STATE FUND SUBCOMITTEE STUDY PROPOSAL

A Report Prepared for the

Legislative Finance Committee

By

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INTRODUCTION

At their October 9, 2007 meeting, the Legislative Finance Committee (LFC) heard a staff report on the budget for the State Compensation Insurance Fund also call the Montana State Fund (MSF) and a presentation by fund management. During the discussion, the LFC members expressed concern over the high premium rates being charged for workers' compensation insurance as compared to other states, as well as other concerns regarding MSF management related to budget impacts. In response, LFC formed a subcommittee to examine increasing legislative oversight of the State Compensation Insurance Fund and workers' compensation insurance related to budget impacts. In addition to the four members appointed from the LFC, the chairman invited the chairman of the Interim Economic Affairs Committee appoint two members. The chairman of the Interim Economic Affairs Committee declined to appoint two members at this time.

To assist in establishing a scope for the LFC subcommittee study, the purpose of this report is to provide background information on a number of areas relating to workers' compensation and the MSF. A study of workers' compensation insurance is currently being conducted by the executive branch through the Workers' Compensation Study Project and the Labor Management Advisory Council on Workers' Compensation. The findings resulting from these two projects could be used by the LFC workgroup to examine legislative options for increased legislative oversight of workers' compensation insurance without requiring significant legislative staff resources.

Legislative recommendations from a previous study of MSF are also outlined. Statutes governing the MSF and potential areas for increased legislative oversight through statutory changes are also presented as options for consideration.

WORKERS' COMPENSATION INSURANCE SYSTEM

The workers' compensation system includes several state and private agencies, including the Department of Labor and Industry, Montana employers and their employees, the State Compensation Insurance Fund, private workers' compensation insurance providers, and the court system.

WORKERS' COMPENSATION STUDY PROJECT

In February 2006, the Employment Relations Division in the Department of Labor and Industry (DOLI) established a workers' compensation study project with the purpose of comparing the Montana system – premiums, costs, benefits, and other factors – to selected other states. Conducted by internal staff, the study was to:

- Provide Montana workers' compensation policy makers with baseline information on the current status of the Montana system, as compared empirically and accurately with other states in the region
- Determine primary cost drivers in the Montana workers' compensation system

To solicit input and support for the study, status meetings were held throughout the year to engage the input of stakeholders such as insurers, medical providers, and injured workers.

Findings

As part of the study the Department of Labor and Industry (DOLI) contracted with the Workers' Compensation Research Institute (WCRI) to conduct an administrative inventory of Montana's workers' compensation system. Other studies and information were obtained from the National Council on Compensation Insurance, John Burton's Workers' Compensation Resources, Ingenix, and internal studies. The key findings of the study include:

- Higher frequency of injuries – 57 percent higher than the national average
- High lost time frequency – 50 percent higher than the national average
- Extended return to work periods – 67 percent longer than the national average
- Higher medical costs – cost per case 45 percent higher than the national average

- Higher permanent partial disability medical costs – 25 percent higher than the national average
- Lower percentage of settlements that close medical and indemnity benefits
- Broader benefit structure – medical benefits remain open longer, more workers receive vocational rehabilitation, temporary total disability benefits are not terminated unilaterally when worker reaches maximum medical improvement, more workers receive permanent disability payments
- Different demographic characteristics from 13 other study states – second highest percentage of workers who work for small employers, few large employers, highest age of workers, and lowest percentage of people covered by health insurance

Recommendations

Using this information, the study identified four areas for further review and recommendations for policy changes. They include:

- Safety (injury/illness prevention) issues
- Medical issues
- Return-to-work
- Settlement issues

A second committee was appointed to study these areas.

LABOR- MANAGEMENT ADVISORY COUNCIL ON WORKERS' COMPENSATION

On December 4, 2006 Lieutenant Governor Bohlinger announced the formation of the Labor-Management Advisory Council on Workers' Compensation, established under agency order by the Labor Commissioner. The purpose of the council is to provide a structure for discussion of workers' compensation public policy, with the outcome of making recommendations for proposed legislation to the Labor Commissioner for the 2009 Montana Legislature using the work of the study project. Members appointed to the council include executive government, management and labor representatives: Lt. Governor John Bohlinger; Jerry Keck, Administrator, Employment Relations Division, DOLI; Doug Buman, Laborers' International Union of North America; Jacquie Helt, Unite Here, Local 427; Dan Lee, AFL-CIO; Don Judge, Injured Workers Resource Council; Jason Miller, Montana AFL-CIO; Bill Dahlgren, Operations Manager, Sun Mountain Sports; Annette Hoffman, St. Vincent's Healthcare; Riley Johnson, National Federation of Independent Business; Connie Welsh, Administrator, Health Care and Benefits Division, Department of Administration; and Bob Worthington, Montana Municipal Insurance Authority.

