Bickmore

Self-Insurers and Solvency in California

March 4, 2013

Bickmore

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Mr. Martin Brady
Executive Director
Schools Insurance Authority
9800 Old Placerville Road
Sacramento, CA 95827

RE: Self-Insurers and Solvency in California

Dear Martin:

Attached is a report on self-insurance and solvency risks of private and public sector employers in California. The purpose of this report is to provide information to the stakeholders and regulators so informed decisions can be made on how best to insure the continuation of workers' compensation benefits to injured workers. The Commission on Health, Safety, and Workers' Compensation (CHSWC) has been directed by the California Legislature to conduct and issue a report on the topic of "solvency and performance of public self-insured workers' compensation programs" by October 2013 (Labor Code 3702.4).

This report was prepared by Bickmore on behalf of its clients and organizations that represent both private and public employers. The data contained in this report was obtained from public information sources, primarily the California Self-Insurers' Security Fund and the Department of Industrial Relations, Office of Self-Insurance Plans. We appreciate their continued cooperation and support of the self-insurance sector in California.

Sincerely,

Gregory L. Trout

Gregory L. Trout
Chief Executive Officer

History of Self-Insurance

California has long maintained a system whereby private companies and public entities can self-insure their workers' compensation exposures. Legislation and regulations governing self-insurance first appeared in the 1950s. More stringent requirements were developed and have continued for private self-insurers versus public self-insureds. Private self-insureds are required to post financial security deposits with the state. The purpose of the security deposits is to provide financial resources for the continued payment of workers' compensation benefits to injured workers in the event the private employer becomes insolvent. Public entity self-insureds have never been required to post security deposits.

The first California public entities to become self-insured for workers' compensation were the County of Los Angeles, the City and County of San Francisco, and the City of San Diego. In the 1970s many more cities, counties, educational institutions, and special districts moved from the California State Compensation Insurance Fund (State Fund) to self-insurance. The State of California has also long been permissibly uninsured, although its claims are handled by the State Fund.

The public sector JPA movement began in the mid-1970s: first with the Schools Insurance Authority and the Self-Insured Schools of Kern County in 1974, closely followed by many municipal, county, and special district JPAs in the late 1970s.

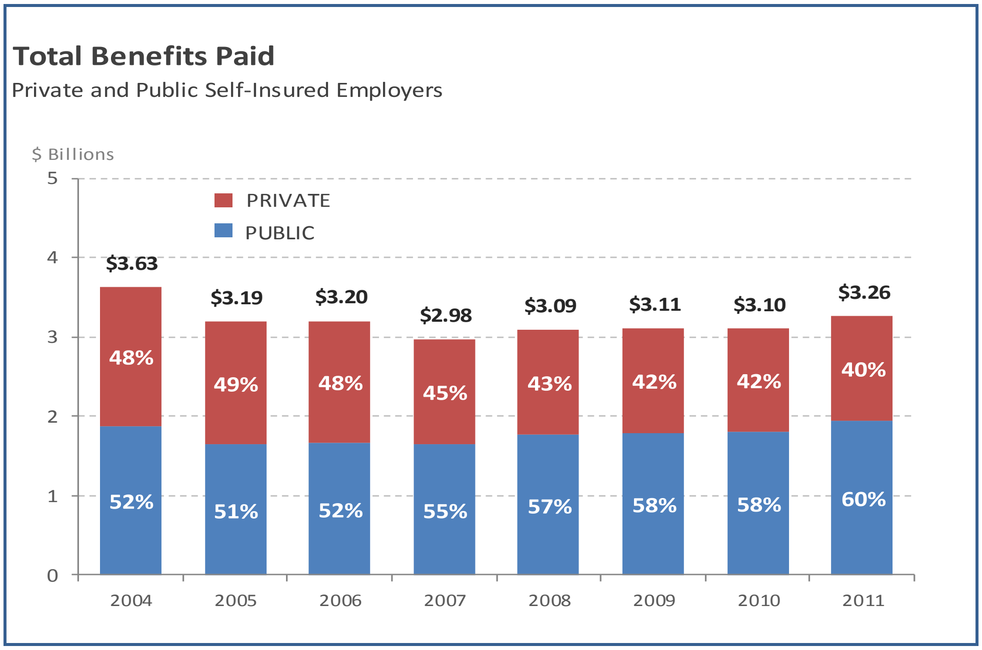
Demographics of Self-Insurance in California (2012)

California has a very significant self-insurance sector, the largest in the United States in terms of number of employers and payroll covered.

