

Reforms Remain Basis for Significant Savings

Legislature Continues Attempts to Roll Back Reform

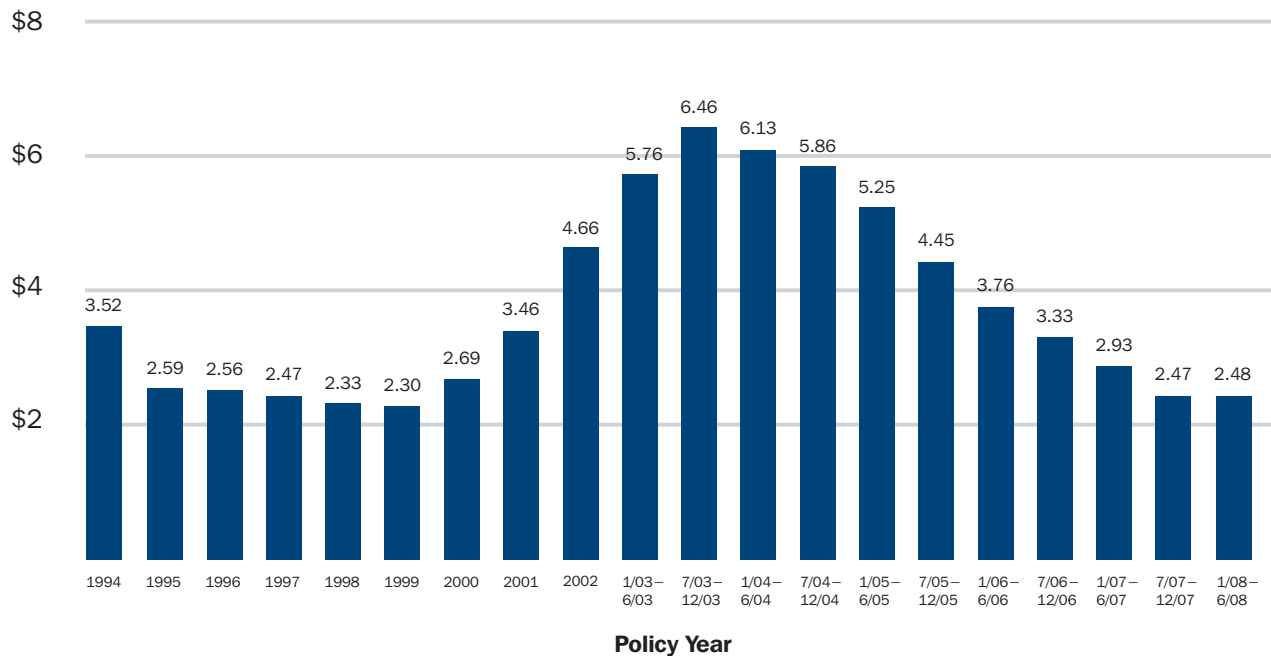
Background

The California workers' compensation system, created in 1913, constitutionally guarantees every worker the right to compensation for workplace injuries and all medical treatment required in order to "cure and relieve" the worker. In the late 1990s, California's system of workers' compensation insurance, which is in a constant state of reform and re-reform, began to see massive cost increases. These increases were the result of over-utilization of medical services, higher-than-normal indemnity benefit costs, and increased litigation. At the height of the workers' compensation crisis in 2003, employers in the state were facing double-digit insurance premium increases, causing California to have the most expensive workers' compensation premiums in the nation.

California's workers' compensation system has undergone major transformation in the last five years. Reforms passed in 2003 and 2004, comprised of SB 228 (Alarcón; D-San Fernando Valley, Chapter 639, Statutes of 2003), AB 227 (Vargas; D-San Diego, Chapter 635, Statutes of 2003) and most importantly, SB 899 (Poochigian; R-Fresno, Chapter 34, Statutes of 2004), have succeeded in bringing balance and fairness to what was a subjective and adversarial system.

The Workers' Compensation Insurance Rating Bureau (WCIRB) estimates that, since the California Chamber of Commerce-supported reforms were passed, insurance premiums have dropped by more than 60 percent. In terms of what an average policyholder pays, workers' compensation rates per \$100 of payroll have decreased from the height in 2003

Average Insurer Rate per \$100 of Payroll



Source: Workers' Compensation Insurance Rating Bureau of California (2008).

of \$6.46 to \$2.48 in 2008. Due to these enormous strides, California dropped from the second most expensive state in the nation in 2006 to the 14th most expensive in 2008, according to the *Oregon Workers' Compensation Premium Rate Ranking Summary*.

