

**WORKERS' COMPENSATION  
GROUP SELF-INSURANCE  
STUDY COMMITTEE**

**FINAL REPORT**

**December 15, 1996**

RECEIVED

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ARIZONA HOUSE OF REPRESENTATIVES

*Rep. Aldridge*

MEMO

DIANA O'DELL, RESEARCH ANALYST, COMMERCE COMMITTEE...542-3745

Date: December 15, 1996

Re: Workers' Compensation Group Self-Insurance Study Committee

Attached is a copy of the interim committee report for the *Workers' Compensation Group Self-Insurance Study Committee*. Copies of the report have been distributed to the following individuals:

**GOVERNOR**

Fife Symington

**PRESIDENT OF THE SENATE**

Senator John Greene

**SPEAKER OF THE HOUSE**

Representative Mark W. Killian

**COMMITTEE MEMBERS**

Senator Brenda Burns, Cochair

Senator David Petersen

Senator Manuel ("Lito") Peña

Representative Pat Conner, Cochair

Representative Paul Mortensen

Representative Ruben Ortega

Larry Etchechury

Deloris Williamson

Donald A. Johnson

Wayne Wilson

Gregory Casadei

Michael Allen

Michael Murphy

Bob Newsome

**Senate Staff**

Wendy Baldo

Chris Thomas

Minority Staff

**House Staff**

Jeff Grant

Minority Staff

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# **WORKERS' COMPENSATION GROUP SELF-INSURANCE STUDY COMMITTEE**

## **FINAL REPORT**

### **I. ESTABLISHMENT**

The Workers' Compensation Group Self-Insurance Study Committee was established by Laws 1996, Chapter 129, SB 1244 and is repealed December 31, 1996. (Attachment A)

### **II. PURPOSE**

The purpose of the 14-member committee is to review and make recommendations regarding the following:

- ▶ workers' compensation group self-insurance in other states;
- ▶ the authorization of workers' compensation group self-insurance for trade associations and other groups;
- ▶ other alternative options to the current rating bureau system, such as competitive rating, loss cost rating, pooling or self-rating programs.

### **III. REPORT**

The Workers' Compensation Group Self-Insurance Study Committee must submit a report of its findings to the Governor, the President of the Senate and the Speaker of the House of Representatives by December 15, 1996.

### **IV. MEMBERSHIP**

The Committee comprises the following members:

Senator Brenda Burns, Cochair	Representative Pat Conner, Cochair
Senator David Petersen	Representative Paul Mortensen
Senator Manuel ("Lito") Peña	Representative Ruben Ortega

Larry Etchechury, Industrial Commission  
Gregory Casadei, State Compensation Fund  
Michael Murphy, Department of Administration  
Deloris Williamson, Department of Insurance  
Wayne Wilson, American Insurance Association  
Donald A. Johnson, Arizona Contractors Association  
Bob Newsome, Continental Homes  
Michael Allen, Sureway Properties

## V. MEETINGS

The Workers' Compensation Group Self-Insurance Study Committee held three public hearings on September 23, 1996, October 1, 1996 and December 12, 1996. The Committee received testimony from interested parties, potential service providers and lobbyists representing various organizations.

*Group self-insurance* consists of a group of employers that generally form a non-profit corporation or trust corporation that operates as an *employer-controlled* insurer, with each member within the group bound by a Joint and Several Indemnity Agreement. Generally, groups maintain a board of directors and hire a third party administrator or service company to assist in providing necessary insurance functions. Groups are set up to retain profits, and excess revenues are often returned to the members of the self insurance group.

Testimony at the public hearings consisted of an explanation by Senate staff regarding the current methods for employers to insure their workers in Arizona, as well as the Industrial Commission's self-insured requirements for political subdivisions such as school districts, counties and contractors doing business with the State.

House staff reviewed various other states' requirements, problems encountered and suggestions regarding group self-insurance and their common factors, including authorization, membership, administration and finance.

Further testimony revealed that group self-insurance would allow an additional alternative to the current system, which would provide competition, motivate loss control and allow a tailored safety program, as well as provide the same opportunity now afforded some larger public and private entities. Those opposing the formation of groups cited the fact that the current system allows for ample competition, with more than 100 insurance carriers and a substantial reduction in rates during recent years. In addition, they cautioned that formation of groups may adversely affect the State Compensation Fund and result in increased premiums due to adverse selection.

The Committee elected to draft a questionnaire to obtain community input and reaction concerning the authorization of group self-insurance, ascertain whether the particular respondent would participate, and gather any additional suggestions or recommendations. Based on the results of that questionnaire, the Committee voted to recommend that the Legislature authorize the formation of groups to self-insure for their workers' compensation coverage.

Meeting notices and minutes of the three public hearings are attached. (Attachment B)

**VI. FINAL RECOMMENDATIONS**

The Study Committee made the following final recommendations:

1. That the Legislature pass enabling legislation that authorizes group self-insurance.
2. That the enabling legislation vest responsibility for oversight of self-insured groups with the Industrial Commission of Arizona, consistent with individual self-insureds and public group self-insureds.
3. That the enabling legislation establish the following minimum requirements for group self-insureds:
  - a.) Each member must have been in business for five or more years.
  - b.) The group must demonstrate \$750,000 or more in gross annual workers' compensation insurance premiums.
  - c.) The group must have an elected Board of Trustees actively involved in oversight of the group.
  - d.) The group must have been formed for a specific purpose prior to engaging in self-insurance.
4. That the enabling legislation establish that each member of the group be jointly and severally liable for the liabilities of the group, including after termination of membership for claims incurred during the period of membership.
5. That the Industrial Commission be directed to exercise its rule making authority to address all other issues pertaining to group self-insurance.

**VII. ATTACHMENTS**

- A. Copy of Enabling Legislation
- B. Meeting Notices and Minutes

*Note: All documents submitted to the committee are on file in the Office of the Chief Clerk and the Office of the Secretary of the Senate.*

# Attachment A

WORKERS' COMPENSATION GROUP SELF-INSURANCE STUDY COMMITTEE

(Laws 1996, Chapter 129; SB 1244)

Section 1. Workers' compensation group self-insurance study committee

A. A workers' compensation group self-insurance study committee is established consisting of:

1. Three members of the senate who are appointed by the president of the senate, not more than two of whom are from the same political party.

2. Three members of the house of representatives who are appointed by the speaker of the house of representatives, not more than two of whom are from the same political party.

3. The director of the department of insurance, or the director's designee.

4. The director of the state compensation fund, or the director's designee.

5. The director of the industrial commission, or the director's designee.

6. An employer or a representative of an employer that purchases workers' compensation coverage from an insurance carrier for its employees who is appointed by the governor.

7. An employer or a representative of an employer that provides self-insurance for its employees who is appointed by the governor.

8. A representative of an insurance carrier that provides workers' compensation coverage who is appointed by the governor.

9. A representative of an organization of employees who is appointed by the governor.

10. A representative of a trade association who is appointed by the governor.

B. The unexcused absence of a member for more than three consecutive meetings is justification for removal. If the member is removed, notice shall be given of the removal pursuant to section 38-292, Arizona Revised Statutes.

C. Vacancies shall be filled by appointment of a qualified person by the person entitled to make the appointment pursuant to subsection A of this section.

D. The committee may use the expertise and services of legislative staff and the staff of the industrial commission.

E. Members of the committee are not eligible to receive compensation or reimbursement of expenses.

F. The committee shall:

1. Review workers' compensation group self-insurance in other states and make recommendations based on the review.

2. Review and make recommendations regarding the authorization of workers' compensation group self-insurance in this state for trade associations.

3. Review and make recommendations regarding the authorization of workers' compensation group self-insurance in this state for groups other than trade associations.

4. Review and make recommendations regarding other alternative options to the current rating bureau system that could be made available to trade associations and other employer groups, such as competitive rating, loss cost rating, pooling or self-rating programs.

5. Submit a report containing the committee's study results and recommendations to the president of the senate, the speaker of the house of representatives and the governor by December 15, 1996.

Sec. 2. Delayed repeal

Section 1 of this act is repealed from and after December 31, 1996.

