apples" basis with experience in other jurisdictions for the purpose of evaluating actual and proposed public policy options;
- d. a lack of comprehensive data, created by the number of players in the workers' compensation market, the fact that no one body appears to collect all the data, and the apparently significant number of employers for whom no data exists because they have been able to evade their responsibilities to obtain coverage;
- e. a lack of reliable and detailed information about the expense components of the workers' compensation system and use of such data in constructive efforts to improve the industry's claims-handling process.

The Report addresses a number of these same points, and ends by giving passing grades to CIRB for all functions except: CIRB's "scoring" of proposed changes in public policy to determine their potential effect on rates; and CIRB's objectivity in preparing rate filings.

PIANY responds favorably to the argument of the Report that "a switch away from a New York-specific RSO" could reduce or eliminate the influence of New York's own business, labor and domestic insurance communities in the rate development process. For this reason, PIANY would not want to see New York contract with the National Council on Compensation. Rather, PIANY prefers that New York side with other populous states like California, Pennsylvania, Massachusetts and Wisconsin in continuing to maintain its own, single-state RSO.

Another factor in PIANY's thinking is that maintaining an in-state, not-for-profit entity also helps protect PIANY members and their clients from the high fees charged by NCCI in other states. The New York workers' compensation rate manual, including rates for all classifications and all revisions, is available at no charge at the CIRB web site, as are all CIRB's frequent updates, bulletins, etc. By contrast, NCCI charges for its manual and yearly manual updates; charges extra to get NCCI bulletins announcing changes; charges for workers' compensation forms; and restricts the availability of some information altogether unless the party is an affiliated NCCI insurer. PIANY questions the propriety of sanctioning a for-profit entity to perform the many essential tasks required by New York's workers' compensation system,

while charging high fees to parties that need access to this information and having the authority to restrict access so some data is available only to insurance companies.

That said, PIANY strongly endorses changes in the governance of CIRB and a much more active role by the Department in overseeing data collection for accuracy and data dissemination for clarity, transparency and completeness. In fact, PIANY believes it is understood that the Insurance Department, in taking this step, would be assuming responsibility for effecting remedies for the shortcomings of CIRB's performance in the past.

With respect to alternative models, we find that insurance producers in New Jersey have had positive experiences with the New Jersey Compensation Rating and Inspection Bureau, which (operating as an arms-length branch of the New Jersey Department of Banking and Insurance) brings a certain degree of regulatory authority to its role, especially in resolving issues relating to employee misclassification. New Jersey CRIB also maintains a liaison program with PIANJ and other producer organizations, providing regular forums where PIANJ can represent its members' concerns and make recommendations for change. So, among the proposed changes at New York's CIRB, PIANY would welcome a similar degree of decisiveness and openness, going forward.

PIANY recognizes the need for continuity and the fact that CIRB could provide the infrastructure to ensure this in the short term. However, we believe that any extension of CIRB's authority should include significant changes along the lines envisioned by the Report, and another opportunity to revisit the possibility for a separate bureau of the Insurance Department to serve as New York's RSO, similar to the New Jersey model. The Report, by outlining the reasons against recommending this option "especially in the short term," does appear to leave this door open.

One advantage of having a state entity collect data could be in attaining greater access to the "missing" data that currently makes it difficult to compare the effectiveness of the various types of players within New York's workers' compensation system, as well as to aggregate New York's total data for purposes of comparison with other states. PIANY believes that some single body should have access to and be able to compile all data, including the financials and underlying claims and expense data of the self-insured trusts, individual self-insured employers including those with large self-insured retentions, and (with the advent of better detection systems) estimated data on the dimensions of the uninsured employer universe and the state's progress toward eliminating it.

This last point is especially important to rate development, since studies using various methodologies have concluded that perhaps 20 percent of all premium dollars are missing from the system due to noncompliance. Together with the current effort by the state to identify misrepresentation of employees as independent contractors, stepped-up enforcement efforts by the Workers' Compensation Board have significant implications for the collection of additional premiums to support the costs of the system.

The oversight or active participation of the Insurance Department also could be helpful in ensuring that CIRB or a similar entity could fulfill other important functions. For example, CIRB at one time nominally maintained a committee on claims. Properly structured, and operating under Department auspices, we envision such a committee could bring together experts from the member carriers and the State Insurance Fund (“SIF”) to help develop resources and best practices for managing claims and restoring injured workers to health most effectively. PIANY believes inefficiencies and frictional costs in claims handling remain a significant factor in New York’s high premium rates. If the commercial market will be prompted by loss cost based rating to become more cost-efficient, they will benefit from the sharing of such information.

Finally, the authority of the Insurance Department could be helpful in implementing features of the Workers’ Compensation Law which could provide extra incentives in the rate for employers to invest in safety equipment and undertake safety consulting programs. We refer here to the programs created by Sections 134 (the “Safety Incentive Program”) and 135 (the “Safety Investment Program”) of the Workers’ Compensation Law in 1996 but so far never actually put into place. PIANY has long believed that the ultimate defense against high workers’ compensation rates is better safety for workers. Whatever obstacles to implementation may have prevented these programs from providing their intended benefits in the past, we would like to see CIRB working actively with the appropriate regulatory bodies to incorporate the incentives of these programs into its rating system.

3) New York should adopt a loss cost approach to rate-making.

Provided that prior approval of rate filings is maintained and the Insurance Department genuinely remains on guard against predatory pricing, PIANY is not averse to moving toward loss cost based rate filings. However, we do caution that it should be implemented very deliberately and with due regard for its potential financial impact on insurance carriers as they transition away from the administered rate system.

