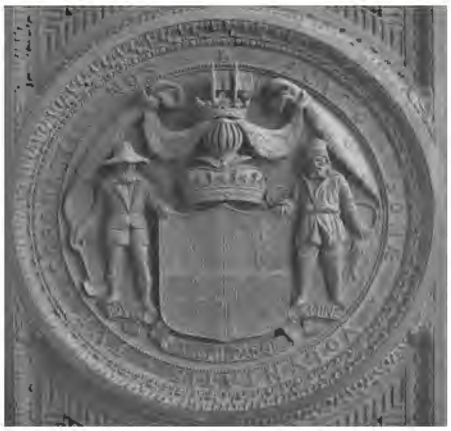
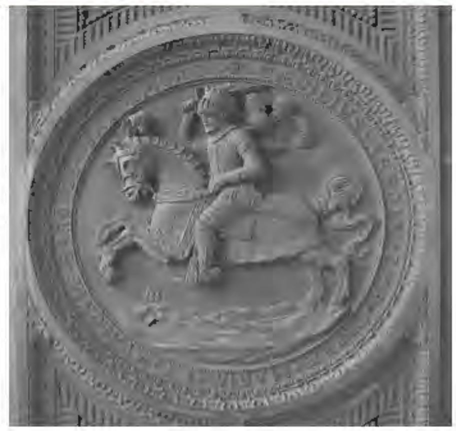
State Workers' Compensation Liabilities





DEPARTMENT OF LEGISLATIVE SERVICES 2019

State Workers' Compensation Liabilities

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

January 2019

Contributing Staff

Writer
Laura M. Vykol

Reviewer
Patrick S. Frank
David B. Juppe
David C. Romans

For further information concerning this document contact:

Library and Information Services
Office of Policy Analysis
Department of Legislative Services
90 State Circle
Annapolis, Maryland 21401

Baltimore Area: 410-946-5400 • Washington Area: 301-970-5400
Other Areas: 1-800-492-7122, Extension 5400
TTY: 410-946-5401 • 301-970-5401
TTY users may also use the Maryland Relay Service
to contact the General Assembly.

Email: libr@mlis.state.md.us
Home Page: http://mgaleg.maryland.gov

Department of Legislative Services
Office of Policy Analysis
Maryland General Assembly

Victoria L. Gruber
Executive Director

Ryan Bishop
Director

January 2019

The Honorable Thomas V. Mike Miller, Jr., President of the Senate
The Honorable Michael E. Busch, Speaker of the House of Delegates
Members of the Maryland General Assembly

Ladies and Gentlemen:

During the 2018 interim, the Department of Legislative Services conducted a review of the State's workers' compensation liabilities. The State is self-insured for workers' compensation claims and provides funding annually to address projected claims; however, since fiscal 2003, the State no longer provides funding to address the unfunded liability. As a result, the unfunded liability has grown over time. As of fiscal 2018, the State's unfunded workers' compensation liability was $445.3 million. The resulting report includes:

- an overview of the State's workers' compensation program;
- a discussion of liabilities and the factors contributing to the increase; and
- recommendations to improve the funding status of the State workers' compensation program.

Laura M. Vykol of the Office of Policy Analysis wrote the report, which was reviewed by Patrick S. Frank, David B. Juppe, and David C. Romans. Katherine K. Hayward was responsible for production of the manuscript. Your questions and comments are welcomed.

Sincerely,

Victoria L. Gruber
Executive Director

Ryan Bishop
Director

VLG:RB/LMV/kkh

Legislative Services Building · 90 State Circle · Annapolis, Maryland 21401-1991
410-946-5530 · FAX 410-946-5555 · TDD 410-946-5401
301-970-5530 · FAX 301-970-5555 · TDD 301-970-5401
Other areas in Maryland 800-492-7122

Contents

State Workers' Compensation Liabilities

Purpose of the Study

The State of Maryland provides workers' compensation benefits if the harm suffered by an employee was an accidental personal injury or occupational disease arising out of and in the course of covered employment. The State is self insured for the purposes of providing these benefits. The State's third-party administrator for workplace injuries is the Injured Workers' Insurance Fund (IWIF), a statutorily created entity and affiliate of Chesapeake Employers' Insurance Company (CEIC).