**The Committee Terminates: December 31, 1996.**

# Attachment B

**ARIZONA STATE LEGISLATURE  
MEETING NOTICE  
OPEN TO THE PUBLIC**

**WORKERS COMPENSATION GROUP  
SELF-INSURANCE STUDY COMMITTEE**

DATE: Monday, September 23, 1996  
TIME: 9:00 a.m. - 11:30 a.m. and 12:30 p.m. - 3:30 p.m.  
PLACE: Senate Hearing Room 1

**AGENDA**

1. Call to Order
2. Opening Remarks
3. Overview and Charge of the Committee
4. History and Background of Group Self-Insurance
5. Applicability to Arizona
6. Public Comment
7. Adjourn

**COMMITTEE MEMBERS**

Senator Brenda Burns, Cochair  
Senator David Petersen  
Senator Manuel "Lito" Peña

~~Representative Pat Conner, Cochair~~  
Representative Paul Mortensen  
Representative Ruben Ortega

Larry Etchechury, representing Arizona Industrial Commission  
Gregory Casadei, representing State Compensation Fund  
Deloris Williamson, representing Arizona Department of Insurance  
Michael Allen, representative of Trade Association  
Donald A. Johnson, representative of Organization of Employees  
Michael Murphy, representative of Employer that Provides Self-Insurance  
Bob Newsome, representative of Employer that Purchases Workers Compensation  
Wayne Wilson, representative of Insurance Carrier

Title II of the Americans With Disabilities Act prohibits the Arizona Senate from discriminating on the basis of disability in the provision of its services and public meetings. Individuals with disabilities may request reasonable accommodations, such as interpreters or alternative formats, by contacting the Senate secretary's Office at (602) 542-4231 (voice) as soon as possible. Please be specific about the agenda item in which you are interested and for which you are requesting an accommodation. The Senate may not be able to provide certain accommodations prior to the meeting unless they are requested a reasonable time in advance of the meeting. This agenda will be made available in an alternative format on request..

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**ARIZONA STATE LEGISLATURE**

**WORKERS COMPENSATION GROUP  
SELF-INSURANCE STUDY COMMITTEE**

Minutes of Meeting  
September 23, 1996 - 9:00 a.m.  
Senate Hearing Room 1

**Legislative Members Present**

Senator Brenda Burns, Cochairman	Representative Pat Conner, Cochairman
Senator David Petersen	Representative Paul Mortensen
Senator Manual "Lito" Peña	

**Non-Legislative Members Present**

Larry Etchechury	Gregory Casadei
Deloris Williamson	Michael Allen
Donald A. Johnson	Michael Murphy
Bob Newsome	Wayne Wilson

**Member Absent**

Representative Ruben Ortega

**Staff Present**

Wendy Baldo, Senate Research Analyst  
Diana O'Dell, House Research Analyst

Cochairman Burns called the meeting to order at 9:06 a.m. and roll call was taken. See attached list for other attendees. She introduced each non-legislative member: Larry Etchechury, Director, **Arizona Industrial Commission**; Gregory Casadei, Vice President, Benefits & Legal Division, **State Compensation Fund**; Deloris Williamson, Assistant Director, Rates & Regulation, **Arizona Department of Insurance**; Michael Allen, **Sureway Properties**, representing a trade association; Donald A. Johnson, **Arizona Contractors Association**, representing an organization of employees; Michael Murphy, Risk Management, **Arizona Department of Administration**, representing an employer that provides self insurance; Bob Newsome, **Continental Homes**, representing an employer that purchases workers' compensation; and Wayne Wilson, **American Insurance Institute**, representing an insurance carrier

Thanking all of the non-legislative members for their attendance and assistance in the self-insurance group endeavor, Cochairman Burns deferred to Cochairman Conner for additional comments.

Cochairman Conner expressed appreciation to the private sector for taking time to meet with the Committee and to provide assistance in drafting legislation, in the event that legislation is recommended by the Committee. Thanking all members for their attendance, he expressed hopefulness for the Committee to accomplish its assignment.

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Concluding opening remarks, Cochairman Burns asked Ms. Baldo to present an overview and charge of the Committee.

**Wendy Baldo, Senate Research Analyst**, distributed a packet of information to each Committee member containing the following documents (on file with original minutes):

- House Engrossed Senate Bill 1244 (Chapter 129)
- Typewritten presentation entitled "Workers' Compensation Group Self-Insurance Study Committee, Monday, September 23, 1996"
- The National Council of Self-Insurers (NCSI) 1994 State Self-Insurance Requirements
- National Association of Insurance Commissioners Private Employer Workers' Compensation Group Self-Insurance Model Act

Referencing the National Association of Insurance Commissioners (NAIC) model act, Ms. Baldo stated the Committee will use this model act as a guide in drafting a form of enabling legislation in Arizona, if the Committee makes such a recommendation.

Historically, Ms. Baldo explained that while authorization of self-insurance groups has been previously proposed in Arizona, the proposals never moved any distance because of concerns expressed that adequate time had not been given to study the issue in depth. She stated this Committee was created in the 1996 Legislative Session.

Ms. Baldo explained that large Arizona employers currently have the ability to self insure and take responsibility for their own losses. She added such law has proven to be effective in reducing long term workers' compensation costs for large businesses. Commenting that small Arizona employers are not able to take advantage of this type of self insurance because they cannot meet the financial requirements presently in statute, Ms. Baldo stated there are over 30 states in the United States that allow pooling for small employers.

Referring to current methods for insuring for workers' compensation in Arizona, Ms. Baldo stated the four principle methods include (a) independent carriers, (b) State Compensation Fund, (c) Assigned Risk Pool for employers who have been turned down by at least two insurance carriers as well as the State Compensation Fund, (d) self insurance for large employers, authorized by the Industrial Commission to self insure their employees, with group self-insurance pools for political subdivisions such as school districts, counties and contractors doing business with the State.

Ms. Baldo explained that group self insurance is a group of employers that generally form some kind of non-profit corporation or trust organization that operates as an employer controlled insurance company. Referring to some of the key features of group self insurance, Ms. Baldo stated that each employer joining the group is bound by a Joint and Several Indemnity Agreement making the employers liable for any additional amounts necessary; the liability is spread among the different employers in the group; there is a third party administrator or service company that is generally hired to work with the organization to provide claims and other insurance functions, the employers pay premiums to the group fund which is similarly calculated to present full insurance coverage; the employer's premiums are paid to the group fund for paying out claims and paying for the cost of running the program that includes losses, excess insurance protection, claims and loss prevention services, and administrative services associated with the self-insurance group. Because group funds are not set up to retain profits, Ms. Baldo added that employer members earn investment income on the group funds. The excess revenues are often returned to the members of the self insurance group.

Senator Burns inquired of the degree of liability imposed on the non-profit corporation or individual member if the self-insurance group becomes defunct and unable to pay its claims. Because of the Joint and Several Indemnity Agreement, Ms. Baldo stated the members are responsible for picking up those claims.

With respect to composition of a standard self-insurance group, Ms. Baldo referred Committee members to the organizational chart contained in the information previously distributed. She explained the self-insurance group would consist of a group of "like employers" who would form a non-profit corporation or trust organization, with a Board of Directors. Ms. Baldo stated that the emphasis of this Committee will look at employers who are homogeneous in nature. She added there are some states that do not have the requirement that the self-insurance groups must be of similar risk factor. Referring to the organization chart, Ms. Baldo explained that the self-insurance group would have a program administrator that would oversee the various services performed including risk management, safety management, claims management and so forth. She added the self-insurance group would actually do the underwriting and the actuarials in loss prevention.