Such transitions can be disruptive. When California moved to an open rating system for workers’ compensation in 1995, a period of market turmoil ensued for the state’s insurers. According to *Insurance Journal*, “The numbers reveal that maintaining a share of the California workers’ comp market was a much greater and more immediate priority than producing sound underwriting results” (March 25, 2002). By 2000, California’s Workers’ Compensation Insurance Rating Bureau estimated the state’s insurers were under-reserved by some \$7.1 billion. High-profile insolvencies resulted, led by Superior National Insurance Group Inc., which in 1998 had been the state’s largest private-sector workers’ compensation insurer. In 2000, the California Department of Insurance took control of Superior National, “citing the company’s hazardous financial condition and severe under-reserving” (ibid.). In the following year, the HIH Insurance Group and Sable Insurance Co. failed. Then Fremont General Corp., California’s second largest private workers’ compensation insurer, went under. “Just like Superior National, Fremont’s problems stemmed, in large part, from charging rates that were inadequate to cover their losses and other underwriting costs” (ibid.). In 2002, California-based PAULA Insurance Co. was liquidated after agreeing to cease writing workers’ compensation

business a year earlier. According to the trade group Small Business California, from 2000 to 2003 there were 27 insolvencies in all.

In view of California's disastrous experiment with open rating, we are somewhat reassured that the Insurance Department proposes to retain prior approval authority for New York workers' compensation rates. However, we believe all the vigilance of the Department will be required. Clearly, the Department's long-range plan is to employ market competition to bring about greater efficiencies. Yet, in the short term, insurers feeling this pressure may believe they cannot afford to lose market share. As attractive as lower rates may appear from a public policy standpoint, the Department must remain on guard to help the market maintain underwriting discipline, prevent financial impairment and assure that a California-style spiral out of control does not occur here.

Adding to our concerns in this regard, we note that changes in the handling of reserves to support permanent partial disability claims, effective for awards made on and after July 1, 2007, will concurrently impact the cash flow of these insurers. Commercial carriers (but not SIF) now will be required to transfer these reserves to the Aggregate Trust Fund rather than retaining control of the reserves and the income they generate. In addition, myriad changes are taking place within the system that are expected to produce cost savings and have been priced accordingly in the rates taking effect on October 1, 2007. The more variables, we fear, the more chance for error, whereby insurers' future rate filings could prove inadequate to support the true cost of the system's benefits. So, PIANY would like to hear more about the Department's plans to ensure rate adequacy even as more competition is encouraged.

PIANY: New York's SIF should pay for insurance producer services

Regarding competition, New York's commercial insurance market faces unique problems because of the state's competitive residual market for workers' compensation business (SIF). SIF already operates at a significant cost advantage to private carriers, to the extent it is exempted from certain taxes, is permitted to maintain control of its reserves, and pays nothing for the substantial amount of work provided to its policyholders by the state's licensed insurance producers. SIF's only tax liability is for New York State franchise tax and the MTA surcharge. It is exempt from federal taxation, so SIF pays no taxes on income from its statutorily authorized investments. Again, SIF retains control over its reserves while commercial carriers are required to transfer control of reserves to support longer-payout claims to the state's Aggregate Trust Fund.

The Report does not explore in depth the dynamic the Department would expect to ensue between SIF and the commercial market in the event of a move to loss cost based filings. It speaks about greater competition for the poorer risks (because commercial insurers would newly be enabled to file for rates above the level at which an administered rate would fall). However, the Report does not address the extent to which it believes the commercial market could compete effectively against SIF for average and better risks, and how that success could be supported and encouraged.

As the effects of inadequate rates impaired the capacity of California's commercial carriers to write new business, California's state fund increased from 22 percent to 40 percent of the market. While that may sound high, it really is comparable to New York. In fact, there have been times in recent history when SIF wrote around half of the employers that use insurance policies to comply with workers' compensation law.

New York's SIF maintains an active marketing operation and takes steps, such as its advance-notice cancellation requirements, easy payment plans and an accommodative rating structure, to ensure that it gets and keeps business. The Act does not, and was not intended to, address the belief of some that SIF should truly be a "residual" market. Arguably, SIF, like its counterparts the New York Automobile Insurance Plan and the New York Property Insurance Underwriting Association, should play the part of a "last resort" market instead of an avid competitor against the private sector. The introduction of loss cost based rating raises many questions about whether the keen competitive posture of SIF could become another factor that could drive insurers toward filing destructively inadequate rates, and how that potential should be addressed.

PIANY believes that SIF should incorporate within its rates a factor to compensate New York's insurance producers for the many services they provide to clients who obtain coverage through this state-sanctioned market. Clients whose insurance is placed in SIF rely on their producers to answer questions and provide advice and service, to the same extent as they would if placed in any other market. However, SIF pays no compensation to the insurance producers, although their work effectively subsidizes its operations by handling many situations that otherwise would consume SIF resources to address. Insurance producers either must obtain agreement from their clients to pay a separate fee for such services, or else choose to perform these duties on a completely uncompensated basis, effectively diluting the compensation the producer receives from these clients' other insurance business.

PIANY repeatedly has made the case to SIF for including in its rates a factor that would compensate producers for these services—which are essentially the same services they perform in connection with workers' compensation policies they place with their regular commercial carriers. PIANY has been told that producer compensation would be incompatible with SIF's statutory mandate regarding its rate-setting calculations. At a time where the rating and competitive structure of SIF, relative to the commercial marketplace, is open for discussion, PIANY believes SIF's continued reliance on the uncompensated services of licensed insurance producers is an issue of equity. It should be resolved by amending SIF's statutory rating provisions to provide compensation to the insured's broker of record.

Conclusion

In conclusion, PIANY will remain actively involved in advocating for these points and offers its services to public officials who seek additional information on these and other issues relating to the 2007 workers' compensation reforms.