Funding for the State workers' compensation program is budgeted at the discretion of the Department of Budget and Management (DBM) and then allocated to State agencies' budgets based on historical claims. The appropriation covers IWIF's claims administration costs and projected costs for claims and settlements for that year. The State also previously provided funding to reduce the unfunded liability of workers' compensation claims, but no funding has been provided since fiscal 2003. As a result, the unfunded liability has grown over time; as of fiscal 2018, the unfunded liability is $445.3 million undiscounted or $294.6 million discounted.

The State has an interest in addressing unfunded liabilities, which can call into question the State's ability to meet future obligations and draw attention from credit rating agencies. Failure to address large unfunded liabilities can endanger the State's AAA bond rating that could result in higher costs to borrow money for infrastructure projects and other needs. The State has made efforts to reduce unfunded liabilities in other areas, such as pensions and retiree health care. However, the State does not have a long-term plan to address the unfunded liability for the workers' compensation program.

The purpose of this study is to provide an overview of the State's workers' compensation program, evaluate the funding status, and propose strategies to address the current unfunded liabilities as well as reduce future liabilities.

Entities Involved in the State Workers' Compensation Program

- ***Workers Compensation Commission (WCC):*** WCC is an independent agency within the Executive Branch of the State. The commission consists of 10 members appointed by the Governor, with the advice and consent of the Senate, which serve 12-year terms. WCC administers the workers' compensation law and adjudicates claims for compensation arising under the law.

- ***IWIF:*** IWIF is the State's third-party administrator for workers' compensation with responsibility for initial determinations on compensability of workplace injuries, payment of claims, and negotiation of settlements. Effective October 1, 2013, IWIF's insurance operations were transferred to a new company, CEIC (Chapter 570 of 2012). IWIF remains an instrumentality of the State and an affiliate of CEIC.

- ***CEIC:*** CEIC is a private insurance company self-supported through premium and investment income. CEIC acts as the insurer of last resort in the State.

- ***DBM:*** DBM determines the annual appropriation to fund the State workers' compensation program and assesses the required amount to State agencies' based on historical claims.

Workers' Compensation Overview

Workers' compensation is an insurance program established by State law that all employers having one or more full- or part-time employees are required to have for the benefit of their employees. The cost of workers' compensation insurance is borne entirely by the employer; no payroll deductions are taken out of individual employees' paychecks. To be covered under workers' compensation, an employee must have incurred an accidental personal injury or occupational disease that must have arisen out of and in the course of employment. Not all workplace claims are compensable.

Employees who believe that they have suffered a compensable claim must notify their employer. The employer must then notify the insurance carrier or administrator, who will then notify WCC. If a claim is found compensable, all medical doctor, hospital, physical therapy, prescriptions, and necessary expenses related to the claim are covered by workers' compensation insurance up to limits established by the *Official Maryland Workers' Compensation Medical Fee Guide*. Medical expenses related to the claim may be covered for the injured worker's lifetime unless the claim is settled. The employee may also be entitled to partial income replacement or wage replacement benefits. Wage replacement benefits are based on the employee's average weekly wage that is generally capped by the State average weekly wage and on the type of injury as prescribed in statute. The Maryland Workers' Compensation Act provides for the following benefits as appropriate:

- ***Temporary Total Disability Benefits:*** The time period frequently referred to as the "healing period." If an employee's injury has resulted in a disability that prevents the person from returning to work, that person is eligible to receive temporary total disability benefits.

- ***Temporary Partial Disability Benefits:*** Benefits to which an employee is entitled during the process of recovery when the worker is not totally disabled. Benefits are intended to be temporary and apply only when a worker can perform limited or part-time duties at a reduced income level.

- ***Permanent Total Disability Benefits:*** Benefits provided when a worker is permanently and totally disabled.

- ***Permanent Partial Disability Benefits:*** Benefits provided when a worker is not totally disabled, but the injury has resulted in some permanent impairment.

- ***Death Benefits:*** Benefits provided to eligible dependents and funeral expenses.

State Workers' Compensation Program

In 1914, the State workers' compensation program began as the State Accident Fund, established as part of the State Industrial Accident Commission (Chapter 800 of 1914). The fund was reorganized as the Commissioners of the State Accident Fund, a separate agency, in 1941 (Chapter 504 of 1941). The agency joined the Department of Personnel in 1970 (Chapter 98 of 1970) but then became independent on July 1, 1988 (Chapter 585 of 1987). In 1990, it was renamed IWIF and made an independent State entity (Chapter 71 of 1990).