Referencing the current rules for workers' compensation self-insurance pool applicants, Ms. Baldo stated the following criteria currently exists in Arizona statute and Industrial Commission regulation. For a political subdivision, she explained that the applicant must (a) be engaged in business in Arizona for at least five years, (b) provide an annual Arizona payroll of at least \$2 million, (c) meet total reported assets of at least \$50 million or have a combination of \$10 million in net worth and a cash flow ratio of .25, (d) provide copies of the employer's audited or reviewed financial statements for the most current and prior

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two years, (e) provide the names of all other jurisdictions in which the applicant has been granted authority to self insure and in which the applicant has been denied, revoked or suspended, (f) file a completed indemnity agreement signed by a duly authorized agent of the pool, jointly and severally binding the pool and each of its members to comply with statute and rules relating to the Workers' Compensation Act, (g) provide the names and addresses of the members of the Board of Trustees of the pool, (h) provide the agreement indicating the terms and conditions of coverage within the pool, including any exclusions from coverage, and (i) provide a copy of the Intergovernmental Agreement.

Senator Burns inquired of the kinds of criteria used in other states who have self-insurance groups. Ms. Baldo replied that the criteria differs from state to state.

With respect to criteria requirements in considering the formation of a self-insurance group, Ms. Baldo explained the size of the group should be determined, i.e., two employers or 10 employers; the compatibility of the members of the group, i.e., homogeneous groups, heterogenous groups or both; the solvency of the group and how to insure solvency for these types of organizations; each individual member's ability to purchase excess insurance and meet surety requirements; how to guarantee for payment of losses; and how to set up, administer and regulate the self-insurance group.

Representative Mortensen asked if the current rules for workers' compensation self-insurance pool applicants is directed to an individual business or corporation.

Ms. Baldo explained that the requirements are part of the Industrial Commission regulations for the large employers that currently self insure. She stated that if the Committee were to recommend moving forward with self-insurance pools, different requirements could be considered.

Representative Mortensen asked Ms. Baldo if she is speaking about single employers. Ms. Baldo answered yes.

**Diana O'Dell, House Research Analyst**, stated that at the request of Representative Conner, she made contact with various organizations to glean information on self-insurance groups operating in other states. She reported that in her conversation with the National Council of Self-Insurers (NCSI), she learned that the Grocers Association of Oklahoma and the State of Oklahoma in general had problems with group self insurance.

The Grocers Association Group Self Insurance Fund in Oklahoma was a homogeneous group of 24 members that had been self insured for about 11.5 years, became completely disbanded one year ago, and is currently being audited to determine exactly how many

dollars the 24 members will still have to pay out because of the joint and several liability issue.

She added that Jim Hopper of the Grocers Association of Oklahoma reported to her that because the courts are tied to the Oklahoma workers' compensation system, the self-insurance group has no control over the large court awards. This was a big problem for the Grocers Association because they had several catastrophic claims. To insure a successful group self-insurance program, Ms. O'Dell relayed Mr. Hopper's assessment that the most important factor is the group's ability to hire a knowledgeable and known company to oversee the group fund; that it is important to maintain a reserve to cover unexpected losses, and to refrain from paying out premium dividends at the end of the year without having enough money in reserve. She also relayed Mr. Hooper's caution that some group members may be lured out by the private sector. When the premium base decreases, the cost to the other members in the group will then increase.

Based on the review of self-insurance groups in other states, Ms. O'Dell explained that states do have some things in common. The regulatory authority tends to be either the Department of Insurance or the State Industrial Commission. The types of groups are usually homogeneous, meaning that the employer members are within the same classification or work field. Ms. O'Dell stated that homogeneous groups are allowed in Arkansas, California and Connecticut, while Alabama, Florida and Kansas allow either homogeneous or heterogeneous groups; the management is under a Board of Trustees consisting of 3-7 members that are either elected or appointed; the Board of Trustees contract with the service company; the service company may determine premiums, although most states use the National Council of Compensation Insurers (NCCI) calculations; and the Board of Trustees invest surplus monies and accept applications for membership. As previously mentioned, Ms. O'Dell commented that the premium rates are calculated usually by NCCI, based on experience modifiers, and have to be approved by the insurance regulator to cover the claims and administrative costs, taking into account the unexpected losses. She added most states require additional security in the form of surety bonds, certificates of deposit, aggregate excess insurance, letters of credit, or cash. In conclusion, Ms. O'Dell stated the annual financial information is filed with the state regulator and regular audits are performed by the staff or by an independent auditor.

Referring to the Grocers Association incident involving a large deficit, Senator Peña, asked if the state fund in Oklahoma will be expected to pick up the losses whenever the organization or the group is no longer able to do so.

Ms. O'Dell stated that Jim Hopper commented to her that in all probability, several of the smaller companies would go under as a result of the Oklahoma incident. Without any

specific details from Mr. Hopper, Ms. O'Dell stated she is of the understanding that in cases like the Oklahoma incident, the state would probably have to pick up those types of losses.

Senator Peña asked if his understanding is correct that Mr. Hopper is saying the big companies that are already self insured and those who are dealing with insurance companies are at risk to pick up the slack somewhere down the line.

Ms. O'Dell answered that Mr. Hopper did not specifically state that the companies were at risk, per se, nor did he specifically say that their state's special fund would have to pick up the losses. Ms. O'Dell stated she is of the assumption that if the state has workers who were severely injured, the state's welfare system or some other state entity would have to pick up the cost if that worker was not able to work in the future.

Senator Peña characterized Ms. O'Dell's assumption as a good assumption.

Based on Ms. O'Dell's review of the specific states with self-insurance groups, Representative Conner asked which regulatory agency, most often, was responsible for overseeing the self-insurance groups.

Absent a breakdown, state by state, Ms. O'Dell explained that states do it differently.

Senator Burns commented that she is interested in learning more about the Oklahoma incident with respect to the Grocer Association's deficit, how the claims are being satisfied, and whether a surety bond requirement would have solved the problem. Additionally, Senator Burns stated she would like to know for a fact which states allow group self insurance and which of those states have experiences to share.

Ms. O'Dell stated she is of the understanding there are over 30 states that do allow group self insurance in some manner. Because the states all have different requirements, Ms. O'Dell stated it is difficult to say one program is better than another. No two programs are exactly alike. Because the Grocers Association is currently in the auditing process, Ms. O'Dell stated many of the questions are still unanswered.

Mr. Wilson asked how many of the 30 states allow political subdivisions to self insure on a group basis, i.e., workers' compensation versus private enterprise. He asked if his understanding is correct that not all 30 states allow private enterprise and political subdivisions to self insure. He asked if all 30 states allow both.

Ms. O'Dell answered she is of the understanding that all 30 states allow both; however, the exact requirements differ between all of the states.

Senator Burns commented it is important to determine the specific states that allow private group self insurance so that Committee members can seek input from those states.

**Suzanne Gilstrap, Executive Director, Arizona Multihousing Association**, expressed appreciation of the Legislature's support in establishing a study committee to review and consider private groups having the ability to self fund. She explained that Arizona Multihousing Association consists of members from a variety of industries including the construction, housing, hospitality, manufacturing and retail grocery, as well as members of the Arizona Self Insured Association, a broad-based coalition of interests that would like to see Arizona adopt legislation that would allow groups to self fund.

Coupled with the Arizona Legislature's history of supporting free enterprise, supporting competition in the marketplace, economic development, privatization, regulatory reform, free market solutions to problems, and allowing large employers and public groups to self fund, Ms. Gilstrap stated the Multihousing Association views the Committee's charge as the "last piece of the puzzle" to allow trade associations and/or groups the ability to self fund and to provide Arizona with a more competitive system than currently exists.

Ms. Gilstrap explained that the term, "fully competitive" means giving Arizona employers three options as opposed to the two options in today's market – purchasing insurance from a private carrier or purchasing insurance from the State Compensation Fund. The third option of allowing trade associations and/or groups to self fund for purposes of workers' compensation would fully round out the menu of options available to Arizona employers.

Ms. Gilstrap stressed the importance of understanding that the Multihousing Association is not advocating to "do away with" an existing system, but rather is advocating alternatives to the existing system. The Multihousing Association does not want to see the existing system dismantled.

Referring to her printed information, entitled, "Private Self-Insurance Groups (SIGS)" (on file with original minutes), Ms. Gilstrap stated her testimony in this Committee meeting would explore the concept of private self-insurance groups, how they work and how they would impact the existing system. At the next Committee meeting, Ms. Gilstrap stated her testimony would focus on the details of private self-insurance groups, including criteria, liability, safeguards and implementation. She stated that while it is important to talk about all of the problems that exist with self-insurance groups, such as the Oklahoma incident,

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it is also important to discuss the good things that have occurred as a result of other states that enacted legislation allowing private employers to self fund.