The council's findings and recommendations to date on the four areas identified by the study project are discussed below.

Safety (injury/illness prevention)

Findings

Montana workers are injured at significantly higher rates than other workers in the same industries. Bureau of Labor Statistics show that in 2005 incidence rates of nonfatal occupational injuries and illnesses were higher in Montana than the average for the U.S. The Montana injury rate was higher than the average for these industries:

- Private industry 57.1 percent
- Natural resource and mining 100.0 percent
- Residential building construction 362.5 percent
- Manufacturing 146.7 percent
- Trade, transportation, and utilities 17.6 percent
- Information 114.3 percent
- Financial activities 20.0 percent
- Professional and business services 66.7 percent
- Leisure and hospitality 27.3 percent

Recommendations

Due to concerns with the high levels of injuries suffered by Montana employees, the council recommended that DOLI hire 2 FTE from current positions to begin a safety campaign called WorkSafeMT. The department is in the process of hiring a project manager and a safety specialist to oversee and implement a statewide safety awareness campaign. The program is patterned after a successful program used in British Columbia called WorkSafeBC.

Medical

Findings

Currently, medical fee schedule rates for workers' compensation are 67 percent higher overall than the Medicare rates for the same services. Medicare reimburses medical providers using a resource based relative value scale (RBRVS) with a single conversion factor. However, the current workers' compensation fee schedule rates vary based on seven separate conversion factors. Surgical fees are 153 percent higher and radiology is 151 percent higher than Medicare, while evaluation and management is equal to the Medicare fee. According to the administrative inventory, the spread is significant because the potential for distortion of utilization exists in states if the fee schedules differ significantly from one service type to another as compared to Medicare - the larger the difference, the greater the potential distortion in incentives to overuse the higher-premium services and underuse the lower-premium services. An example would be that higher surgery fees may lead to higher invasive treatment. This seems to be borne out in studies which show that the high cost of medical treatment is due in part to higher than average surgical treatment. In particular, Missoula and Billings have two of the highest back surgery rates in the country.

Recommendations

Issues raised in relation to medical costs have been partially addressed through SB 108 of the 2007 Legislative Session, which provided for utilization and treatment guidelines, and HB 738, which updated the medical fee schedule used to reimburse medical providers. The DOLI revised and adopted a fee schedule for non-facilities based on an RBRVS fee schedule as required by HB 738. The adoption of RBRVS based fee schedules effective January 1, 2008 corrects the inconsistencies between specialties of medical services in the former fee schedule and sets medical provider fees at approximately 67 percent above Medicare reimbursement rates. The new fee schedule should remove the disparity in reimbursement rates between medical specialties and provides stronger incentives for primary care and removes the excessive incentive for invasive procedures.

The fee schedule for facilities is currently being reviewed, and it will be issued in the near future following completion of the review process. The department is examining the effect of utilizing diagnostic related group (DRG) fee schedules, used by Centers for Medicare and Medicaid Services (CMS) to reimburse hospitals. In Montana critical access hospitals, mainly rural hospitals, are exempted from fee schedules and would continue to be reimbursed at 100 percent of their costs for workers' compensation claims. SB 108 also repealed the existing pharmacy rate and allows the rate to be set annually by rule. The goal of this is two fold: 1) cost savings; and 2) retention and assurance of access to pharmacy services.

Utilization and treatment guidelines based on evidence-based best medical practices will be implemented following completion of the process of examining the effects of conversion to DRG methodologies for facilities.

Return to Work

Findings

The study identified that the time it takes to return injured workers to work is 67 percent higher in Montana than the national average. A part of the explanation for this may lie with education of employees and lack of choices to bring injured workers into other positions until they are fully able to return to their previous position.

