

MEMORANDUM

February 7, 2013

To: Management-Labor Advisory Committee

From: John Shilts, Administrator

Subject: Self-insurance overview

All Oregon employers subject to ORS chapter 656 must provide assurance that their subject workers will receive compensation for compensable injuries. Per ORS 656.017, employers must do so in one of the following two ways:

1. As a carrier-insured employer; or
2. As a self-insured employer as provided in ORS 656.407.

This memorandum describes the main components of the current self-insurance program in Oregon.

Carrier-Provided Insurance

Oregon employers who meet their obligation as a carrier-insured employer pay a workers' compensation insurance company to finance their risk of occupational injury or disease of their employees. Insurers provide a variety of insurance plans and pricing for coverage that is closely indexed to the employer's injury history, nature and type of work done by employees, and expected losses.

Self-Insurance

In Oregon, employers who wish to be self-insured must apply to do so with the Department of Consumer and Business Services (DCBS). To qualify for self-insurance, employers must meet certain criteria, provide assurances they can process claims promptly, and show that they have the financial ability to make certain and prompt payments that are due by the law and administrative rule.

An employer can be individually self-insured or as part of a self-insured employer group. Generally, all self-insured employers are required to post financial security with the department

that is reasonably sufficient to ensure payment of compensation and the cost of paying for the administration of compensation for all amounts that may become due.

A self-insured employer directly assumes responsibility for providing compensation due subject workers or their beneficiaries. They are subject to all the same claims management rules as an insurer. They may self-administer claims management or arrange for claims management services through a third-party vendor in Oregon. Below, we cover in more detail the requirements and information for the two types of self-insurance currently available for individual employers and groups of employers.

Self-Insurance Assessments and Reserve Funds

Like carrier-insured employers, self-insured employers are required to pay a premium assessment which provides revenue for the operation of the workers' compensation regulatory, enforcement, and administrative functions at DCBS. For carrier-insured employers, that rate is based on a percentage of premiums charged. For self-insured employers, an estimated premium is calculated and the assessment rate is based on that premium. An additional 0.2% assessment is added to self-insured employers' assessment rate to provide revenue for two funds:

1. Self-Insured Employer Adjustment Reserve (SIEAR); and
2. Self-insured Employer Group Adjustment Reserve (SIEGAR)

These two small reserves are used as a bridge to make claim payments on behalf of workers or their beneficiaries in the event a self-insured employer or group becomes insolvent or defaults, but prior to the department calling on their security deposit. The reserves are also used to make payments in the event the funds in the security deposit are exhausted and benefit payments are still due. Currently, DCBS is making payments from these funds for 11 individual self-insured employers. In calendar year 2011, the department paid \$1,219,238 in claims benefits on 52 claims from the SIEAR. Some payments were offset by reimbursements for cost-of-living adjustments from the Retroactive Reserve and reimbursements from excess insurance, so the actual amount ultimately expended is quite a bit less.

Individual Employer Self-Insurance

Oregon has 125 individual self-insured employers, representing 166 business entities. Approximately 97 are private employers and the remaining are public entities such as cities and counties. A primary concern in qualifying an employer for self-insurance is that the employer demonstrates a high likelihood of success in meeting the statutory objectives for the Oregon workers' compensation system detailed in ORS 656.012 (see below). This is determined in a review by DCBS that starts with the employer applying for certification to become a self-insured employer.

Qualifications for an Individual Self-Insured Employer

To qualify as an individual self-insured employer, the employer must:

1. Establish proof that the employer has an adequate staff qualified to process claims, per administrative rule requirements;
2. Establish proof of the financial ability to make certain the prompt payment of all compensation and other payments due under ORS chapter 656; and
3. Obtain excess insurance coverage in the amounts approved by the director.

An employer establishes proof of financial ability to the director by providing a security deposit that the director determines is acceptable under administrative rules. Currently the department only accepts surety bonds and irrevocable letters of credit made payable to the director. More discussion of the security deposit is below.

Failure of a certified self-insured employer to continue meeting these criteria will result in revocation of the employer's self-insured certification after a written notice process. Revocation can be done in less than 45 days.