Mr. Gilstrap briefly described the benefits to be gained by employers who self insure, including (a) a third option of coverage to round out the menu; (b) the ability to insure at a lower cost; (c) better performance with their loss prevention and more individual attention to claims; (d) an ownership feeling of the program; (e) the ability to tailor needs specifically to that particular industry, resulting in fewer accidents in the workplace, being able to return employees to work faster, and enjoying a more productive work force; and (f) making the small employer equal with the large employer who currently has the ability to self fund in Arizona.

Regarding evidence that private self-insurance groups work, Ms. Gilstrap stated it is her understanding that no major problems have been experienced with self-insurance groups in Arizona and that the programs are successful. She added the success in part is because the Industrial Commission has done an exceedingly good job in laying out guidelines and criteria that employers have to follow in establishing self-insurance pools or self-insurance funds. Additionally, she stated the public group has also benefited.

Of the 37 states that have self funding capability for workers' compensation, with very active state compensation funds as well as very active private carriers, Ms. Gilstrap stated nearly three-quarters of the states allow group self insurance.

Mr. Casadei inquired of the number of states that had state compensation funds at the time that they began to allow self-insurance groups.

Ms. Gilstrap replied she did not know the exact number. She added she would research the matter further and provide Committee members with the information.

Mr. Murphy announced he was in possession of a publication, produced by the U.S. Chamber of Commerce, that listed the 50 states and identified whether they provided self insurance or approved self insurance.

Cochairman Burns requested staff to make photocopies of the publication for distribution to Committee members.

Ms. Gilstrap stated that her research has identified 18 states that have competitive state compensation funds. Fourteen of the 18 states allow groups to self insure. Referring Committee members to page 4, she pointed out the listing of those 14 states, including California, Colorado, Hawaii, Louisiana, Maine, Maryland, Michigan, Minnesota, Montana,

New York, Oklahoma, Oregon, Pennsylvania and Tennessee. She added she is of the understanding that California, at the present time, does not have any private employer groups due to the fact that California is still in the implementation phase of their regulatory requirements. Ms. Gilstrap commented that even though Texas is included in the 18 states, that state is somewhat different in the sense that workers' compensation coverage is not compulsory in Texas. She added she recently become aware that Michigan sold its state compensation fund two years ago and no longer has a state compensation fund.

With regard to the impact of allowing private companies to self insure, Ms. Gilstrap stated the Multihousing Association believes it will produce a more fully competitive market and one that is consistent with this Legislature's position on free enterprise and general competition in the market place. Additionally, Ms. Gilstrap added it will give small businesses a choice they have not had in the past.

Referencing previously asked questions relative to what would happen to existing companies in the market place, i.e., the State Compensation Fund or private insurance carriers, Ms. Gilstrap stated she has not been able to identify any evidence that would suggest a negative impact on existing providers. By way of example, Ms. Gilstrap cited the State of New York, with 33 self insurance groups, that has had private insurance groups for approximately 30 years. She added that 33 groups is not very many groups over an extended period of time which shows there was no "mass exodus" to a self funding plan from existing carriers such as the state compensation fund or private carriers. Commenting that self funding is not for everyone, Ms. Gilstrap stated she believes the self-funding group has to be sophisticated and has to have a sophisticated membership that understands the pros and cons of self funding.

Commenting that a shifting in market share was the only happening that occurred in those states that allowed self funding, Ms. Gilstrap stated she believes competition is good and everyone benefits from a healthy competition in their state. Citing the market share in the State of New York, Ms. Gilstrap stated 22% is either individual, private or public groups and the remaining 78% is split equally between the state compensation fund and private carriers in New York. Referring to the other states that allow private funding, she pointed out there are few groups that have participated in self funding. Commenting again that self funding is not for everyone, Ms. Gilstrap stated she believes it is a viable option that should be available to employers in the State of Arizona. In conclusion, Ms. Gilstrap stated that while she has not seen any evidence showing that group self funding has a negative impact, she has seen evidence that points to the opposite such as improved loss control programs, improved claims management, and lower costs.

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Representative Mortensen asked Ms. Gilstrap if her reference to a small business includes independent contractors who may be just one or two persons.

Ms. Gilstrap replied she is of the belief that in any kind of a self-funded pool or group self-funding mechanism, it would be desirous of having several companies in the pool versus limiting it to one or two.

Commenting on his assumption that many independent contractors do not insure, Representative Mortensen asked if his assumption is correct.

Ms. Gilstrap replied she is of the understanding that an independent contractor cannot go without insurance unless they are a sole proprietor. If a person is a sole proprietor, she stated that person is not required to be insured and can opt out of workers' compensation; however if the business has as few as one employee, the employee has to be insured for workers' compensation.

Mr. Newsome asked Ms. Gilstrap if she is aware of any states that allowed group self insurance but no longer allow it, or where group self insurance was detrimental to the state compensation fund. Ms. Gilstrap replied no.

Cochairman Burns asked Mr. Etchechury if he could answer any of the Committee members' questions.

Commenting on a good source of information that answers many questions surrounding the group self-insurance issue, Mr. Etchechury referred Committee members to Michigan's report entitled, "A Study of Group Self Insurance in 1995" (on file with original minutes). With respect to the Oklahoma situation, Mr. Etchechury explained that Oklahoma does have a guarantee fund. If the Grocers Association is defunct, the individuals will be covered in some fashion. With respect to surety bonds, he added all self-insurance groups have surety bonds that provide security in the amount of 25% of the first year premium. In the Oklahoma case, Mr. Etchechury stated that because the surety bond will not cover the losses, the guarantee fund will have to make up the deficit. Addressing Representative Mortensen's question, Mr. Etchechury stated that most of the groups are larger groups because of the joint and several liability issue; a group has to be large enough to be able to absorb any of the losses of the particular members.

**Knox Kimberly, representing Arizona Association of Industries (AAI) and Arizona Self Insured Association (ASIA)**, testifying in support of moving forward with the concept of allowing groups to self insure, stated the experience of the Arizona large business self insureds in the ASIA organization has been very positive. Based on concerns expressed

by Committee members, Mr. Kimberly stated he believes there is a need to "carefully" proceed in crafting legislation that will allow Arizona to have the same positive experience of many other states and avoid some of the problems that have been experienced by other states such as the Oklahoma incident.

While not hearing any testimony regarding reinsurance and excess insurance, Mr. Kimberly stated he is of the understanding that reinsurance and excess insurance is a very important part in a system that allows for groups.

Regarding the impact on the existing system, Mr. Kimberly reiterated Ms. Gilstrap's testimony that group self insurance is not an effort to upset the existing system. It is an effort to provide, within the existing system, the additional option of group self insurance that will allow other groups to enjoy the same opportunity that Arizona's large private sector and public groups already enjoy. Mr. Kimberly stated he agrees that group self insurance could result in some shifting of market shares. He also referenced the New York example that has had many years of experience in group self insurance. In terms of existing market share in Arizona, Mr. Kimberly stated that the State Compensation Fund might be taken from a position of having the "dominant" market share to "nearly the largest" market share. He stated he does not believe that kind of market share impact should define what is harmful to the existing system. In conclusion, Mr. Kimberly thanked the Committee for studying the group self-insurance issue and volunteered his services to conduct any further research or provide any further information to Committee members regarding group self insurance.

**Ralph Korn, representing Strategy & Risk Group (SRG)**, explained that SRG is an independent risk management consulting firm, headquartered in Phoenix, who has performed a number of feasibility studies for alternative financing and funding of risks, including a number of self-insured pools. He distributed a summary sheet listing some of the reasons that SRG believes pooling or group programs work successfully (on file with original minutes).

Referencing a prior question posed by a Committee member to identify states that permitted group self-insurance pools, Mr. Korn stated SRG performed a feasibility study in Colorado for the formation of a private sector self-insured workers' compensation pool involving 21 rural electric utility companies. In addition to performing feasibility studies for self insurance, Mr. Korn stated SRG is the pool administrator of the Valley Schools Workers' Compensation Pool comprised of three large school districts in Arizona: Paradise Valley, Deer Valley and Peoria.