Research shows that the longer a worker remains out of work due to injury, the less likely they are to return to work. The American College of Occupational and Environmental Medicine (ACOEM) includes the following in their introduction to their guideline "Preventing Needless Work Disability by Helping People Stay Employed":

- *The focus of this paper is on the surprisingly large number of people who end up with prolonged or permanent withdrawal from work due to medical conditions that normally cause only a few days of work absence.*

One consideration of not returning to work is its significant effect on the future wages of the injured employee. Data by DOLI staff indicates that an injured worker in Montana loses 40.5 percent of their future potential wages after injury. In many cases the lost wages result because the injured employee does not return to work.

Recommendations

As part of its review of return-to-work issues, the council requested DOLI explore development of a summit to examine adoption of the ACOEM new work disability prevention guidelines adapted for Montana's unique workers' compensation environment, which includes an older than average work force and greater number of small employers than comparable states.

Settlement

Findings

Montana law allows for lump-sum settlements under certain conditions. For example, permanent total disability benefits may be converted to a lump sum only if the worker demonstrates financial need for the necessities of life; payment of debt; or for a self-employment endeavor. Medical benefits can be settled only when there is a reasonable dispute over the benefits. The administrative inventory determined that settlement of claims occurs much less often in Montana than in other states. In Montana 11 percent of indemnity claims and 3 percent of medical claims are settled through lump sum agreements. According to the administrative inventory a ten state median is 38 percent of indemnity claims settled.

Consideration of this issue will be completed by the council in early 2008. DOLI officials have expressed a willingness to meet with the workgroup to discuss the council's recommendations.

LFC WORKGROUP OPTION

Given the extensive nature of the review of the workers' compensation system currently being undertaken by the executive and their expressed willingness to report to the workgroup, the workgroup may wish to consider having a representative from DOLI report the council's recommendation for policy changes, either statutory or budgetary, following their completion of examining workers' compensation settlement methodologies. This should occur by May 2008.

STATE COMPENSATION INSURANCE FUND

The State Compensation Insurance Fund provides a guaranteed market for Montanan employers to obtain workers' compensation insurance. Currently MSF insures almost 70 percent of the workers' compensation market in Montana and as such is a significant component of the system. MSF is one of three options in that

employers have to provide for their workers' compensation coverage in Montana. MSF is the guaranteed market for Montana employers and is required to insure any employer in state who requests coverage.

PREVIOUS LEGISLATIVE EXAMINATION OF MONTANA STATE FUND

The 2003 Legislature passed Senate Bill 304, a bill directing a committee to study the role of the State Compensation Insurance Fund to determine if it was cost-effective and in the best interest of involved parties to sell all or a portion of MSF assets and liabilities and to create an assigned risk pool. The committee was to make separate determinations on the role of MSF, the sale of assets and liabilities for the Old Fund and the New Fund, and the creation of an assigned risk pool.

The committee issued its report November 2004. The report recommended:

- 1. No sale of the New Fund
- 2. No creation of an assigned risk pool
- 3. Two members of the House and two members of the Senate be assigned as legislative liaisons to the Board of the MSF.
- 4. MSF be assessed premium taxes which are paid by private insurers
- 5. MSF be allowed to bid on third party administrator services
- 6. Department of Administration review the current lease with MSF to determine the fairness of the lease agreement
- 7. The role of the MSF is to guarantee a market for Montana employers and to be a competitive marketplace for Montana employers to purchase their workers' compensation insurance
- 8. MSF is not entitled to have state agencies as an exclusive book of business, and that that business be available for self-insurance or to private carriers in four years.
- 9. No sale of the Old Fund.

The 2005 Legislature passed SB 61, which appointed two legislative liaisons to the State Compensation Insurance Fund Board of Directors and considered HB 189, which would have imposed a phased-in net premium tax on the State Compensation Insurance Fund. HB 189 missed the deadline for revenue bill transmittal. Bills to allow MSF to bid on third party administrator services and to remove state agencies from MSF exclusive book of business were not considered by the 2005 Legislature.

