STATE OF MINNESOTA

DEPARTMENT OF COMMERCE

In the Matter of the Proposed
Rules Governing Administration of the
Workers' Compensation Assigned Risk Plan
4 MCAR § 1.9500 - § 1.9505

STATEMENT OF NEED
AND REASONABLENESS
OF PROPOSED RULES

STATEMENT OF AUTHORITY

Minn. Stat. § 79.251, subd. 3 (Laws of 1983, ch. 290, sec. 5) requires the Commissioner of Commerce to adopt a rating plan, including a merit rating plan, for establishment of workers' compensation assigned risk premiums. A rating plan, as defined in Minn. Stat. § 79.52, subd. 15, is the combination of rules, factors, and adjustments applied to a particular employer's circumstances, loss experience and rates in order to calculate a final premium. A rating plan is the framework in which rates and rate factors are applied. The proposed 4 MCAR § 1.9504 establishes an assigned risk rating plan as required by Minn. Stat. § 79.251, subd. 3, including the merit rating plan authorized by Minn. Stat. § 79251, subd. 2.

Minn. Stat. § 79.252, subd. 5 (Laws of 1983, ch. 290, sec. 6) authorizes the Commissioner of Commerce to adopt rules as may be necessary to administration of the assigned risk plan. Proposed 4 MCAR § 1.9503, Coverage, and 4 MCAR § 1.9505, Reserves, come under this authority.

FACTS ESTABLISHING NEED AND REASONABLENESS

As more specifically stated below, the proposed rules are necessary to the fair and orderly administration of the assigned risk plan, and reasonably address that need.

4 MCAR § 1.9503 Assigned risk coverage.

Rule 4 MCAR § 1.9503 establishes criteria and procedures governing eligibility for coverage through the assigned risk plan. Minn. Stat. § 79.252, subd. 1 (Laws of 1983, ch. 290, sec. 6) states that the assigned risk plan's purpose is to provide workers' compensation coverage to employers rejected by a licensed insurance company. It is necessary and reasonable to delineate the procedures and standards for identifying rejected employers, and for granting or denying coverage through the assigned risk plan in accordance with the usual and customary provisions of workers' compensation insurance policies, pursuant to Minn. Stat. § 79.252, subd. 3 (Laws of 1983, ch. 290, sec. 6).

Subdivision B defines the two minimum qualifications for coverage. The first is that the employer is obligated under Minn. Stat. ch. 176 to carry workers' compensation insurance. As the last resort source of coverage it is not reasonable for the assigned risk plan to extend coverage to persons exempted by statute from the insurance obligation. Other markets, including residual markets, exist for persons desiring medical, disability, and other benefits provided under workers' compensation coverage. The second qualification for coverage is written evidence of rejection by an insurance company. This is reasonable because it explicitly links the provisions of Minn. Stat. § 79.252, subdivisions 1 and 2 (Laws of 1983, ch. 290, sec. 6) concerning the assigned

risk plan's purpose and the insurer's obligation to provide a notice of rejection. The plan's purpose is not to compete for business, but only to provide coverage to employers unable to obtain insurance elsewhere. The application form provides a mechanism for the plan to ascertain an employer's eligibility for coverage.

Subdivision C defines five conditions under which an employer may be disqualified from coverage. (1) Employers may not apply for only a portion of their statutory liability, lest the assigned risk plan become a repository for every employer's unfavorable operations. Were such splitting permitted it could attract business to the plan which, if not split, could be insured as part of a voluntary market policy. This would be inconsistent with the plan's purpose. (2) Coverage may be denied to employers with an outstanding debt to the assigned risk plan. This is reasonable and necessary to prevent abuse of the plan by employers cancelled for non-payment of premium then re-applying for coverage without satisfying the outstanding debt. Subdivision C also affirms the right of the plan's service contractors to cancel for nonpayment of premium, consistent with Minnesota Statutes § 176.185 and § 79.252, subd. 3. (3 - 4) Coverage may be denied to employers who abuse the payroll audit system by refusing completion of an adequate payroll audit or by repeatedly submitting false or misleading information. Payroll audits are necessary to verify the exposure base and the appropriate premium. It is necessary and reasonable to deny coverage to employers who seek an unfair advantage through continuing misrepresentations or non-cooperation. (5) Finally, coverage may be denied to employers who flagrantly disregard safety or loss control recommendations. The assigned risk plan cannot guarantee the safety of employers' worksites, although it does provide safety and loss control services to interested employers. Where significantly dangerous conditions exist the plan's service contractors will

call them to the employer's attention and suggest remedies. If, despite such recommendations, an employer persistently refuses to correct a flagrant safety problem within their power to correct, it is reasonable and necessary for the assigned risk plan to be able to cancel coverage. Cancellation protects the plan and its covered employers from subsidizing continuing and avoidable dangerous conditions, and may be sufficient as a possibility to convince the employer of the urgency of removing the dangerous conditions.