Applying for Certification as a Self-Insured Employer

An employer applying for certification as a self-insured employer must submit:

1. A completed "Application for Self-Insurance" (Form 440-1868);
2. Proof of the employer's claims processing ability and the information about processing the employer's claims in Oregon;
3. The employer's audited financial statements or audited annual reports for the last three fiscal or calendar years;
4. The employer's most recent experience rating modification worksheet and supporting documentation;
5. The type, retention, and limitation levels of excess workers' compensation insurance the employer is planning to obtain;
6. If applicable, within 30 days after the date of certification, the signed service agreement between the employer and the service company that will process claims. The agreement must also contain the location, mailing address, telephone number, and any other contact information of the service company;
7. Evidence from a surety bond company that they will issue a surety bond for the employer, listing the Oregon Department of Consumer and Business Services as the obligee or evidence from a qualified bank that they will issue an irrevocable standby letter of credit for the employer with the Oregon Department of Consumer and Business Services as the beneficiary;
8. Evidence of an occupational safety and health loss control program; and
9. Evidence of authorization to do business in this state under ORS chapters 58, 60, 62,

63, 65, 67, 70, and 648, as applicable.

Within 30 days of receipt of all information required above, the director reviews the application and notifies the employer that the request for certification as a self-insured employer is approved or denied. If denied, the reason for denial is provided. If the director approves the application, the notice informs the employer of:

1. The type and the amount of the security deposit required;
2. Approval of the type, retention, and limitation levels of the excess insurance; or
3. The type, retention, and limitation levels of excess insurance required.

The certification of self-insurance is issued upon receipt of the security deposit and the appropriate excess insurance binder and is effective the first of the following month.

Security Deposit Requirement

A self-insured employer is required to provide a security deposit that is acceptable to the director as being sufficient to cover future claims payments and the cost of administering those payments. Currently, a surety bond or an irrevocable standby letter of credit (ISLOC) are the two types of security that are accepted by the director. The performance of the security deposit is triggered by specific financial events, such as employer bankruptcy filings and defaults. These instruments typically can be “called” immediately upon the occurrence of those events and the funds become available to pay claims expenses within a few days. Letters of credit must include a statement that the funds provided are not construed to be an asset of the self-insured employer and a statement that if legal proceedings are initiated by any party with respect to the payment of the security, it is agreed that such proceedings must be subject to the jurisdiction of Oregon courts and Oregon law.

For existing self-insured employers, the annual security deposit requirement is determined by the director. Subject to a minimum amount, the deposit must be no less than the greater of:

1. Future claim liability, including losses incurred but not reported, a claims processing administrative cost, and the anticipated assessments payable to the director for the employer’s next fiscal year; or
2. The annual incurred losses for the self-insured’s last fiscal year, including IBNR, a claims processing administrative cost, and anticipated assessments payable to the director for the employer’s next fiscal year.

If the employer is applying for self-insurance, the amount of the first security deposit is based on factors including anticipated assessments payable to the director and a share of what premium would have been if the employer were carrier-insured, specific thresholds based on the employer’s net worth, or based on the approved self-insured retention level for the

employer's excess workers' compensation insurance.

Generally, in determining the amount of deposit the director must consider the financial ability of the employer to pay compensation and other payments due, the employer's probable continuity of operation, retention and limitation levels of the employer's excess insurance in relation to the employer's financial status, changes in the employer's business such as mergers or acquisitions, changes in employment level, nature of employment, claims costs, or material growth in their self-insured exposure, and the balance of the Self-Insured Employers Adjustment Reserve.

The adequacy of the security deposits are reviewed by the department regularly. The review includes an audit of claims liabilities, financial reporting from the employer, and a review of the self-insured employer's net worth and ability to pay future liabilities.

Federal bankruptcy courts may or may not deem workers' compensation liabilities as a priority for payment. Oregon law used to allow security deposits to be in the form of cash and government securities. Because bankruptcy courts have often decided that cash and securities were assets of the bankruptcy seeking employer, they were no longer reliable securities for payment of future workers' compensation liabilities. Thus, the legislature provided the director the authority to determine by rule the types of security that are acceptable to secure these long term liabilities to protect injured workers and their beneficiaries, and cash and securities are no longer accepted as surety.