The reason for the significant cost decreases is multifaceted, but the vast majority of the decrease has resulted from removing subjectivity from the system and introducing various tools to objectively steer claims along to a reasonable conclusion. Recent reforms altered the way that medical care is authorized in the workers' compensation system. Before the reforms, an injured worker's treating physician could request, and get authorized, virtually any type of treatment.

The introduction of medical treatment guidelines, and implementation of those guidelines through utilization review, has helped bring the cost of medical care back into alignment. Permanent disability (PD) benefits have also benefited from objectivity in that SB 899 completely reformed how PD ratings are established. The American Medical Association guides were instituted as a way of objectively measuring impairment following a workplace injury, and that impairment is then translated into a PD rating. Objectivity in the system has resulted in less friction while providing better care and a fair method of determining impairment, all at a reduced cost.

The decreases in California workers' compensation premiums slowed

during 2008 and now the WCIRB has recommended a 16 percent increase in advisory pure premium rates for policies as of January 1, 2009. This is the first significant increase in workers' compensation premiums recommended by the WCIRB since the adoption of the 2004 reforms. This recommended increase does not reflect potential cost increases that would result from the regulatory adjustment of the PD rating schedule that is currently being considered by the Division of Workers' Compensation (DWC). Another increase could be on the horizon once those regulations are adopted.

Regulatory Efforts

The CalChamber worked to implement the regulations needed to ensure that reforms took effect in 2005 and 2006. Many of the reforms passed in 2004 required extensive regulatory work by the DWC in order to deliver savings to employers.

The CalChamber worked on numerous regulatory packages, including: the PD rating schedule; medical provider networks; independent medical review; utilization review standards; and audit penalties. Although the bulk of the regulations needed to implement the reforms of 2003 and 2004 have been adopted, there is an ongoing effort to review and update the regulations to make sure that the reformed system is working efficiently as planned.

As 2009 begins, the CalChamber believes that the regulatory structure

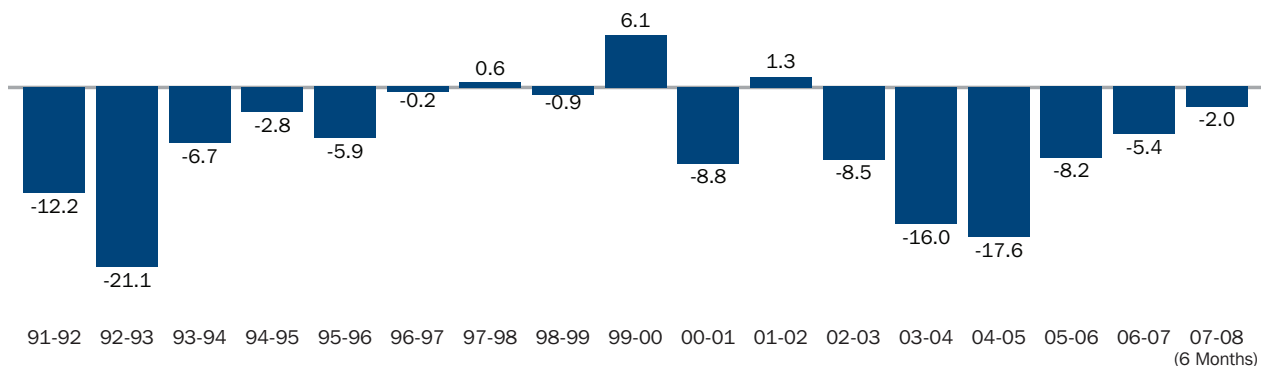
created to implement the recent reforms should be reviewed to ensure that the system is operating as efficiently and fairly as possible. There may need to be some minor adjustments to regulations pertaining to medical treatment guidelines, utilization review, medical provider networks and permanent disability. DWC has already started the process of adjusting the PD rating schedule to ensure that appropriate benefits are being paid to permanently disabled workers.

A Healthy Insurance Industry

Further evidence of the success of the workers' compensation reforms is reflected in the health of the workers' compensation insurance market. The State Compensation Insurance Fund (SCIF) is the state-underwritten carrier of last resort. During the workers' compensation crisis, however, many insurance carriers left the out-of-control California system, leaving more than 50 percent of the market to be insured by SCIF. Such imbalance further hurt policyholders. The number of carriers providing workers' compensation insurance has increased significantly, which has created healthy competition among insurance companies, to the benefit of policyholders.