Subdivision D requires special physical examinations to be made of employees where an employer has a significant occupational disease exposure. The purpose of such examinations is to establish the physical condition of employees at the time of becoming covered by the assigned risk plan, particularly the extent of occupational disease effects, if any. Because occupational diseases are gradual, there is some flexibility in choosing when to recognize that a liability exists. Physical examination requirements are a reasonable precaution for preventing employers from entering the assigned risk plan, choosing that time to recognize a significant amount of occupational disease liability actually long in the making, and then leaving the plan with a clean record. The physical examinations would establish the extent of disease effects which predate coverage by the assigned risk plan, and which therefore would be the prior insurer's responsibility.

4 MCAR § 1.9504 Assigned risk rating plan.

Rule 4 MCAR § 1.9504 establishes the rating plan applicable to employers insured through the assigned risk plan, specifically the premium calculation method to be used for such employers. The rating plan includes a classification system, experience modification and merit rating plans, and

premium discount factors. These elements have, with the exception of the merit rating plan, long been the basis for calculating workers' compensation premiums (including assigned risk premiums). Each element is necessary, and has proven over time to be a fair and reasonable method for evaluating exposure and distributing costs.

Subdivision B states that the assigned risk plan will employ the Basic Manual classifications as approved for Minnesota. This system of work classifications is essentially the same as the system used for workers' compensation insurance nationwide. Exceptions from the standard National Council on Compensation Insurance (NCCI) classifications have been adopted over the years, in some cases with hearings, to better accomodate the circumstances of Minnesota employers. The nature of workers' compensation insurance requires a method for apportioning costs according to the relative risk of various employments. This, in turn, requires classifying various employments. The Basic Manual classifications will have the force and effect of law until the advent of open competition. Their use has been and will likely continue to be the standard industry practice, and is clearly the most reasonable course for the assigned risk plan.

Subdivision C states that the assigned risk plan will employ the experience rating plan now standard in the industry, also published by the NCCI. As with the classification system, the experience rating plan has been refined over the years, some Minnesota exceptions have been developed, and the plan will likely continue to be widely used. The experience rating plan serves the dual purpose of maintaining incentives for employers to avoid accidents by modifying premium according to loss experience, and the actuarial purpose of apportioning costs according to the expectation of losses. The latter purpose requires that small employers, whose loss experience is less statistically credible, receive

smaller experience adjustments than large employers. The Minnesota exception which is revoked established the eligibility level for experience rating at $750; it will now be $2500. This change is necessary to accomodate changes in experience modification calculation under open competition, which will begin at the $2500 level for employers insured in the voluntary market. The assigned risk plan cannot offer a more generous rating plan than is generally available in the voluntary market. Employers in the $750 - 2500 range, and lower than $750, will be subject to the small risk merit rating plan, and so will continue to enjoy advantages of an experience rating factor.

Subdivision D states that employers with premiums too small to qualify for the experience rating plan will be subject to the small risk merit rating plan. This complies with Minn. Stat. § 79.251, subd. 2 (Laws of 1983, ch. 290, sec. 5) which requires that all employers insured through the assigned risk plan be subject to an appropriate experience or merit rating plan. Small employers' experience is not statistically credible, so inclusion under the general experience rating plan would be inappropriate. Yet some merit factor is necessary if premium incentives are to be maintained to avoid accidents. The small risk merit rating plan establishes a simple, readily understandable method for modifying employers' premium based on the number of recent indemnity claims. The simplicity heightens the effectiveness of the incentive, while lessening the administrative burden on the assigned risk plan. The reliance on indemnity claims alone establishes a minimal level of statistical validity, as indemnity claims are less frequent and more significant than medical only claims.