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Mr. Korn remarked that SRG believes the key issue in permitting private sector group self insurance of workers' compensation lies in the equity concept. As the law presently stands in Arizona, Mr. Korn stated small employers who have very good workers' compensation experience and who work very diligently in controlling their costs, are not large enough to be permissibly self insured in the State; they are not able to buy their insurance from the commercial market nor from the State Compensation Fund. Not to be construed as criticism of the commercial market or the State Compensation Fund, Mr. Korn stated small employers are simply not given the same opportunities that larger companies are given who can qualify as stand-alone self insureds.

Regarding concerns expressed about whether or not the pool or the self-insured group is going to be economically feasible or financially sound, Mr. Korn stated that proper structuring of a group is essential, including a very conservative actuarial evaluation of the exposures and of the funding requirements. He added that good conservative actuarial evaluation will, generally speaking, set the standards and guidelines. If the standards and guidelines are followed by the group and if the standards and guidelines are mandated by statute and regulation, Mr. Korn stated those standards and guidelines will result in the formation of a group that is going to make sense and is going to be successful. He pointed out that virtually all groups, in virtually every state with self-insured pools and groups, are assessable, meaning that in the event additional contributions are required from the group members in order to keep the group solvent, the assessability provision in the By Laws of the group or of the pool require that the members contribute additional capital in order to make certain that the pool can meet its obligations. He emphasized the importance of including an assessability requirement in the formation of a pool or group so that members of the group understand they can be called upon, if necessary, to contribute additional funds in order to guarantee the solvency of the group.

Adding to Ms. Gilstrap's testimony on the benefits of group self insurance, Mr. Korn added that the members of the group, whether they are homogeneous or heterogeneous, understand their industry and their business, they know where their loss exposures are coming from, they know what their requirements are, they have the best ability to determine what kind of loss control and safety issues should be addressed, and can go out and purchase services from companies to develop and design loss control programs that fit their needs directly and that will be responsive to their needs.

Mr. Korn stated he believes group self insurance of the private sector in Arizona would be a major step forward because it closes the loop and "fills in" the remaining gap for smaller employers who today do not have the option of self insurance.

Regarding Representative Mortensen's question of whether very small independent contractors can belong to a group self-insurance plan, Mr. Korn stated that technically they could belong but most likely would not want to because of the exposure to the joint and several liability feature of a small company. Mr. Korn stated he is of the opinion that a 3-4 person employer probably would not feel comfortable in a self-insured environment.

Representative Conner asked Mr. Korn if he finds that "cherry picking" takes place with these pools so that they can keep their rates down, such as "watching people who have losses." Pointing out that the State of Arizona has a good workers' compensation program and has benefited over the years of having fairly low rates in Arizona, Representative Conner explained that the State of Arizona, as a last resort, is going to have to pick up all employees. He questioned whether there would be some increase in premiums on the "other side" if one sector is being benefited by group self insurance while the other sector has to pick up all remaining employees.

Mr. Korn replied there is always the possibility that the "cream" is all going to move off into the self-insured program, leaving the less desirable businesses and high loss ratio businesses for the insurance carriers and the State Compensation Fund. While "cherry picking" is a possibility, Mr. Korn stated he believes "cherry picking" is an unjustified conclusion.

Commenting on his desire to hear more about specific experiences of other states who are allowing group self insurance, Representative Conner emphasized the importance of hearing about the good things and the bad things for purposes of weighing both sides if the Committee recommends drafting legislation. Expressing his desire to learn what happens to the "bad apple" and where that person goes, and how the state funds have been impacted with group self insurance, Representative Conner stated he believes there must be statistics available that answer those kind of questions.

Mr. Korn commented that if the pool is properly structured, it has built into its underwriting methods a means of assessing a surcharge to those pool members who are developing bad experience; they would have to pay a higher surcharge premium rate and greater premium into the pool, in order to compensate the other pool members for the adverse experience created by the "bad apple." He also added he is of the opinion that a pool that does not provide that kind of surcharge methodology is a pool that has not been well thought out. He discussed the California experience of self-insured members leaving the pooling arena, or their self-insurance status, and returning to the commercial insurance market because of the dollars they believed they would save. Mr. Korn emphasized the importance of structuring a pool in such a manner that the members continue to be liable in the future until all of their outstanding obligations, incurred in the course of the pool's

operation, have been taken care of. He added that these are all issues that need to be written into the regulation.

Discussion followed between Representative Conner and Mr. Korn. Representative Conner asked if there is any history available that can be beneficial to the Committee with respect to the effect that group self insurance has had on any state funds, as pools have been moving around and different experiences have been seen regarding loss ratio.

Mr. Korn answered that he did not know the answer. He added SRG has not been involved in any kind of an analysis or study of the success or failure, or the general trending of self-insurance groups, state by state.

Mr. Murphy asked Mr. Korn to describe the benefits gained by the three school districts administered by SRG in terms of controlling workers' compensation costs and providing a safe work place for the employees.

Mr. Korn replied that the pool has been in existence for 14 months. Two of the school districts had been insured with the State Compensation Fund and one had been insured with a private carrier of workers' compensation. Due to the fact that losses are quite new, Mr. Korn stated it is not possible to quantify the benefits at this point in time. He added that the school districts feel they have accomplished and benefited from such things as (a) adding to their internal staff two loss prevention people with many years of expertise who have experience with school exposures, (b) participating in the normal bidding process to select a third party administrator, and (c) selecting the attorneys they feel are best qualified to defend their claims. Mr. Korn stated he believes the three school districts are pleased with their decision. Because of the short time in existence of the school district pool, Mr. Korn stated that while it is too early to say that their self-insurance pool is successful, it is believed it will be successful.

With respect to Mr. Korn's suggestion to include a provision for assessing different companies in the event the Committee recommends proposing legislation, Mr. Newsome asked Mr. Korn for his thoughts on how groups could be insured for one catastrophic loss within a group, or some type of aggregate loss where there were several catastrophic losses within the group, so that the whole group would not be penalized.

Mr. Korn answered that the group could purchase stop loss insurance or they could purchase excess self-insured workers' compensation insurance, either on an aggregate basis or on a specific basis. If it was on a specific basis, each individual loss that the pool had to pay would be limited to a stated figure. By way of example, Mr. Korn stated that the self-insured retention on a per-loss-basis is \$250,000 for the Valley School Workers'

Compensation Pool; the pool buys stop loss insurance to protect them for any losses above that \$250,000 on a per case basis rather than on an aggregate basis. He explained that aggregate stop loss insurance says once the overall pool's self-retained loss has hit a certain amount, i.e., \$1 million or \$2 million, the insurance policy then kicks in on top of that and picks up everything over that figure. In this manner, Mr. Korn stated the individual members of the group would be protected against stop loss.

Alternatively, Mr. Korn stated the pool, if it is going to structure a surcharging system within itself so that the premiums of each pool member are dependent to a certain extent upon their loss experience, it can build things into the plan, similar to what the insurance industry does such as an experience modification formula or calculation where losses are limited so that a particular member, who may be small and who may have had the misfortune of having a huge loss which was not his or her fault, could be relieved of a tremendous impact in the surcharge formula. He added there are ways to structure the computation of premium contribution to recognize good experience versus bad experience and to limit the impact of the bad loss experience against the unfortunate member in a fashion that could be drawn out over a number of years where they are reimbursing the pool.

In conclusion, Mr. Korn stated SRG feels that if legislation is written, regulations should specifically state that pools must purchase specific and/or aggregate insurance; that there has to be an assessability feature in the pool's By Laws, and that there has to be a provision whereby the individual members are charged a "premium" contribution that is commensurate with their loss experience. He added these elements should be demonstrated before the pool is given the authority by the regulating entity to go into business.

