Bickmore Risk Services

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August 2, 2004

Mr. Mike Fleming
General Manager
CSAC Excess Insurance Authority
3017 Gold Canal Drive, Suite 300
Rancho Cordova, CA 95670

Re: Impact of Legislation on Funding Requirements

Dear Mr. Fleming:

As you requested, we have summarized our analysis of SB 899.

Based upon statistics provided by the Workers' Compensation Insurance Rating Bureau (WCIRB) of California, costs incurred in the California workers' compensation system have skyrocketed in recent years, doubling from $5.9 billion in 1998 to $13.1 billion in 2003.

In an effort to bring these costs under control, state lawmakers have enacted a number of changes to the workers' compensation system over the past year. Assembly Bill 227 (AB 227) and Senate Bill 228 (SB 228) were signed by Governor Davis in September 2003, while Senate Bill 899 (SB 899) was signed into law by Governor Schwarzenegger in April 2004. A brief description of SB 899 follows.

SB 899 requires employers to authorize medical treatment within one working day of a claim, creating a liability until the claim is either accepted or denied. Employers are also authorized to establish medical provider networks for providing medical treatment to injured workers.

Under SB 899 temporary disability benefits will now be capped at 104 weeks, down from 240 weeks previously. In addition, the employer is now only liable for the portion of permanent disability directly caused by the present work-related injury.

It should be noted that all benefit level increases for lost wages called for in AB 749 will continue as planned, unaffected by recent reform.

The WCIRB estimates the average savings from SB 899 at 14.7%. This impact is broken down by type of change in the following table:

WCIRB Estimated Impact of SB 899

Immediate Medical Costs	+0.4%
Medical Utilization	-9.4%
Temporary Disability	-2.5%
Permanent Disability	-3.1%
Medical-Legal Evaluations	-0.2%
Total	-14.7%

BRS Estimated Impact of SB 899

Primary Losses	-8.0%
Excess Losses	-10.0%

Note that we are estimating the impact on losses to be less than that estimated by the WCIRB. Overall we anticipate that public agencies in California will see less than average savings from reform over the next few years for a number of reasons. First of all, many public agencies already have some type of safety program in place, while WCIRB estimates include employers which perform little or no risk management. Second, the private sector is generally adding new employees, while the public sector is downsizing. Laying off workers often correlates with higher workers' compensation costs. Third, we anticipate that the percentage of employees who opt out of medical provider networks will be higher in public agencies than in the private sector.

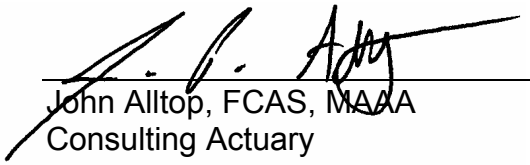
Note that all of these figures are averages; thus, the actual impact on any given employer will vary depending upon that employer's individual risk characteristics. Furthermore, maximizing the savings will not be easy. It will require the establishment of medical provider networks, development of a sound back-to-work program, and the like.

The only thing that is certain about these reforms is that the ultimate impact is uncertain. We'll just have to wait and see if "what goes up, can be legislated down."

We appreciate the opportunity to prepare this review for the EIA. Please feel free to call John Alltop at (916) 691-6119 with any questions you may have.

Sincerely,

BICKMORE RISK SERVICES



John Alltop, FCAS, MAAA
Consulting Actuary

The Latest California Workers' Compensation Reform: SB 899

CSAC-Excess Insurance Authority

Since the passage of SB 899, workers' compensation is no longer business as usual in the State of California. The following is a brief overview of some of the major components of SB 899 and its anticipated impact on workers' compensation costs. This overview is provided by Bickmore Risk Services and includes our opinions on the most significant changes. The cost estimates are based on releases from the California Workers' Compensation Insurance Rating Bureau (WCIRB).

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Content Guide

It is likely you have received numerous overviews of the legislation. Should you like copies of summaries received by Bickmore Risk Services, please contact us. There are varied interpretations of the new legislation and there is little doubt the interpretations will be modified over time with the adoption of the rules and regulations for implementations.