In 2013, Chapter 570 converted IWIF from an independent State entity into a statutorily created private, nonprofit, nonstock, workers' compensation insurer to be named CEIC. CEIC is subject to – and has all the powers, privileges, and immunities granted by – provisions of the law applicable to other insurers authorized to write workers' compensation insurance in the State. Since 2013, CEIC serves as the workers' compensation insurer of last resort in the State, is generally regulated in the same manner as other authorized property and casualty insurers, and is a member of the Property and Casualty Insurance Guaranty Corporation. However, the company is required to set actuarially sound rates, subject to review by the Insurance Commissioner. In calendar 2013, employees of IWIF were allowed to either continue as IWIF employees or elect to be employees of CEIC. At the time of the transition, 321 employees chose to remain with IWIF. IWIF, as an instrumentality of the State and affiliate of CEIC, continues to serve as a third-party administrator for the State's workers' compensation program.

CEIC is governed by a nine-member board appointed to serve a maximum of two five-year terms (Insurance Article Section 24-307); however, Chapter 36 of 2015 changes the board composition to two members appointed by the Governor and seven members elected by the policy holders. The change in board composition will be phased-in beginning in calendar 2020.

Budgeting and Unfunded Liabilities

The annual budget for the State workers' compensation program is determined via a formula based on the percentage of total CEIC claims administered on the State's behalf, removing expenditures not related to securing the State's business, such as the cost of marketing. The claims paid in a given fiscal year form the basis for the budget two years later – so that the actual fiscal 2018 claims experience informs the State's assessments for fiscal 2020. DBM budgets the entire appropriation at the beginning of the fiscal year; and IWIF, in turn, pays State claims costs.

Financial reporting from IWIF to DBM and the State Treasurer's Office is completed on a monthly basis. The appropriation for the State workers' compensation program is allocated to State agencies' budgets based on prior claims. As shown in **Exhibit 1**, the Department of Public Safety and Correctional Services (DPSCS), the Maryland Transit Administration, the Maryland Department of Health (MDH), institutions of higher education, the Department of State Police, and the Department of Juvenile Services (DJS) accounted for over 80% of the total workers' compensation cost in fiscal 2018.

Exhibit 1
State Agencies' Workers' Compensation Costs
Fiscal 2017

Department/Agency	Workers' Compensation Cost
Public Safety and Correctional Services	$18,364,152
Transit Administration	13,921,018
Health	9,263,128
Higher Education	8,405,920
State Police	6,509,538
Juvenile Services	5,878,303
Other	12,582,426
Total	**$74,924,485**

Source: Department of Budget and Management

Historically, State funding has been provided to IWIF for costs related to annual claims and to prefund the long-term liability associated with outstanding claims. Funding is provided to cover the cost of claims every year, but funding has not always been provided to address the long-term liability. From fiscal 1999 to 2003, the State appropriated $20 million annually to address the unfunded liability, but no funding has been provided since.

IWIF has also been the target of general fund transfers during times of constrained budgets, further depleting the fund's reserves. In fiscal 2003, $114.2 million was transferred from IWIF to the General Fund, per Chapter 440 of 2002 ($39.2 million) and Chapter 203 of 2003 ($75 million) – BRFAs. Transfers to the General Fund also occurred in fiscal 2009 ($28 million) and 2010 ($6 million). **Exhibit 2** shows the growth in the long-term liability since fiscal 2015. As of fiscal 2018, IWIF has a cash reserve of approximately $4.9 million and an unfunded liability of $445.3 million – only 1.1% funded.

Exhibit 2
State Workers' Compensation Claims Unfunded Liability
Fiscal 2015-2018
($ in Thousands)

	Undiscounted		Discounted*	
Year	**Total**	**% Change**	**Total**	**% Change**
2015	$417,861		$294,628	
2016	426,168	2.0%	300,275	1.9%
2017	439,452	3.1%	313,210	4.3%
2018	445,275	1.3%	318,636	1.7%

*Assumes a discounted rate of 4% per the Deloitte Consulting, LLP actuarial study.

Source: Chesapeake Employers' Insurance Company; Deloitte Consulting, LLP

Reducing the State's workers' compensation unfunded liability will require a long-term strategy. The State could take action to address the liability on two fronts:

- prefunding liabilities already in existence; and
- reducing future liabilities through increased settlements and improved worker safety.