In the event the Committee moves forward with drafting legislation, Mr. Korn stated he believes a specific study commission should be established consisting of persons familiar with the operation of setting up a pool that can work with the regulating entity to assess the items that make sense, what should be in the regulations, and how to best insure that group self insurance for the small businesses is not going to turn into some kind of disaster. At the conclusion of the study, the commission would then report back to the State with its recommendations. He briefly described Hawaii's successful group self-insurance pool involving captive insurance companies that are ultimately licensed by the State of Hawaii. Mr. Korn strongly suggested the State of Arizona consider establishing a specific study commission, or retaining an independent firm, to review the applications for participation in group self-insurance pools.

Referring to Mr. Korn's testimony that SRG was involved in putting together a rural electric utilities self-insurance group in Colorado, Mr. Wilson asked Mr. Korn if any underwriting

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criteria was used in terms of the risks the group would accept, or whether the group would take "all comers" into the pool. He explained the reason for his question is to determine if there is an indication of what risks are left for the state fund or other markets of assigned risk plans and so forth.

Mr. Korn explained that the association ended up with 21 rural electric utilities. He added that all of the Rural Electric Authorities (REAS), with the exception of three, decided to move forward with group self insurance, fund the feasibility study, and put the pool together. Mr. Korn stated that while he did not know the specific reasons why the three REAs opted out, he believed it was because local issues were involved and not because the three pools had very bad loss experience. Mr. Korn explained that SRG constructed into the feasibility study an actuarially sound method whereby those member companies who did incur bad loss experience would make a greater contribution over a period of time to make the pool whole and to pay their share. For those companies, it was a loss sensitive contribution formula. He added that the concept is "if you had good experience, your annual contribution was reduced; if you had bad experience, it was increased."

Referring to the Arizona school district self-insurance pool, Mr. Wilson asked if "any" school district is eligible to participate in the pool or if there is some specific underwriting criteria that relates to participation in the pool.

Mr. Korn answered that the Arizona school district pool does have underwriting criteria. The school districts are eligible to participate, by invitation of the three members of the pool. Commenting that he knows of several school districts that are desirous of joining the pool, Mr. Korn stated it is his understanding the three existing school districts do not want anyone else in the pool at the moment; they are satisfied with the plan they have and do not want to get any larger. By having a limited number of members, the pool believes they can better control the loss issues, claims management issues, and so forth from the onset. As the pool administrator who attends the Board of Trustees meetings, Mr. Korn stated that SRG does not know whether other school districts will be invited by the Valley Schools Workers' Compensation Pool to join that pool at some point in the future.

Referencing third party administrators who perform underwriting functions, make claims adjustments, collect monies and so forth, Ms. Williamson asked Mr. Korn if he has knowledge of whether third party administrators involved with self-insurance groups, in any of the 30 states, are regulated by the Industrial Commission, Department of Insurance, or any other regulatory body.

Mr. Korn replied he did not know the answer to Ms. Williamson's question. He added it is his assumption that third party administrators would have to be licensed because they are "funds adjusters."

Regarding actuarial determination of rates that could be accomplished by a third party administrator, Ms. Williamson asked Mr. Korn if he has knowledge of how this function is performed.

Referring to the Valley Schools Workers' Compensation Pool, Mr. Korn explained that the pool retains an independent actuarial firm to do actuarial evaluations. Referring to other pools that SRG has been involved with, either as a claims audit firm or in some other capacity, Mr. Korn stated he cannot recall of any instance where the pool administrator also did the actuarial work. Again referring to the Valley Schools Workers' Compensation Pool, Mr. Korn named the independent service providers who perform the overall administrative functions of the pool: (a) one actuarial, (b) one pool administrator (SRG), (c) one third party claims administrator (Frank Gates Service Company), (d) three law firms who handle claims, (e) one law firm that is general counsel, (f) one accounting firm that does the monthly accounting, independent of the fiscal agent who writes the checks, and (g) another independent accounting firm who is retained as an auditor who monitors the other accounting firm and fiscal agent. From an internal control perspective, Mr. Korn stated he believes it makes good sense to generously disburse the activities of the pool.

**Mark Minter, Executive Director, Arizona Builders' Alliance**, testifying on behalf of approximately 300 Arizona members of a trade association comprised of commercial and industrial contractors, stated the Alliance supports the concept of self-insurance groups. He added it was the consensus of the Alliance that group self insurance would allow more competition and more choice, that it would not have a damaging effect on the existing system of workers' compensation in Arizona, and that some changes could be made that would encourage competition. Of most importance, Mr. Minter stated the Alliance believes the individual worker, who works for an employer that is part of a self-insurance group, is going to be better off.

Prefacing that "self-insurance groups" equates to "ownership," Mr. Minter stated that with group self insurance, an employer will no longer be able to shuffle the risk off onto the insurance company and will have to be prepared to deal with some of the risk themselves and with their fellow members of that group. With ownership, there is a need to pay greater attention to risk. Mr. Minter stated that paying greater attention to safety means improvements in safety, as evidenced by many large self-insured employers in Arizona who are enjoying greater safety in the work place. He briefly described a general contractor's success story involving a significant decrease in loss time accidents during an

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entire building project in Chandler -- only 6 loss time accidents during the entire project. In conclusion, Mr. Minter stated that while the current system is not "broken," the Alliance believes the system can be improved.

Regarding Mr. Conner's question about whether "cherry picking" would take place, Mr. Minter stated that the construction industry's experience has been that those contractors who are not paying attention to safety, get "adversely selected out" by going broke. He added that the combination of exposure modifications, safety incentive plans and the aggressiveness in Arizona with respect to Occupational Safety and Health Administration (OSHA) laws contribute to those contractors' demise. Mr. Minter stated he does not believe adverse selection, i.e., "cherry picking" is taking place, other than the adverse selection of contractors themselves who go broke.

In the event the Committee recommends to move forward with group self-insurance legislation, Senator Burns asked Mr. Minter to explain how he foresees the construction industry moving forward in that direction, and if the industry assumes that directed care will be part of group insurance.

Mr. Minter answered that because he did not know enough about directed care, he could not answer the question.

Mr. Casadei asked Mr. Minter if it is correct to say that if certain construction industry employers in a self-insurance group go broke, the losses that were generated by those employers while in the group would then fall back on the rest of the group that survived.

Mr. Minter replied that those companies who have a track record of not paying attention to safety would not be able to join a self-insurance group. He added that a very good feature of a self-insurance group is that members have to initially be allowed when the group is formed; subsequently, new members have to be allowed to join the group by the existing member participants.

Mr. Casadei asked Mr. Minter if the description just given was in fact "adverse selection."

Replying that he believed it would be, Mr. Minter emphasized that in the construction industry, an employer that is not paying attention to safety is not going to be around. Because workers' compensation premiums for the construction industry is one of the very highest cost factors of doing business, Mr. Minter stated that a construction company with a bad safety record eventually becomes non-competitive and no longer gets new business.

Representative Conner remarked that his question is not who is left, what the premiums are and what has happened to those workers that were with those bad companies. He restated his questions. He asked what happens to the premium rates for the employers that do not get into the "low rate pooling deals" and what happens to the remaining employers' rates for workers' compensation insurance.

Referring to Mr. Minter's testimony regarding those companies that fall out of the pool, leaving other pool members to pick up the losses for their bad experiences, Mr. Allen asked Mr. Minter if he has any knowledge of how other states make that allocation to the remaining members of the pool; if it is on a member basis or premium basis.

Mr. Minter replied that while he did not have the knowledge of other state's processes, he stated he is aware of people having joint and several liability that are participating in these pools.

Having listened to testimony provided to Committee members regarding the various levels of administrative oversight, the joint and several liability issue, the suggestion for some accessibility requirement, the suggestion of purchasing other insurance for excess loss, Senator Burns commented that if she were a company, she might not want to spend a lot of time looking into group self insurance because of her first reaction that the opportunity may not be profitable and that the headaches and potential liability to her company could be devastating.

Mr. Minter commented that for some of those reasons mentioned by Senator Burns, the State of New York, allowing group self insurance for 30 years, has only 22% of the insured in self-insurance groups. He reiterated previous testimony that group self insurance is not for everyone.