Excess Insurance Requirement

A self-insured employer must have excess workers' compensation insurance coverage appropriate for the employer's potential liability with an insurer authorized to do business in Oregon. The excess insurance must include a provision for reimbursement to the director of all expenses paid by the director on behalf of the employer. When an excess insurance policy is canceled by the excess insurer or the employer, the notice must be filed with the director 30 days prior to the effective date of cancellation. Changes in the self-insured retention level and policy limits of the excess insurance require prior approval of the director. Items considered in determining and approving the retention and limitation levels of the excess insurance will be the employer's financial status, risk and exposure, claim history, and the amount of security deposit.

Excess insurance does not relieve any self-insured employer from full responsibility for claims processing and the payment of compensation required under ORS chapter 656. Regardless of the types and amounts of excess coverage, a self-insured employer may not transfer claims to an excess insurer for processing.

Annual Reporting Requirements

To determine the financial status of a self-insured employer and to evaluate the employer's continuity of operation, most self-insured employers must annually file an audited financial statement or annual report with audited financial statement for the just-completed fiscal year. The self-insured employer must report claim loss data for the purposes of experience rating

modification, retrospective rating calculations, and determining deposits. The report must be certified by an authorized representative of the self-insured employer and meet standards in the administrative rules. The director may require a self-insured employer to submit claim loss data more frequently if the nature of the self-insured employer's business has changed since the last annual loss report.

Group Self Insurance

As of July 1, 2012, Oregon has five self-insured groups covering 1,054 employers. Two of the groups consist only of public entities, covering over 800 cities and counties. Three self-insured groups are made up of about 250 privately owned employers.

To qualify as a group self-insurer and to maintain authorization to operate as a group self-insurer in Oregon, the group must include at least five members and meet certain operating and financial requirements. The employers must have a combined net worth of \$1 million or more, the director must find the grouping is likely to improve accident prevention and claims handling, and the group of employers must agree to be jointly and severally liable for payment of compensation and other amounts due incurred by any member of the group. Other requirements for the group include maintaining:

1. Excess insurance;
2. A security deposit, in the form of an ISLOC or surety bond;
3. Meeting many of the same criteria as for an individual self-insured employer (some cities and counties may be exempt from the security deposit requirement in specific circumstances); and
4. A common claims fund equal to 30% of known future liabilities from which to pay claims costs.

In order to provide sufficient security that covers the costs of incurred claims and separately finance the expenses of operating as a group, group members must provide regular "premium" payments (or "member assessments") to the group administrator. In the event of a default or insolvency of a group self-insurer, participating members are held jointly and severally liable for the unpaid obligations of the group incurred during the time of the employers' participation.

656.012 Findings and policy.

(1) The Legislative Assembly finds that:

(a) The performance of various industrial enterprises necessary to the enrichment and economic well-being of all the citizens of this state will inevitably involve injury to some of the workers employed in those enterprises;

(b) The method provided by the common law for compensating injured workers involves long and costly litigation, without commensurate benefit to either the injured workers or the employers, and often requires the taxpayer to provide expensive care and support for the injured workers and their dependents; and

(c) An exclusive, statutory system of compensation will provide the best societal measure of those injuries that bear a sufficient relationship to employment to merit incorporation of their costs into the stream of commerce.

(2) In consequence of these findings, the objectives of the Workers' Compensation Law are declared to be as follows:

(a) To provide, regardless of fault, sure, prompt and complete medical treatment for injured workers and fair, adequate and reasonable income benefits to injured workers and their dependents;

(b) To provide a fair and just administrative system for delivery of medical and financial benefits to injured workers that reduces litigation and eliminates the adversary nature of the compensation proceedings, to the greatest extent practicable;

(c) To restore the injured worker physically and economically to a self-sufficient status in an expeditious manner and to the greatest extent practicable;

(d) To encourage maximum employer implementation of accident study, analysis and prevention programs to reduce the economic loss and human suffering caused by industrial accidents; and

(e) To provide the sole and exclusive source and means by which subject workers, their beneficiaries and anyone otherwise entitled to receive benefits on account of injuries or diseases arising out of and in the course of employment shall seek and qualify for remedies for such conditions.

(3) In recognition that the goals and objectives of this Workers' Compensation Law are intended to benefit all citizens, it is declared that the provisions of this law shall be interpreted in an impartial and balanced manner.