Prefunding Liabilities

Prefunding liabilities increases benefit security and, in the long-run, reduces borrowing costs. Prefunding generally allows for a discount rate by actuaries due to increased financial stability, allowing states to reflect a reduced obligation. As demonstrated in Exhibit 2, the State workers' compensation unfunded liability would benefit from a discount rate of 4% if prefunding was provided that would reduce the liability in fiscal 2018 from $445.3 million to $318.6 million, a reduction of $126.7 million. Prefunding also gets the benefit of investment returns and interest payments to add to fund reserves.

Credit rating agencies take into consideration whether a state is prefunding liabilities. High unfunded liabilities can call into question the ability of a state to meet future obligations and can endanger bond ratings that could result in higher costs to borrow money for infrastructure projects and other needs. The State has made efforts to reduce unfunded liabilities in other areas, such as pensions and retiree health care.

Workers' compensation liabilities do not operate under Governmental Accounting Standards Board standards; and, therefore, do not have an actuarial determined contribution recommended to address the long-term liability. However, to ensure long-term stability, prefunding is recommended. In the case of pension reform, the State set a target date of fiscal 2039 for the State's pension systems to achieve 100% funding status. To achieve this goal, the State has increased contributions and payments and, as a result of the increased funding and system reforms, 71.6% funding status has been attained. **The Department of Legislative Services (DLS) recommends that a funding schedule and target date be established to achieve 100% funding of the workers' compensation liability, similar to those established for pension reform.**

Reduction of Future Liabilities

Settlements

There are essentially three statuses of workers' compensation claims:

- ***Open Claims:*** Sometimes referred to as an outstanding claim, open claims mean payments are ongoing, creating a liability for the State.

- ***Closed Claims – Not Settled:*** Closed claims that are not settled mean that all payments have been made as required, but there is nothing preventing the claim from reopening in the future due to the worsening of an injury. Closed claims that are not settled may result in future payments and liabilities for the State for the employee's lifetime.

- ***Closed Claims – Settled:*** Claims that are closed and settled mean that an agreement has been reached with the claimant, and that the State is no longer liable for future payments. Settled claims may not be reopened as a result of a worsening condition. In regard to liability reduction, settled claims are the most effective strategy.

Workers' compensation benefits include medical costs, wage replacement, vocational rehabilitation, death, and funeral costs. Whereas wage replacement payments have been relatively flat due to strict standards and limited salary increases in recent years, medical and prescription drug costs continue to be the primary driver of workers' compensation costs. IWIF has undertaken several initiatives to constrain medical and prescription drug inflation costs, including (1) establishing out-of-state hospital fee guides; (2) contracting with Express Scripts to administer prescriptions for claimants; (3) implementing national standards of care practices in claims systems; (4) hiring of 3 staff physicians; and (5) increasing coordination with hospitals to reduce payment delays and unnecessary extended hospital durations. However, the most effective cost containment for workers' compensation liabilities is to eliminate liabilities through settlement. Settled claims generate savings through avoidance of future liabilities.

Exhibit 3 shows claims settled and savings generated from settlements for fiscal 2017 and 2018. In fiscal 2017, IWIF saved $5.6 million, or 44.6%, of projected costs of claims settled. In fiscal 2018, IWIF generated less savings – $3.2 million – than fiscal 2017 but saved a larger portion of the settled cases – 63.6% of projected costs of claims settled. This indicates that IWIF was able to effectively target the most expensive claims in fiscal 2018 despite reduced funding spent on settlements. While fiscal 2017 shows a reduced marginal return with increased settlement funding, saving $5.6 million (44.6% of projected costs) is still significant, which indicates greater cost savings could be generated if IWIF was provided increased funding to pursue settlements.

Exhibit 3
Settled Claims and Cost Savings Generated
Fiscal 2017 and 2018

	2017	2018
Claims Settled	222	142
Amount Paid for Settlement	$6,932,888	$1,813,348
Total Projected Claims Cost	12,514,821	4,981,767
Cost Savings from Settlement	**$5,581,933**	**$3,168,419**
Percent Cost Saved from Settlement	44.6%	63.6%

Source: Chesapeake Employers' Insurance Company; Injured Workers' Insurance Fund

In comparison to claims settled early, aged claims or claims that have been open for a longer period of time generally result in a lower percentage of costs saved, as shown in **Exhibit 4**. In fiscal 2017, the settlement of aged claims saved 29.5% of total projected claims costs, while other claims saved 49.9%. In fiscal 2018, the settlement of aged claims saved 53.7% of total projected claims costs, while other claims saved 65.1%. While the settlement of aged claims generally generates less savings in comparison to newer claims, the savings of settling aged claims can still be worthwhile – as evident by 53.7% savings of total projected costs in fiscal 2018.