INCREASING LEGISLATIVE OVERSIGHT OF THE STATE COMPENSATION INSURANCE FUND

The LFC workgroup was established, in part, due to concerns about the lack of legislative oversight of MSF, particularly related to the impact of budget decisions on policy rates. MSF currently provides workers' compensation insurance for approximately 70 percent of employers in Montana and as such is a very significant component of the workers' compensation insurance system in Montana. Issues discussed in the budget analysis of the MSF budget completed by Legislative Fiscal Division staff and possible legislative considerations are addressed in a separate report. Possible areas for workgroup consideration of increased legislative budget oversight are presented below.

Current Oversight

The Legislative Audit Division (LAD):

- Issues an opinion on the presentation of the financial statements completed using Governmental Accounting Standards Board standards
- Makes recommendations if concerns relating to compliance with statutes are found
- Evaluates the claims reservation process, the amounts reserved, and the current report of MSF's actuary
- Reviews the rates established by MSF's board to determine if rates are excessive, inadequate, or unfairly discriminatory

LAD also conducts performance audits of various state agencies as decided through the Legislative Audit Committee (LAC) approval of the LAD workplan. The LAC includes the MSF as a priority in the workplan for the current biennium. LAD is currently in the planning phase of a performance audit of the MSF, and areas to be examined during the audit have not yet been determined.

The management and control of MSF is vested solely with the MSF board of directors consisting of seven members appointed by the governor. Four of the members of the board must be state fund policyholders. The MSF is subject to state laws applying to state agencies, except as provided by law, and is exempt from the provisions of the Legislative Finance Act and the provisions of Title 17, chapter 7, part 1 through 4, which outline budget systems and program plans, long-range building programs and budget, supplemental appropriations, encumbrances, and reversions, and budget amendment requirements applicable to other state agencies. However, MSF's board of directors must set an annual budget so that the state fund is neither more nor less than self-supporting. Premium rates must be set at a level sufficient to ensure adequate funding of the insurance program, including costs of administration, benefits, and adequate reserves. In addition, the board must adopt a business plan each year that includes specific financial and operating goals. These goals should set specific standards for senior management, underwriting and claims administration.

The executive director of the MSF is required by statute to submit to the board an estimated budget and upon approval of the budget it is to be submitted to the LFC for review. An annual financial report is to be submitted to the Governor and the legislature. While this provides the legislature with information on MSF board decisions, it does not allow for legislative input on the budget. As noted above, two legislative liaisons are appointed to the board.

Workgroup Options for Consideration of Increased Legislative Oversight

Increased legislative oversight of workers' compensation insurance and MSF could be accomplished through statutory changes or increased reporting on areas of concern and their continued resolution to various legislative committees. As the main cost drivers of high workers' compensation rates in Montana include high injury rates, high medical reimbursements, low rates of claim settlements, and high numbers of workers out of the workforce longer due to injuries, the workgroup may wish to examine how legislators can influence the workers' compensation system through the interim committee process and the continued involvement of the legislative liaisons appointed to the MSF board.

If the LFC workgroup wishes to examine statutes specific to the operations of the MSF, which have less of an impact on workers' compensation rates, but are included as a component of the rates, an examination of the statutes governing MSF could be conducted.

MSF exemptions from the Legislative Finance Act and the provisions of Title 17, chapter 7, parts 1 through 4 may be considered. Other statutes for consideration and their impacts on rates include those relating to the powers of the state fund and the powers and duties of the board. The workgroup may wish to consider specific functions allowed by the statutes such as dividends or employee incentive payments or consider various components of the operations of MSF such as personal services, commissions, technology updates, etc. and examine if statutory changes should be implemented to change the governance of the board over these operational components.

The workgroup could also consider statute governing the cost of administering the New Fund in total. Currently, the MSF has an administrative cost cap of $1.25 million a year for the Old Fund. Previous statute limiting administration costs of the New Fund to 15 percent of earned annual premium were amended to eliminate the requirement due to concerns about MSF ability to comply with the requirements. The workgroup may wish to examine statutory changes to limit the overall amount of administrative charges accessed to rate payers through the loss cost multiplier.

DECISIONS FOR THE WORKGROUP

This report outlines 3 nonexclusive options for the workgroup to consider. The options are presented below.

- Monitor the work of the Labor-Management Advisory Council on Workers' Compensation
- Explore means for establishing mechanisms for continued legislative involvement in the resolution of factors effecting high premium rates
- Examine various statutes governing State Compensation Insurance Fund to increase legislative oversight.

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