- Private Self-Insureds (active)
  - Individual self-insurers 447
  - Self-Insured Groups 22
- Public Self-insureds (active)
  - Individual self-insureds 365
  - JPAs 89
- State of California (permissibly uninsured)

Self-insureds now represent nearly 30% of the overall payroll of all employers in California. Of all self-insureds, the public sector represents 60% of all benefit payments (indemnity and medical) compared to 40% for the private sector (refer to Figure 1). In fiscal year 2010/11, public sector self-insureds paid $1.95 billion in benefits. Private self-insureds paid $1.31 billion.

Figure 1
Benefit Payments by Year
2004 - 2011



A more detailed breakdown between indemnity and medical benefit payments is shown in Appendices A and B.

Insolvencies and Defaults

Public Entity Employers

Since the beginning of public sector self-insurance, a span of over 50 years, no individual public entity or JPA has defaulted on the payment of workers' compensation benefits. There have been a number of bankruptcy filings (Chapter 9) by individual public entities -- Orange County the most notable in the 1990s, and more recently the municipalities of Vallejo, Stockton, San Bernardino, and the Town of Mammoth Lakes. None of these entities has defaulted on their workers' compensation benefit payments.

No self-insurance JPA has ever filed for bankruptcy protection. JPAs are considered special districts under the Government Code and could file under Chapter 9. However, for the nearly 40 years of their existence, no JPA bankruptcy has occurred. Members of a JPA, like private self-insured group members (SIGs), are liable for each other's obligations within the JPA under the joint and several indemnity agreements specified in the Labor Code and required by the Department of Industrial Relations (DIR). Consequently, if a member entity of the JPA were to go into bankruptcy, the other members of the JPA would be jointly and severally liable for the continued benefit payments to the bankrupt member's employees. The JPA could then seek recovery against the bankrupt member as an unsecured creditor.

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Private Sector Employers

The experience of private sector self-insurers and self-insured groups (SIGs) is vastly different from that of the public sector, which has experienced no defaults. The first individual self-insurer to default was Signal Trucking in 1968, and since then there have been 75 defaults (see **Appendix C**). In 1984, California Canners and Growers Cooperative (Cal Canners) defaulted. This was the first time the security deposit posted by the self-insurer was insufficient to cover the defaulted employer's workers' compensation obligations. This default led to the formation of the California Self-Insurers Security Fund (SISF) as the guaranty fund for defaulted private individual and group self-insurers.

Although SIGs were allowed by legislation and regulation in 1993, the first private SIG did not form until 2002. There are currently 22 active and nine revoked SIGs. There has been one default (the Contractors Access Program in 2010). There is concern that others will follow.

Guaranty Funds Protecting Injured Workers

Workers' compensation benefits for employees of *insured* employers are protected by the California Insurance Guarantee Association **(CIGA)** which was created in 1973 as a private non-profit entity. Employees of private self-insurers and self-insured groups are protected by the California Self-Insurers' Security Fund **(SISF).** After the default of Cal Canners, legislation was passed in 1984 (the Young-LaFollette Act) creating SISF as a non-profit mutual benefit corporation which then assumed the payment of workers' compensation benefits to injured workers of all private self-insurers that have defaulted since that date. SISF has continued to serve as the safety net for injured workers, as the security deposits required by DIR have generally been insufficient to pay all the necessary benefits and claims adjusting costs. On average, security deposits have been only about 55% of the ultimate projected costs.

A flow chart (**Appendix D**) shows the sources of recovery from the various types of employer workers' compensation coverage arrangements (insured, individual self-insured, JPA, and SIG). There is no "guaranty fund" or financial backstop for employees of public sector individual self-insurers or JPA member entities. However, to-date there has been no occasion for a public sector security fund to be seriously considered in light of past experience. Formation of an entity similar to SISF was considered by CAJPA in the 1990s, but no action was taken.