Many aspects of the legislation went into effect on 4/19/04, while others will be effective on future dates, and some are contingent upon the development of rules and regulations by the new Administrative Director appointed 4/26/04.

Financial Impact

SB 899 makes some sweeping changes to the delivery of workers' compensation benefits in California. The WCIRB estimates that the total impact will be a reduction in costs of 14.7% for injuries occurring on or after 7/1/04. The following three areas are projected to have the most impact on workers' compensation costs:

1. Medical Utilization (9.4%): Elimination of presumption of correctness of treating physician, establishment of medical provider networks, and other changes.
2. Permanent Disability (3.1%): Changes related to apportionment.
3. Temporary Disability (2.5%): Most benefits are capped at 104 weeks.

California Educational and Public Agencies

Overall we anticipate that educational and public agencies in California will see less than average workers' compensation savings over the two years for the following reasons:

1. Opting Out of the Medical Provider Network: We anticipate the percentage of employees who opt out of the upcoming medical provider networks will be higher in educational and public agencies than the statewide average.
2. Financial Condition: The private sector in California is generally adding new employees, whereas many educational or public agencies are downsizing. Laying off workers often correlates with higher workers' compensation costs. In addition, SB 899 guarantees that employees will be compensated for some medical costs even on denied claims. This will create an incentive to file a claim, and employees who are concerned about job security or who have been laid off are probably more likely to respond to this incentive.

Part-time employees and volunteers represent a substantial workers' compensation exposure to many educational and public agencies. It appears the treatment of injuries from these workers will be restricted to the workers' compensation medical provider network just as they are for full-time employees. The fact that part-time workers and volunteers are not offered health benefits by the educational and public agency does not affect the application of the workers' compensation medical provider network.

BRS Observations

The broad changes encompassed in SB 899 are bound to bring about both intended and unintended consequences. The following are our observations of this legislation:

1. Uncertain Financial Consequences: It is much more difficult to estimate the monetary impact of SB 899 as opposed to other workers' compensation reform, because many of the changes in SB 899 are procedural. SB 899 changes some of the fundamental ways in which the system works: how doctors are selected, how doctors determine and assign the extent of injury, how disputes are resolved, etc. Quantifying the impact of procedural changes is much more difficult than projecting the likely impact of an increase in lost wage benefits or a decrease in the medical fee schedule. In addition, some of the changes are dependent on future actions of the Administrative Director. The WCIRB could not reasonably estimate the impact of these changes.

2. Financial Impact Will Vary by Employer: Some of the new regulations explicitly impact employers differently. For example, credits/debits for return-to-work programs only apply to private employers with more than 50 full-time employees. Similarly, the doctors which employees can initially turn to in order to treat workers' compensation injuries may vary if the employer offers group health insurance.

3. Reaping the Savings Requires Work: Maximizing the savings from SB 899 will not be easy. It will require the establishment of medical networks, rethinking Agreed Medical Evaluator (AME) panels and having a sound return-to-work program.

4. Importance of High Quality Claim Administration: SB 899 comes on the heels of two other major workers' compensation reforms: AB 749 and AB 227/SB 228. The process of delivering proper benefits to injured workers while minimizing overall workers' compensation costs is now much more complicated than at any other time in recent memory. Failure to comply with all of these regulations will result in fines and lawsuits.

   Most importantly, the claims administrator will take the lead in establishing a medical provider network, which is a key component of realizing savings from SB 899. It has never been more important to make sure that those handling your claims are adequately trained and have reasonable caseloads.

5. Differing Effective Dates for Different Components of SB 899: SB 899 was passed as emergency legislation on 4/19/04. As a result, some of the provisions in SB 899 took effect on 4/19/04, while others take effect on various dates (7/1/04, 11/1/04, 1/1/05).

Medical

Effective immediately, medical treatment under the utilization guidelines must be authorized by the employer within one working day after an employee files a claim form and shall continue until the claim is either accepted or denied. Until the claim is accepted, liability for medical treatment shall be limited to $10,000. Provision of benefits will not be considered an admission of liability.