Subdivision E states that a premium discount factor will be applied to assigned risk premiums. As with the classification system and experience rating plan, premium discount factors are standard industry practice and have been required for use in Minesota. Premium discounts reflect the fact that as

premium increases administrative costs do not increase proportionately. It is reasonable that this fact be acknowledged in an appropriate discount factor. The cited break points are those currently in force. The actual factors, as with the small risk merit rating factors, will be determined in conjunction with the schedule of rates based on the assigned risk plan's loss and expense experience over time.

4 MCAR § 1.9505 Reserves.

Rule 4 MCAR § 1.9505 states that the commissioner and the assigned risk plan review board shall monitor and have jurisdiction over all assigned risk plan losses and reserves. This rule is necessary because of the effects of transferring the assigned risk plan to the direct oversight of the commissioner from the oversight of the Workers' Compensation Insurers Rating Association of Minnesota (WCIRAM). This administrative transfer was conducted over the course of 1982. WCIRAM continues to assist the commissioner in handling the business, however it is necessary that all responsibility for the plan's current and historical experience reside with one office. This clarifies the scope of the assigned risk plan review board's responsibilities, namely current and historical reserves, and the commissioner's assessment responsibilities under Minn. Stat. § 79.251, subd. 5 (Laws of 1983, ch. 290, sec. 5).

IMPACT ON SMALL BUSINESSES

Quantitative and Qualitative Impact

The proposed rules will have an impact on small businesses which obtain mandatory workers' compensation insurance through the Workers' Compensation Assigned Risk Plan ("Plan"). As of December 6, 1983, 16,350 employers were insured through the Plan, representing an annual premium volume of $14,757,653. The average annual premium per employee is approximately $900, which indicates that most employers insured throught the Plan are small businesses.

Proposed 4 MCAR § 1.9503 concerning eligibility and application procedures for coverage, and proposed 4 MCAR § 1.9505 concerning reserves, embody standards currently practiced and required by contract or by administrative decision. Fixing these standards in rules will not affect small businesses.

Proposed 4 MCAR § 1.9504 establishes an assigned risk rating plan. Subdivisions C and D differ from current procedures in establishing a small risk merit rating plan (MRP) for the smallest employers insured through the Plan, and in increasing from $750 to $2500 the minimum annual premium of policies subject to the experience modification plan (EMP). The quantitative impact of these changes depends on the particular circumstances of a small business, and on the MRP factors in force at a given time.

In general, employers with good loss experience will pay less premium than those with poor loss experience. The premium of employers in the $750 - $2500 annual premium range will change according to the difference of the EMP

factor and the MRP factor. The premium of employers with annual premium under $750 will change according to the MRP factor alone. Previously employers with annual premium under $750 were not affected at all be their individual loss experience. The Commerce Department estimates that approximately 80% of the employers subject to the small risk MRP will receive a merit adjustment to premium in their favor (a credit modification factor).

The primary qualitative impact of these changes will be to establish a simple, readily understood incentive for small and well as large businesses to limit work related injuries.

The rules' effects will be slight on other small businesses such as insurance agencies. Those matters affecting them are already practices as a result of former rules of the Workers' Compensation Insurers Rating Association of Minnesota, as a result of long-standing administrative practices not fixed in rules.

Evaluation of Impact

Pursuant to Minn. Stat. § 14.115, subd. 2, the Commerce Department has considered the feasibility of modifying the rules to lessen any negative effects on small businesses.

Proposed 4 MCAR § 1.9503 has the primary effect of fixing in rules the assigned risk plan application and eligibility determination procedures currently in practice. By streamlining and codifying these procedures their usefulness and accessibility to insurance agencies and covered employers is enhanced. Any dimunition or elimination of these procedures would go contrary to the assigned risk plan's statutory purposes.

Proposed 4 MCAR § 1.9504 has the primary effect of establishing an assigned risk rating plan, including special provisions for small employers. The nature of rating plans is such that all reporting and administration is handled by the Plan and its contractors directly. As such, there are no standards or requirements imposed on small businesses by this rule.

CONCLUSION

For the reasons stated above the commissioner believes that the proposed rules governing administration of the workers' compensation assigned risk plan are necessary to the fair and orderly administration of the assigned risk plan, and reasonably address that need.

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SUPPLEMENT TO THE STATEMENT OF NEED AND REASONABLENESS

As stated in the Statement of Need and Reasonableness, the assigned risk plan is the last resort source of coverage for employers unable to obtain insurance in the voluntary market. The assigned risk plan currently provides coverage to approximately 15,000 Minnesota employers. Although precise data is unavailable, it is likely that over 90% of these employers would be considered small businesses under Minn. Laws 1983, ch. 188, codified as Minn. Stat. section 14.115. It is not uncommon for employers with very small annual premiums to be relegated to the plan because their smallness makes it impossible for insurers to profit on such business.