SB 863, the workers' compensation reform bill passed in 2012, requires the Commission on Health Safety and Workers' Compensation (CHSWC) conduct a study of "*the costs of administration, workers' compensation benefit expenditures, and solvency and performance of public self-insured workers' compensation programs, as well as provisions in the event of insolvencies*" (Labor Code Section 3702.4). The report is due by October 1, 2013.

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Risk Exposure to Employees of Public Sector Employers

The experience of the past is not necessarily an indication of the future exposure of defaults by public sector self-insurers. The recent recession and continuing financial distress of the public sector has raised concerns about the financial viability of certain public entities, their ability to meet their financial obligations, and the treatment of self-insured obligations in a Chapter 9 bankruptcy proceeding.

The financial risk appears to be highest with cities and school districts. Counties may pose less risk since they are subdivisions of the State, and as such, the State may be the financial guarantor in the event of bankruptcy and default. A similar relationship to the State may also exist with K-12 school districts.

The greatest exposure to injured workers may be with municipalities and special districts that are self-insured outside of JPAs. There has been no evidence that any of the 89 public sector JPAs is financially troubled. Most JPAs operate like assessable mutual cooperatives or insurance reciprocals. Assessments are levied and collected from the members when needed. Non-payment of assessments is generally pursued aggressively by the JPAs. No serious non-payment of assessments has threated the solvency of a JPA, and it is highly unlikely that the members of a JPA would let it fall into bankruptcy.

JPAs provide greater security for the employees of their member agencies because: (1) protection through the Labor Code joint and several liability requirement; (2) the more predictable, stable revenue sources available to the public sector entities compared to private companies; (3) the past proven history of assessment collectability; and (4) the greater financial stability of a group of entities as opposed to an individual entity.

Funding a Public Entity Security Fund

However, if the DIR and public sector self-insureds determine that a public entity security fund is necessary as a safety net for injured workers of public employers, one model to follow would be SISF. The public sector guaranty fund could be funded by assessments as needed following, or immediately preceding, a default. The statute creating SISF in 1984 stated that "….. *no member shall be assessed at one time in excess of 1.5 percent of the benefits paid by the member for claims incurred during the previous calendar year as a self-insurer, and total annual assessments in any calendar year shall not exceed 2 percent of the benefits paid for claims incurred during the previous calendar year.*" (Labor Code Section 3745). This remains in effect.

If a similar funding mechanism were enacted for the public sector, it would generate revenue for benefit payments in the current year as shown in Figure 2.

Figure 2
Potential Annual Revenue from Assessments on Public Sector Employers

	JPAs	PEs	Total
Benefits Paid (Ind & Med) in 2010-11 for Claims Occurred in 2010-11*	$82,000,391	$260,787,971	$342,788,362
Assessment %	2%	2%	
Total Revenue Generated	$1,640,008	$5,215,759	$6,855,767

* Source: Information published on DIR OSIP's website for the Public Self-Insured Annual Report.

However, analysis by Bickmore indicates this total assessment amount would be inadequate to cover the potential cash flow needs from the default of a large municipality, or a number of medium size entities.

Public Sector Defaults -- Options for Consideration

We have identified four basic options for policy makers and stakeholders to consider.

1. **Maintain the status quo.** No public sector defaults have occurred in over half a century, so there does not appear to be a need for any change in the system.

2. **Require security deposits**. This could be a similar system to that imposed on the private sector. The cost to the public sector would be minimal, but a large amount of financial assets would be restricted since most public entities would post cash and securities, not letters of credit or surety bonds. The cost of state regulation would be high, similar to that of the cost of regulating the private sector.

   Many JPAs and individual self-insured entities obtain frequent actuarial estimates of unpaid liabilities and pre-fund those liabilities. The accreditation program of the California Association of Joint Powers Authorities (CAJPA) requires that JPAs receive actuarial estimates and that they be funded with a conservative contingency margin. Many JPAs in California are accredited. Such JPAs and individual self-insureds that identify and fund their liabilities could be exempted from a security deposit requirement, or at a minimum, be allowed to discount their liabilities. Another alternative would be to require security deposits on entities with low credit ratings.