On or after 1/1/05, employers are authorized to establish or modify medical provider networks for the provision of medical treatment to injured workers. The employer must submit a plan for the network to the Administrative Director for approval. On or before 11/1/04, the Administrative Director shall adopt regulations to establish a plan. Absent a network, the employee will have the right, after 30 days, to select a treating physician or medical facility.

If the employee disputes either a diagnosis or treatment prescribed by the treating physician, the employee may seek an opinion from a second and third physician within the network. If the employee continues to dispute the issue, an independent medical review can be requested. The Administrative Director is tasked with establishing a system of independent medical reviewers effective 1/1/05. If the independent medical reviewer finds in favor of the employee, the disputed treatment can be rendered by a physician within or outside the panel.

Effective immediately, an employee can pre-designate a treating physician only if the employer offers non-occupational group health coverage. The pre-designated physician must be the employee's regular physician, a licensed physician or surgeon, and agrees to be pre-designated as the treating physician. Disputes over the provision of medical treatment will be handled under the Health and Safety Code or Insurance Code depending on the type of non-industrial coverage. Prior to this legislation, there was no provision that an employer offer private health coverage for an employee to pre-designate a treating physician.

Effective immediately, the presumption of a pre-designated personal physician or the primary treating physician is eliminated.

Effective immediately, alternative dispute resolution procedures are expanded allowing employers and groups of employers of union employees to negotiate pilot programs such as 24-hour care.

Temporary Disability

Effective immediately, temporary disability benefits are capped at 104 weeks from the commencement of the first payment of temporary disability benefits except if an employee suffers from any one of the nine injuries or conditions identified in the bill. Prior to this legislation, temporary disability benefits for all injuries were capped at 240 weeks.

When the last payment of temporary disability has been made, a reasonable amount of permanent disability benefits shall be paid regardless of whether the extent of permanent disability can be determined at that time.

Permanent Disability

Effective immediately, with a finding of permanent and stationary, a physician must address apportionment by determining the approximate percentage of the permanent disability caused by the present work-related injury, and what portion was caused by all other industrial and non-industrial factors of disability. An employee claiming industrial injury must disclose all previous permanent disabilities or physical impairments.

Effective immediately, the employer is only liable for the portion of permanent disability directly caused by the injury. Prior awards are presumed apportionable and no combination of disabilities for a single body region can exceed 100% over an employee's lifetime. The seven regions of the body are described as follows: 1) hearing, 2) vision, 3) mental and behavioral disorders, 4) spine, 5) upper extremities (including the shoulders), 6) lower extremities (including the hip joints), and 7) the head, face, cardiovascular system, respiratory system, and all regions or systems not listed in the previous six areas. Of special note, multiple body regions could exceed 100%.

On or before 1/1/05, the Administrative Director is required to revise the standard for evaluating permanent disability from "ability to compete in the open labor market" to "diminished future earning capacity" based on the loss of earning capacity from the occupation at the time of injury. The final determination is to be based on American Medical Association Guides to the Evaluation of Permanent Impairment. This represents a change from permanent disability based on preclusion from any job in the open labor market, whether or not the individual was capable of the occupation prior to the injury.

With the adoption of the adjusted rating schedule, if an employer with 50 or more employees, within 60 days of a disability becoming permanent and stationary, makes an offer of regular, modified, or alternative work lasting at least 12 months, permanent disability payments will decrease by 15%. If the employer does not make an offer of regular, modified, or alternative

work, permanent disability payments will increase by 15%. This will be retroactive to dates of injury prior to 4/30/04, where the employee has not yet been deemed permanent and stationary.

Effective 1/1/05, the number of weeks of permanent disability benefits is increased for ratings above 70% and decreases the number of weeks for permanent disability benefits rated 15% or below.

Vocational Rehabilitation

Effective 1/1/04, eligible small private employers (with 50 full-time employees or less) will be allowed to apply for reimbursement of expenses for workplace modification and special equipment necessary to return workers to work who were injured on or after 1/1/04. Reimbursement is limited to a maximum of $1,250 for temporary modifications and $2,500 for permanent modifications per employee.