Some of the reforms of the 1990s, especially the creation of open competition of rates, produced a race to the bottom, thereby forming a precarious insurance market. By 1999, loss ratios, or the ratio of losses to premiums, had reached an astounding 139 percent.

Estimated Percentage Change in Indemnity Claim Frequency by Accident Year (as of 6/30/08)



Source: Workers' Compensation Insurance Rating Bureau of California (2008).

These unsustainable ratios led to the insolvency of many carriers. The systemic reforms of 2003 and 2004, however, allowed carriers to reduce rates naturally while maintaining healthy loss ratios. The combined loss and expense ratio for 2005 is 53 percent. The WCIRB reports that the combined ratios for insurers in California are increasing. The loss ratio for 2006 is currently at 67 percent, and the loss ratio for 2007 is currently at 87 percent. This reflects both an increase in actual losses and an increase in loss adjustment expenses and administrative costs. The increase in insurer loss ratios is a sign that costs in the California workers' compensation system are beginning to rise — premium increases are likely to follow.

Organized labor has repeatedly pushed to regulate workers' compensation insurance rates through legislation limiting the types of insurance policies that are available to employers. The CalChamber and other business organizations have consistently opposed measures that would lead to a one-size-fits-all workers' compensation insurance market in California because the result would be limited options and reduced competition. California employers would no longer have the ability to choose a policy that fits their exact needs and

would see premiums increase because of reduced competition.

Rollback Attempts Persist

Since the passage of the reforms in 2003 and 2004, efforts to roll back the reforms have been increasing steadily. In 2005, bills were introduced that would have created new penalties for employers and increased litigation within the system. Legislative proposals introduced in 2006 dealt with just about every area of significant reform. Bills introduced would have imposed additional reporting requirements on medical provider networks, restricted their use and mandated redundant and costly procedures upon the networks. By far the most contentious legislation in 2006 would have doubled cash awards for permanently disabled workers, undermining reforms that brought objectivity to those very cash benefits.

The CalChamber worked with allies to ultimately defeat any measures that posed a significant threat to the newly balanced and rational workers' compensation system.

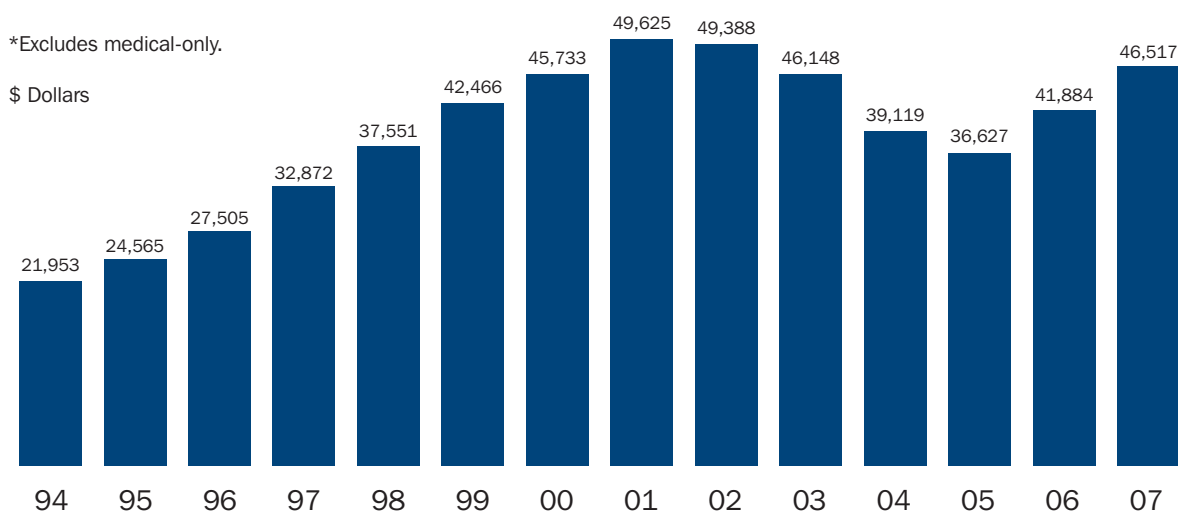
In the 2007-08 legislative session, there was renewed vigor in attempts to roll back AB 227, SB 228 and SB 899. Legislators introduced bills to increase the number of weeks an injured worker

could receive temporary disability benefits; end caps on physical medicine visits that were a cost driver before the reforms; create new penalties on employers; increase the cost of supplemental job displacement vouchers; and double PD benefit payments to injured workers.