3. **Require that a public entity security fund be created**. Public entities could create a non-profit association similar to SISF and CIGA, or a statewide JPA to insure the payment of benefits to any public entity self-insured or JPA that defaults. The cost of this mechanism could range from minimal to substantial, depending on the mechanism created, the funding requirements, and the number of defaults that might occur in the future.

4. **Require more regulatory oversight**. The DIR, the Department of Finance, and the State Controller's Office of Local Government Fiscal Affairs could assume a more active role in monitoring the financial solvency and default risk posed by public entity self-insureds. This would most likely have a very high regulatory cost and compliance cost. How public entities budget and fund their workers' compensation liabilities varies widely from entity to entity. There is currently no requirement that public entities fund their workers' compensation liabilities or keep reserve funds in separate, discreet internal service or trust funds.

Future Action

If the State of California and other stakeholders are concerned about the exposure of financial failure and default of public sector self-insureds, then the study required by SB 863 should be monitored closely and input provided by public sector organizations such as:

- CAJPA;
- PARMA;
- League of California Cities;
- California State Association of Counties;
- California Association of Schools Boards Association;
- California Association of School Business Officials;
- California Special District Association; and
- Association of California Water Agencies.

The study should include a detailed analysis of the potential risk by types of public entities and their respective legal status under the Federal bankruptcy law. The relationship of public entities to the State of California as a potential financial guarantor should also be closely examined.

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Appendix A

Total Benefits Paid - - Indemnity and Medical

Private and Public Self-Insured Employers

YEAR	PRIVATE TOTAL	(%)	PUBLIC TOTAL	(%)	TOTAL PAID
A	B		C		D=B+C
04 | 03/04	1,743,905,454	(48)	1,883,869,272	(52)	3,627,774,726
05 | 04/05	1,549,850,220	(49)	1,642,577,096	(51)	3,192,427,316
06 | 05/06	1,537,081,925	(48)	1,666,271,661	(52)	3,203,353,586
07 | 06/07	1,327,545,263	(45)	1,647,674,361	(55)	2,975,219,624
08 | 07/08	1,326,292,117	(43)	1,765,756,685	(57)	3,092,048,802
09 | 08/09	1,312,027,763	(42)	1,795,913,616	(58)	3,107,941,379
10 | 09/10	1,290,461,205	(42)	1,812,467,501	(58)	3,102,928,706
11 | 10/11	1,308,905,714	(40)	1,951,024,734	(60)	3,259,930,448
Total	11,396,069,661	(45)	14,165,554,926	(55)	25,561,624,587
Average	1,424,508,708	(45)	1,770,694,366	(55)	3,195,203,073

NOTES

1.) Data from Statewide Totals provided by DIR/OSIP

2.) Total Benefits paid during year (includes all case expenditures)

3.) Private benefits reported on calendar year, public reported on fiscal.

4.) Does not include the State of California.

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Appendix B

Public Self-Insured Employers
Total Benefits Paid - - Indemnity and Medical

YEAR	INDEMNITY PAID	(%)	MEDICAL PAID	(%)	TOTAL PAID
A	B		C		D=B+C
2003 / 04	951,376,796	(51)	932,492,476	(49)	1,883,869,272
2004 / 05	864,997,452	(53)	777,579,644	(47)	1,642,577,096
2005 / 06	897,383,709	(54)	768,887,952	(46)	1,666,271,661
2006 / 07	868,646,105	(53)	779,028,256	(47)	1,647,674,361
2007 / 08	878,439,826	(50)	887,316,859	(50)	1,765,756,685
2008 / 09	846,463,847	(47)	949,449,769	(53)	1,795,913,616
2009 / 10	833,513,351	(46)	978,954,150	(54)	1,812,467,501
2010 / 11	907,485,883	(47)	1,043,538,851	(53)	1,951,024,734
Total	7,048,306,969	(50)	7,117,247,957	(50)	14,165,554,926
Average	881,038,371	(50)	889,655,995	(50)	1,770,694,366