Effective immediately, vocational rehabilitation services are re-instituted for injuries on or before 12/31/03, and in effect until 1/1/09, unless newly enacted legislation amends the date. Injuries after 1/1/04 are subject to the displacement benefit created in 2003. This is a clarification to prior legislation passed in 2003.

Medical-Legal Process

Effective immediately, there is a new medical-legal process for unrepresented workers referring all disputes regarding disability to a panel of Qualified Medical Evaluators (QME) and for represented workers to AME for resolution. Prior to this legislation, employers had the right to select a physician to comment on disputes regarding compensability and disability.

For an unrepresented employee, the employee is to request a QME panel. Time frames have been established to allow the employer to request the panel if the employee fails to do so and select and schedule the appointment should the employee fail to do so in a timely manner.

For represented employees, an AME may be utilized or effective 1/1/05, a QME panel may be requested by either party. Each party will have the right to strike one name from the QME panel and proceed to evaluation with the remaining panel QME. This panel QME must be utilized to determine any future issues as well.

The new legislation also clarified that, effective immediately, all workers' compensation findings of fact be interpreted in an impartial and balanced manner in order that all parties are considered equal before the law. Labor Code Section 3202.5 indicates all parties shall meet the evidentiary burden of proof on all issues by a preponderance of the evidence in order that all parties are considered equal before the law. However, it should be noted that Labor Code Section 3202 requiring liberal interpretation by the courts regarding injured employee benefits remains in place.

We will continue to monitor development of the Rules and Regulations for implementation guidelines and clarification on interpretation and the intent of the legislation. Keep in mind that SB 899 did not repeal the benefit increases contained in AB 749. As such, we will not know the full effects of the new legislation for several years. Attach is a quick reference guide. A complete copy of SB 899 can be found at www.leginfo.ca.gov/bilinfo.html.

Frequently Asked Questions

◆ **Q1**: I have heard that the WCIRB expects SB 899 to reduce workers' compensation costs by 14.7%. I have also heard that the WCIRB is recommending a rate decrease of under 3.0%. Which is true?

A1: Actually, both are true. The Department of Insurance approved 2004 rates that were roughly 12% lower than what the WCIRB recommended. Therefore the current rates are already 12% inadequate in the eyes of the WCIRB. Since the WCIRB estimates that SB 899 will lower costs by 14.7%, the recommended reduction to the current rates is slightly below 3.0%.

Q2: How will SB 899 affect the rates my insurance company is charging?

A2: It is up to each individual insurance company to decide how to adjust their rates for SB 899. In California, insurance companies are free to charge whatever rates they deem appropriate. The rates recommended by the WCIRB and those approved by the Department of Insurance are merely advisory rates.

◆ **Q3**: Will SB 899 affect my current open claims?

A3: Many of the provisions in SB 899 took effect 4/19/04 and impact claims associated with injuries on or after that date. In addition, some of the medical utilization changes that took effect on 4/19/04 apply to all open claims. For example, if an injured employee has already had treatment that exceeds what is outlined in the utilization guidelines, the claims administrator can refuse to pay for further treatment. Lastly, it is unclear if the medical provider networks will apply to open claims.

◆ **Q4**: What are some of the effects of SB 899 aside from the cost of losses?

A4: We anticipate that SB 899 will cause the following:

1. Increased Frequency of Nonzero Claims (Long Term): In the past, medical benefits were not paid on rejected claims. After SB 899, up to $10,000 in medical benefits are provided until the time a claim is denied. Thus, claims which used to have no medical costs will now have a cost. The WCIRB estimates that 5% of all claims are denied. In addition, this new provision in SB 899 provides a greater incentive to file a claim, which will also increase claims frequency.
2. Increased Frequency of Litigated Claims (Short Term): Many of the provisions in SB 899 will ultimately need to be settled in the courts. Until the legal issues are resolved, we believe there will be an increase in legal disputes.
3. Increased Uncertainty of True Costs (Medium Term): The effects of many of the provisions in SB 899 are very difficult to quantify, and the final impact will not be known for years.
4. Speed-Up of Payout of Medical Costs: Various provisions in SB 899 generally increase the speed in which initial medical payments are made and are intended to decrease some of the payments that are made many years after an injury occurs. On balance this should speed up the overall payment rate of medical benefits.
5. Claims Administration: The WCIRB estimates that SB 899 will lower claims handling costs by 9%, mostly due to decreased penalties for late payments. If your penalties are already minimal, you may not realize these savings. The WCIRB also notes there are several provisions regarding medical utilization, immediate medical care, and disputes over medical treatment that could increase claims administration costs. In the short term, fully and effectively implementing SB 899 will require substantial training and effort on behalf of claims administrators. This cost may not be passed on to the employer, but it is a real cost to the claims administrator.

◆ **Q5**: Are there further potential savings due to SB 899 that the WCIRB did not quantify?

A5: Yes. There are a few provisions related to permanent disability benefits the WCIRB did not quantify because they are dependent on the adoption of a new schedule by the Administrative Director. This is scheduled to be adopted on 1/1/05, and according to one expert, could produce additional savings of 7% - 8%.

◆ **Q6**: Did SB 899 rescind any of the benefit level increases in AB 749?

A6: No. Benefit levels will continue to increase as outlined in AB 749, which took effect 1/1/03 and set in motion scheduled increases in indemnity benefits for injured workers. The benefits increase according to the set schedule through 2006. Commencing in 2007, benefits will increase based on cost of living adjustments.

Effective Dates and Estimated Savings for SB 899

(Changes apply to all date of injuries unless noted otherwise)

2004		
Effective Date	**Regulation Changes**	**Estimated Savings**
April 19	Employers must provide medical care within one working day of the filing of a claim form up to a maximum of $10,000, whether or not the claim is delayed.	0.4%
	An employee can pre-designate a treating physician only if the employer offers non-industrial health care coverage.	*9.4%
	The presumption of the treating physician is eliminated.	*
	Alternative dispute resolution procedures for unionized employers are expanded.	N/A
	With a finding of permanent and stationary, physicians must approximate the percentage of permanent disability caused by the present work-related injury and employers are only liable for that portion of the permanent disability.	3.1%
	Permanent disability benefits are capped at 100% for a single body region (7 regions identified).	Included Above
	Temporary disability benefits are capped at 104 weeks except for designated injuries or conditions.	2.5%
	Reasonable permanent disability benefits must be advanced subsequent to the last payment of temporary disability benefits.	N/A
	Vocational rehabilitation services re-instituted for injuries on or before 12/31/03.	N/A
	New medical-legal process established for unrepresented employees to refer all disputes regarding disability to a panel of QMEs	0.2%
	All parties are considered equal before the law. However, the judges are still required to interpret the laws in favor of the employee.	Included Above
July 1	Private employers with fewer than 50 full-time employees are eligible to request limited reimbursement of expenses necessary to return employees to work. This applies to employees injured on or after 7/1/04.	N/A
Nov. 1	Administrative Director is required to develop regulations to implement the Medical Provider Network program.	*
2005		
Jan. 1	Employers may utilize medical provider networks once approved by the Administrative Director.	*
	If an employee disputes the diagnosis or treatment, a 2nd and 3rd opinion within the medical provider network prior to a referral to an independent medical reviewer.	*
	Administrative Director is required to adopt regulations to implement changes to the permanent disability schedule on or before 1/1/05.	N/A
	With the adoption of the revised rating schedule, permanent disability payments will be adjusted for employees not declared permanent and stationary by 4/30/04. Payments are decreased by 15% for employees offered regular, modified, or alternative work lasting at least 12 months. Payments are increased by 15% for employees not offered return to work.	N/A
	The number of weeks of permanent disability benefits below 15% will decrease and the number of weeks of permanent disability of permanent disability above 70% will increase.	N/A

* 9.4% estimated savings for all medical benefits referenced herein

Providing **direct answers**

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For more information, you may contact
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