● **AB 338** (Coto; D-San Jose, Chapter 595, Statutes of 2007), as initially introduced, would have increased the number of weeks an injured worker can receive temporary disability benefits by 50 percent. In addition, it would have undermined the use of utilization review and created new recordkeeping requirements on employers. The CalChamber worked with Assemblyman Joe Coto and other stakeholders to reach agreement on legislation to resolve an unintended consequence in the current temporary disability cap and also address a problem that resulted from litigation on temporary disability. This compromise legislation ultimately was signed by Governor Arnold Schwarzenegger.

● **AB 2969** (Lieber; D-San Jose) would have required all doctors who make utilization review decisions to be licensed in California despite the fact that the medical treatment guidelines that dictate treatment are nationally based. This 2008 bill would have made utilization review more expensive and may have

Estimated Ultimate Total Loss* per Indemnity Claim (as of 6/30/08) by Accident Year



Source: Workers' Compensation Insurance Rating Bureau of California (2008).

had an impact on the ability to appropriately control medical costs. AB 2969 was vetoed by Governor Schwarzenegger.

● **SB 942** (Migden; D-San Francisco), as introduced in 2007, would have created new penalties on employers, increased litigation and rewritten the rules for supplemental job displacement vouchers. The bill was amended significantly before the end of session, but it still would have required employers to provide benefits to an injured worker when eligibility had not yet been determined. This legislation made the CalChamber “job killer” list and ultimately was vetoed by Governor Schwarzenegger.

● **SB 1115** (Migden; D-San Francisco) attempted to rewrite the rules of apportionment and would have made it significantly more difficult for employers to avoid paying PD benefits for disability that occurred before an industrial injury. SB 1115 made the CalChamber “job killer” list and was vetoed by Governor Schwarzenegger in 2008.

● **SB 1717** (Perata; D-Oakland) was the third attempt in as many years to double PD benefits for injured workers. The bill would have doubled the number of weeks an injured worker would receive the weekly PD award, causing the amount paid to the worker to double. There was no empirical evidence indicating a need for this legislation, and it would have caused a substantial increase in premiums for employers. This legislation made the CalChamber “job killer” list and was vetoed by Governor Schwarzenegger in 2008.

Outlook for 2009

The California Legislature is likely to introduce new legislation to roll back the reforms contained in SB 228 and SB 899. Organized labor and the California

Applicants’ Attorneys Association have sponsored a large number of bills over the last several years in an attempt to turn the clock back to a subjective system.

The CalChamber will again lead a coalition of California employers to defend the reforms and maintain balance in the system.

Permanent Disability

Governor Schwarzenegger has vetoed legislation to arbitrarily increase PD benefits in each of the last three years. The CalChamber has consistently argued that any changes to the PD benefit structure need to be based on empirical evidence. Although some have argued that the mere proof of a decrease in benefits following SB 899 warrants a benefit increase, the CalChamber has argued that any benefit must be based on empirical evidence that PD is not sufficiently compensating injured workers for their loss in future earnings capacity. The DWC has engaged in a significant study on this issue and has determined that a modest increase in benefits is warranted based on the data that has been collected.

The CalChamber supports this modest increase in order to ensure that injured workers are being appropriately compensated and that the rating schedule is based on empirical evidence. The CalChamber will continue to work with the DWC on regulations that preserve balance and equity in benefits paid to injured workers.

Return-to-Work

Many employers and advocates for injured workers believe that the current supplemental job displacement voucher system can be improved to provide a more useful benefit to injured workers and a more streamlined administration for employers. Many employers also are concerned with the workers’ compensa-

tion system and potential difficulties with the interactive process required under the Fair Employment and Housing Act (FEHA). The DWC, in response to concerns expressed by injured workers and employers, convened an advisory committee in 2008 to review reform options. Although no consensus was reached for legislation in 2008, there is hope that there will be legislation in 2009 which will increase return-to-work rates and provide more useful benefits to injured workers.

CalChamber Position

Workers’ compensation costs to employers must continue to decrease to ensure that California remains economically competitive. CalChamber-supported reforms to the system are delivering significant cost savings. Employers must protect and enhance the reforms through both legislative and regulatory work in 2009. The ultimate goal is preserving a balanced system that provides fair benefits to injured workers at a low cost to employers, while minimizing friction in the system.



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