Senator Burns asked Mr. Minter if he believes there will be enough members in the Alliance who will want to participate in group self insurance. Mr. Minter replied the Alliance would like to have the option of participating.

**Jim Klinker, Director of Public Affairs, Arizona Farm Bureau**, stated that the Farm Bureau is a volunteer association of farmers and ranchers involved in production and agriculture, controlled by a Board of Directors. Prior to 1973, he explained that agriculture was exempt from workers' compensation in Arizona; in 1973, Arizona's agriculture workers were included in the workers' compensation law. At that time, Mr. Klinker explained that the Farm Bureau members were insured with a private carrier who was insuring about 300 Farm Bureau members. The private carrier canceled the group because of the risk involved in agriculture and the size of the group. Mr. Klinker stated the Farm Bureau, with

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2,500-3,000 agricultural employers at that point in time who were going to be covered by a new law, had to determine what they could do. Mr. Klinker stated the Farm Bureau approached the State Compensation Fund with the idea of developing "dividend safety groups" within the State Compensation Fund. Speaking with 22 years of experience with a partnership between the agricultural employers and the State Compensation Fund, Mr. Klinker stated the Farm Bureau is very satisfied with the workers' compensation system administered by the State Compensation Fund -- a system that has worked well for the agricultural industry. He added he believes the State owes some measure of discussion about that system that is in place and working for the Farm Bureau's association of small employers.

At the present time, Mr. Klinker stated there are approximately 1,200 Farm Bureau member policy holders with the State Compensation Fund. He added that the vast majority of those policy holders, between \$2,000-7,000, are small employers, with great diversity. Commenting that while most people think of agriculture as being a homogeneous group; Mr. Klinker stated agriculture is not homogeneous. Agriculture includes dairy, livestock cow-calf operations, ranchers, farmers, field workers, heavy machinery operators, airplane pilots, aerial applicators and so forth who may also own the gas station in town, operate a transport business in the off season, use their grain truck to transport rebar to a mine and so forth. To the agricultural industry, Mr. Klinker stated the homogeneous issue is very important. With the implementation of group self insurance for small businesses, he added the Farm Bureau is very concerned about the impact such a program will have on the existing State Compensation Fund. Additionally, the Farm Bureau is concerned about where the small employer will go if group self insurance is implemented and where the "bad risk" will go. Mr. Klinker stated the Farm Bureau sees group self insurance benefiting the medium size to large employer but not the small employer.

Regarding the homogeneous issue, Mr. Klinker stated insurance is either a small group of large premium payors or a large group of small premium payors. He stated the Farm Bureau believes the current workers' compensation program in Arizona allows for the "melting" of those two kinds of insurance payors to come together and make a workers' compensation insurance program work.

Referencing Mr. Minter's testimony regarding safety protection in the work place, Mr. Klinker stated agriculture is a dangerous occupation and generally ranks in the top two or three industries in the country in terms of worker injuries and family member injuries because of such activities as handling machinery, handling livestock and so forth.

In the event the Committee recommends to proceed with group self insurance, Mr. Klinker stated the Farm Bureau has two concerns. If the pool of small employers gets too high

and the rate gets too high for a smaller employer, the employers will go uninsured; a situation that is not good for the employees of that employer nor for the agricultural industry. He added it is important to have a workers' compensation system that does not encourage businesses to go uninsured. Regarding protection of the workers, Mr. Klinker stated that if group self insurance does not have a "rock solid solvency provision," all employers will be paying more which will ultimately drive the smaller employers to even higher premiums resulting in a choice to not insure.

With respect to handling claims, Mr. Klinker stated the Farm Bureau is satisfied with the manner in which claims are handled through the State Compensation Fund. If the Committee proceeds with drafting legislation for group self insurance, Mr. Klinker stated the Farm Bureau is hopeful good medical diagnosis of injured workers and good claims management will not be overlooked in the pursuit of saving money by getting workers back to work faster.

In conclusion, Mr. Klinker stated he believes Arizona has a good competitive workers' compensation system in place in Arizona that offers several options for employers. Absent answers to many of the questions presented in this Committee meeting, Mr. Klinker stated he is not confident that the group self-insurance proposal for small businesses will actually benefit small employers in Arizona.

Mr. Allen asked Mr. Klinker if he is aware of any examples of states that have self-insurance groups in place that have adversely affected their state funds.

Mr. Klinker replied the Farm Bureau, like many of the persons who previously testified, is in the process of checking with other states that have self-insurance groups. He added that in his communication with the New York Farm Bureau, that organization has some concerns with the program in New York. Mr. Klinker stated it was reported to him that subsequent to the formation of a small agricultural association self-insurance group, the state fund in New York found themselves absorbing some of the higher risk employers that were originally in that self-insurance group. He added that the New York Farm Bureau has some concern that the participants in the self-insurance groups are the "cream of the crop" in terms of safety records, with higher premiums falling back on the remaining insurers such as the state fund or private carriers because of the "sick" employers that are the smaller premium payors. While having talked with three other states in depth about their group self-insurance programs, Mr. Klinker stated the Farm Bureau does not yet have a good perception of the impact on state funds in general.

**Lee Shrader, Southwest Regional Sales manager, Frank Gates Service Company,** described Frank Gates Service Company (Frank Gates) as the company that invented the

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third party administrative industry in the early 1900s. Based in Columbus, Ohio, Mr. Shrader stated Frank Gates has an office in Phoenix and has been doing business in Arizona for more than 20 years. Mr. Shrader named some of Frank Gates' clients: the Mesa School District that is individually self insured, Washington Elementary School that is individually self insured, the Phoenix Transit System that is individually self insured, and two school district pools in Arizona. He added there are three pools in Arizona, two school district pools and one accounting pool.

Regarding the Valley Schools Workers' Compensation Pool, consisting of the Paradise Valley, Deer Valley and Peoria School Districts, Mr. Shrader echoed Mr. Korn's comment that the pool does not want additional members in their group at this time. Because of that pool's decision, Mr. Shrader stated another pool was formed and named the Arizona School Alliance for Workers' Compensation, Inc., currently consisting of nine members, including the Bullhead City School District and the Kyrene School District. He added that the pool administrator for the Arizona School Alliance is Greg Jacobs who works for their Board of Trustees.

Naming many of the Frank Gates' accomplishments in dealing with various insurance groups in various states throughout the United States, including Washington and Ohio, Mr. Shrader stated Frank Gates is responsible for passing legislation in Ohio for group self insurance that was modeled after Washington State's law. He added Frank Gates strongly believes in the concept of group self insurance and believes that self-insurance groups are beneficial. Mr. Shrader stated he tells perspective employers who are considering group self insurance that they should not base their decision on the savings of money but rather for the control the employer will receive -- additional control over claims, loss control and savings. He reiterated that group self insurance is not replacing an existing system but merely offering another option to the employer.

Mr. Shrader discussed his research findings of other states with respect to self insurance legislation, groups and pools, including the States of California, Pennsylvania, Nevada, Utah, Colorado, New Mexico and Michigan. He added that New York has 51 self-insurance groups up and running. Referring to a printed chart that describes workers' compensation requirements and penalties for failure to insure in all 50 states (on file with original minutes), Mr. Shrader stated there are 32 states that allow group self insurance and 6 states that allow "some grouping." He pointed out that Arizona is one of the 36 states because it allows public groups.

Under group self insurance, Mr. Shrader stated that more control can be gained, including independent medical examination determinations and directed care. He added that

Arizona School Alliance has a directed care program that was established with CommuniCare Network (CCN) covering the metropolitan areas of Arizona.

As a good resource of information on insurance plans, Mr. Shrader recommended and described a publication listing all Arizona providers and their networks, characterized by counties, cities and specialities.

Mr. Allen asked Mr. Shrader if he had any knowledge of any state funds that have been adversely affected by group self-insurance programs. Mr. Shrader replied he has not come across any states where their state funds have been adversely affected by self-insurance groups.

Representative Mortensen asked if his understanding is correct that New York did not get involved with group self insurance. Mr. Shrader replied that New York has the largest number of self-insurance groups of any state with 51 groups.