Private Self-Insured Employers
Total Benefits Paid - - Indemnity and Medical

YEAR	INDEMNITY PAID	(%)	MEDICAL PAID	(%)	TOTAL PAID
A	B		C		D=B+C
2004	941,048,533	(54)	802,856,921	(46)	1,743,905,454
2005	860,931,930	(56)	688,918,290	(44)	1,549,850,220
2006	736,255,915	(48)	800,826,010	(52)	1,537,081,925
2007	651,495,095	(49)	676,050,168	(51)	1,327,545,263
2008	593,142,897	(45)	733,149,220	(55)	1,326,292,117
2009	550,287,340	(42)	761,740,423	(58)	1,312,027,763
2010	529,956,700	(41)	760,504,505	(59)	1,290,461,205
2011	550,233,459	(42)	758,672,255	(58)	1,308,905,714
Total	5,413,351,869	(48)	5,982,717,792	(52)	11,396,069,661
Average	676,668,984	(48)	747,839,724	(52)	1,424,508,708

NOTES

1.) Data from Statewide Totals provided by DIR/OSIP
2.) Total Benefits paid during year (includes all case expenditures)
3.) Private benefits reported on calendar year, public reported on fiscal.
4.) Does not include the State of California.

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Appendix C

Private Self-Insured Defaults
As of December 31, 2012

Estate	Year
Signal Trucking	1968
Certified Alloy Products, Inc.	1983
California Canners and Growers	1984
IML Freight Inc.	1985
Leeway Motor Freight, Inc.	1985
Delta Lines	1986
Monolith Portland Cement	1986
Powerine Oil Company	1986
Kaiser Steel Corporation	1987
Knudsen Corporation	1987
United Foam Corporation	1988
Strolee of California	1988
Cook Brothers Equipment Co.	1989
Davis Walker Corporation	1989
Smith Transportation	1989
Foster’s West	1989
James Allen & Sons	1990
Pie Nationwide Inc.	1990
Transcon Lines	1990
Wilson Food Corporation	1990
Yellow Cab of Los Angeles	1990
Richards Rack	1990
Lone Star Industries	1991
R.B. Furniture	1991
Stanford Applied Engineering	1991
United Concrete Pipe Company	1991
Interpace Corporation	1992
Thrifty Oil Company	1992
Intermark, Inc.	1992
Anderson School Equipment	1993
Purity Stores	1993
Gust K. Newberg	1994
Ingleside Lodge Hospital	1994
Los Medanos Health Care Corp.	1994
Los Angeles Soap Company	1995

Source: California Self-Insurers Security Fund, 2013

Estate	Year
Bryant Universal Roofing	1996
Standard Brands Paint Co.	1996
The Pullman Company	1996
Montgomery Ward & Co.	1987
Stueve Bros. Farms	1997
California Stevedore and Ballast	1999
Garrett Freightlines/Anr	1999
Western Union/New Valley Corp.	1999
Applied Magnetics Corporation	2000
Rice Growers Association	2000
Western Medical Enterprises	2000
Homebase, Inc.	2001
San Francisco French Bread Co.	2001
Parkview Community Hospital	2002
Santa Clarita Health Care	2002
Eel River Sawmills, Inc.	2002
Bethlehem Steel Corporation	2003
Dillingham Construction	2003
Fleming Companies, Inc.	2003
Waterman Industries, Inc.	2004
Oakwood Homes/Golden West Homes	2004
Moore Dry Dock	2005
Barth & Dreyfuss of California	2005
West Point Stevens	2006
Rexhall Industries	2006
Lorber Industries, Inc.	2006
Amcast Industrial Corporation	2006
National RV	2007
ASARCO	2007
Mervyn’s	2008
Circuit City	2009
Fairchild	2009
Fleetwood	2009
Triple A Machine	2010
Contractors Access Program of California	2010
Interlake Material Handling	2011
Mid Valley Plastering	2011
Mainstay Business Solutions	2011
T and R Painting and Drywall	2011
Administrative Concepts Corp.	2012
Grossman’s Inc.	2012

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