Exhibit 4
Aged Claims vs. Other Claims Settlements
Fiscal 2017 and 2018

	2017		2018	
	Aged	Other	Aged	Other
Claims Settled	27	195	11	131
Amount Paid for Settlement	$2,298,074	$4,634,814	$309,693	$1,503,655
Total Projected Claims Cost	3,257,525	9,257,296	668,747	4,313,020
Cost Savings from Settlement	**$959,451**	**$4,622,482**	**$359,054**	**$2,809,365**
Percent Saved from Settlement	29.5%	49.9%	53.7%	65.1%

Source: Chesapeake Employers' Insurance Company; Injured Workers' Insurance Fund

Funding for settlements fluctuates from year to year and is generally based on funding availability after all operating and ongoing claims' costs have been paid. Settlements tend to increase during better economic times, with more funding provided in the budget, and decrease in times of fiscal constraint. Since settlements are limited by funding availability, IWIF prioritizes settlement opportunities on a claim by claim basis and focuses on claims for back, neck, shoulder, or knee injuries. **Given the cost savings generated and elimination of liabilities as a result of settlements, DLS recommends that increased funding be provided to pursue settlements.**

Improve Workers Safety

Besides settling cases, improving workers safety to reduce incidents of workers' compensation claims is the other way to reduce liabilities. The State Employee Risk Management Administration (SERMA), which originated in 1989 through an executive order and was reissued with each ensuing administration, is the primary advisor and overseer of State agencies' workers safety. The current executive order details the responsibilities of State agencies and risk managers in an effort to establish a safe work environment for all State employees. The executive order also specifies the framework of the SERMA committee that is comprised of representatives from the 14 largest State agencies and IWIF. The SERMA committee meets at least quarterly to discuss workers' compensation and safety needs across the State, share resources, and plan an annual conference.

Managed Return to Work Program

The State also implements an initiative called the Managed Return to Work (MRTW) program for Executive Branch agencies with a goal of providing suitable temporary transitional duty as a bridge back to full normal employment as quickly as medically possible. The initiative focuses on providing suitable transitional work to allow an employee to progressively assume full preinjury duties. Employees who decline transitional duties are placed on leave without pay until they are able to resume full normal duty. While State agencies must comply with MRTW policies that are requirements and procedures published by DBM, participation in the MRTW program is totally voluntary. State agencies that participate in the MRTW program include DPSCS, DJS, and MDH (Potomac Center, Clifton T. Perkins Hospital Center, Spring Grove Hospital Center, Washington County Health Department, Western Maryland Hospital Center, and Holly Center). The Department of Human Services, the Department of Natural Resources, and the University System of Maryland are scheduled to implement MRTW programs in fiscal 2019.

MRTW programs within several large State agencies have been shown to decrease time away from work due to work-related injuries thereby reducing costs, retaining experienced workers, and building morale. **Exhibit 5** shows MRTW program results from fiscal 2014 to 2017.

Exhibit 5
Managed Return to Work Program Results
Fiscal 2014-2017

	2014	2015	2016	2017
Employees Participating in Transitional Duty	299	305	198	226
Percent Participants Returning to Work Full Duty	90.1%	87.1%	82.0%	86.5%
Days Working in Transitional Duty	11,548	8,847	4,481	6,736

Source: State Employee Risk Management Administration, *Annual Report – Fiscal 2017*

MRTW programs are unique in each participating State agency. SERMA believes that the MRTW program could be beneficial if implemented statewide and closely monitored, based on the results of the program to date. However, SERMA states that these programs are being underutilized for many reasons including union concerns and lack of resources to implement and monitor.

Recommendations

Addressing workers' compensation unfunded liabilities require long-term planning. While the State budgets enough to cover claims in a given year, funding has not been provided to address the growing unfunded liability of workers' compensation claims since fiscal 2003. Additionally, the State has exacerbated the issue through multiple transfers of fund reserves to the General Fund during times of economic stress, ultimately resulting in a fund reserve of $4.9 million and an unfunded liability of $445.3 million undiscounted ($294.6 million discounted). In order to address the unfunded liability, DLS recommends the following:

- ***Recommendation 1:*** A funding schedule and target date should be established to achieve 100% funding of the workers' compensation liability.

- ***Recommendation 2:*** Increased funding be provided to pursue settlements, given the benefits of liability elimination and cost savings generated from liability avoidance.