In this sense, the rules affect small businesses that receive coverage through the assigned risk plan. With certain exceptions noted below, the rules will not affect small businesses within the meaning of Minn. Stat. section 14.115, subdivision 2, which cites requirements for compliance, reporting, performance standards, or other matters. As workers' compensation policy holders small businesses are required to submit payroll information, injury and claim circumstances, employment verification, and other information necessary and incidental to administration of their coverage. All such requirements predate promulgation of these rules, and are not modified by the

rules.

Section 1.9503, subd. B requires a written notice of refusal to insure as a condition for admittance to the assigned risk plan. In practice, admittance to the plan is by application filed by an insurance agent on the employer's behalf. Insurance agencies are small businesses. It is current practice for agents to certify in writing on the application that the employer has been rejected for coverage, and to list the name of the insurer. This constitutes acceptable notice of refusal. No lesser standard would fulfill the intent of this secion, as described on pages 2 and 3 of the Statement of Need and Reasonableness. No other section directly affects insurance agencies.

Section 1.9503, subd. C, could cause some small businesses to fail to qualify for assigned risk coverage. For the reasons stated on pages 3 and 4 of the Statement of Need and Reasonableness, the standards for admittance are essential to the plan's purpose, and permit no more lenient standard. Employers which fail to qualify could have obtained voluntary market coverage, or could by their own actions readily correct the condition by which they fail to qualify.

Section 1.9503, subd. D, could require some small businesses to obtain physical examinations of new and departing employees as a condition of admittance to the plan, if the employer has an occupational disease exposure. Such exposure is most likely in connection with large mining, smelting, manufacturing, or chemical operations, that are unlikely to be small businesses. However, in the event a small business does have a significant occupational disease exposure, no action short of physical examinations would fulfill the need described on page 4 of the Statement of Need and Reasonableness.

Section 1.9504, subd. B affects employers covered through the plan by preserving the rate classification system currently in force. It is not possible in the nature of insurance to ever achieve a classification system with

which every insured is completely satisfied--those with no losses particularly. But as stated on page 5 of the Statement of Need and Reasonableness, there is no practical alternative to the basic NCCI classifications. The classifications are not, in any case, prejudicial to small businesses.

Section 1.9504, subd. C affects employers covered through the plan by preserving the experience rating system currently in force for employers with annual premiums exceeding $2500. For those with annual premiums of $750-2500 it revokes the current experience rating system, to be replaced by the small risk merit rating plan pursuant to subd. D. The reasons for maintaining the experience rating system and making the one change are explained on pages 5 and 6 of the Statement of Need and Reasonableness. The quantitative effects of this change on small businesses will depend on the small risk rating plan factors in force at any given time, and on small businesses' actual loss experience. Statistically it is highly probable that most small businesses will continue to enjoy a credit adjustment to premium under the small risk rating plan, just as most now do under the old system. In most cases the credit or debit adjustment will vary slightly form their current experience modification factor because the small risk rating plan offers only three possible adjustments. Some employers will come off slightly better and some slightly worse, although few adjustments will be of much size. As explained on page 6 of the Statement of Need and Reasonableness, the simplicity of the small risk rating plan will heighten the incentive to avoid accidents for employers in the $750-2500 annual premium range, and will establish such an incentive for the first time for employers with annual premiums of less than $750. Most employers in the under $750 range will receive an experience credit for the first time; a lesser number will receive a debit for the first time.

Section 1.9504, subd. E preserves the break points for premium

discounts currently in force. As explained on pages 6 and 7 of the Statement of Need and Reasonableness, premium discounts reflect economies of scale associated with an employer's annual premium. The quantitative effect on small businesses will depend on the actual discount factors in force at any given time. This in turn depends on the plan's experience, but it is unlikely that the discount factors now in force will change significantly in the near term.

No other portions of the rules affect small businesses.

After the rules were published in the State Register on December 5, 1983 and December 19, 1983, comments were solicited concerning the rules' effects on small businesses through a State Register notice published on January 23, 1984. No comments were received in response to that notice, and no comments received in regard to the rules address the question of their impact on small businesses.