A lengthy discussion followed between Representative Mortensen and Mr. Shrader with respect to reasons why some employers choose to self insure while other employers ultimately choose not to self insure in view of established criteria, liability issues and so forth.

Mr. Casadei asked Mr. Shrader to name a minimum premium threshold under which someone should be excluded from a self-insurance group.

Because Frank Gates is a claims administrator and does not get involved in self-insurance criteria requirements, Mr. Shrader stated he cannot answer the question. However, based on his experience working with group self insurance, Mr. Shrader stated he has seen or heard mentioned a \$7,000-\$10,000 premium. He added it is his understanding that a minimum premium threshold is established through legislation, by the self-insurance group, or by the excess carrier.

Mr. Murphy asked Mr. Shrader if he had knowledge of what effect self-insurance groups would have on excess insurance carriers and whether excess insurance carriers would support this legislation.

Mr. Shrader replied he is of the understanding the excess insurance carriers would support group self insurance in Arizona and feel that small and medium size employers would be good risks to write coverage for in Arizona.

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Cochairman Burns announced that the following persons were in attendance and in support of group self insurance:

Michelle Ahlmer, representing Arizona Retailers Association  
Leland Robinson, representing Midwest Employer Casualty Company  
Dwayne Richard, representing Arizona Food Marketing Alliance  
Patti Harrington, representing Arizona Plumbing, Heating & Cooling Contractors Assn.

Cochairman Burns suggested the Committee conclude its business with the review of the kinds of issues that need to be addressed in a future meeting. If the Committee believes Arizona is a good place to initiate self-insurance groups and provide another option for workers' compensation coverage, Cochairman Burns identified some of the following issues that would require further discussion and consideration prior to drafting legislation: reinsurance, excess insurance, surety bonding, joint and several liability, accessibility, the administration, and directed care. Additionally, Cochairman Burns posed the following questions for consideration by Committee members:

Who has oversight -- the Department of Insurance, the Industrial Commission or some separate entity that the Committee would want to set up?

Is the stability of the State Compensation Fund a concern?

Would self insurance group legislation really help the small employer? How would they be helped? Is that the group that needs helping or needs this other option?

Does the Committee believe the Legislature should write criteria into law? Does the Committee and industry actually want it written in statute? Would some of the criteria be written in statute and some be given to the regulating or oversight agency to authorize? Would the regulating agency be the Industrial Commission, the Department of Insurance or a new group?

Cochairman Burns stated she is hopeful her questions will have answers that can be addressed at the next Committee meeting, followed with a recommendation by the Committee to the Legislature for or against initiating self-insurance groups in Arizona. She added that if the Committee believes it is a good idea, the recommendation should contain the various components of self insurance groups including what language should be included in statute, what regulating agency would be given the authority to oversee the plan and so forth.

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Senator Petersen asked if his understanding is correct that there was no testimony given regarding the specific effects self-insurance groups have had on state funds in other states that allow self insurance groups.

Senator Burns commented that her understanding of Mr. Klinker's testimony is that the small agricultural employers, who are members of the Farm Bureau, are concerned about the effect; they are not sure of the effect, and they want to make sure that the State Compensation Fund remains a viable option for small employers.

Commenting that she did not believe the Committee members were provided with specific testimony with regard to the effect self insurance groups have had on state funds, Senator Burns asked Mr. Shrader if she understood him to say there was one state that allows self-insurance groups that no longer has a state fund.

Mr. Shrader replied that Michigan sold their state fund to a private company. He added that his research of the various states has indicated that while market shares may have been reduced because of self-insurance groups, state funds have not been adversely affected because of self-insurance groups.

Senator Petersen asked Mr. Shrader to provide Committee members with a copy of his research documents that show how the state funds were or were not affected by self-insurance groups. Mr. Shrader stated he would provide the written information to all Committee members.

Regarding the printed information previously distributed by Ms. Gilstrap, discussion followed between Mr. Wilson and Mr. Shrader regarding the state fund in Montana and the state fund/mutual insurance companies in Maine and Hawaii.

Commenting that the Committee will meet again if it is the desire of the Committee to continue discussion of self-insurance groups in Arizona, Cochairman Burns asked if any Committee member wants to propose that the Committee should not move forward with the self-insurance group endeavor.

Senator Peña commented he has not heard enough testimony on how "well" the claims are handled in self-insurance group plans. He added he would like to hear from some injured workers of their experience in resolving their claims under self-insurance group plans. Because Arizona presently allows pooling and captive insurance companies, Senator Peña stated he is of the belief there is no need to change the current workers' compensation system in Arizona. Unless he can be convinced that claims handling is not going to be a problem for the seriously injured workers and their dependents, Senator Peña stated he

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does not believe Arizona needs another option. He concluded by stating he has not heard enough testimony in that regard.

Senator Burns expressed an interest in seeing the publication referenced by Mr. Shrader that is being used by some self-insurance groups that identifies choices the injured worker has, choices the employer has, and the number and kinds of providers available.

Cochairman Burns invited further comments and questions. There were none.

Cochairman Burns announced the next meeting:

October 1, 1996

9:00 a.m.

House Hearing Room 2

The meeting adjourned at 11:15 a.m.

Respectfully submitted,



Nancy Boyd, Committee Secretary

(Tapes and attachments on file in the Office of the Secretary of the Senate.)



ARIZONA STATE LEGISLATURE

Meeting Notice

**Open to the Public**

**WORKERS COMPENSATION GROUP  
SELF-INSURANCE STUDY COMMITTEE**

**DATE:** Tuesday, October 1, 1996

**TIME:** 9:00 am - 12:00 pm

**PLACE:** HHR2

**AGENDA**

1. Opening Remarks.
2. Staff Presentation.
3. Public Comments.
4. Panel Discussion.
5. Recommendations.

**MEMBERS:**

Representative Pat Conner, Cochair  
Representative Paul Mortensen  
Representative Ruben Ortega

Senator Brenda Burns, Cochair  
Senator Manuel "Lito" Peña  
Senator David Petersen

Michael Allen, Trade Association  
Gregory Casadei, State Compensation Fund  
Larry Etchechury, Arizona Industrial Commission  
Donald A. Johnson, Organization of Employees  
Michael Murphy, Employer-provides self-insurance  
Bob Newsome, Employer-purchases workers compensation  
Deloris Williamson, Arizona Department of Insurance  
Wayne Wilson, Insurance Carrier

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**ARIZONA STATE LEGISLATURE**

**WORKERS' COMPENSATION GROUP  
SELF-INSURANCE STUDY COMMITTEE**

Minutes of Meeting  
October 1, 1996 - 9:00 a.m.  
House Hearing Room 2

**Members Present**

Senator Brenda Burns, Cochairman  
Senator David Petersen  
Senator Manual "Lito" Peña  
Larry Etchechury  
Deloris Williamson  
Donald A. Johnson

Representative Pat Conner, Cochairman  
Representative Paul Mortensen  
Bob Newsome  
Gregory Casadei  
Michael Allen  
Michael Murphy

**Members Excused**

Representative Ruben Ortega  
Wayne Wilson

**Staff Present**

Wendy Baldo, Senate Research Analyst  
Diana O'Dell, House Research Analyst

Cochairman Conner called the meeting to order at 9:02 a.m. and attendance was noted.

Cochairman Conner announced that Committee members would review the key issues of private group self insurance, review and discuss a proposed Questionnaire, hear Mr. Etchechury's overview of his research findings on the effects of group self insurance on state compensation funds, hear public comment, and possibly make recommendations of where the Committee is headed with private workers' compensation group self-insurance plans.

**Diana O'Dell, House Research Analyst**, summarized the various questions posed by Cochairman Burns in the September 23, 1996 meeting, as contained in the printed information entitled, "Key Issues" (on file with original minutes). Based on the assumption that the Committee makes a recommendation to move forward with the concept of a private workers' compensation group self-insurance program for the State of Arizona, Ms. O'Dell stated there are certain key issues that need to be addressed. She identified the key issue categories: authorization, membership, administration and finance.

With respect to membership, Ms. O'Dell stated answers are needed for the minimum number of employees, the financial condition of each member and number of years in business, whether the group should be "completely open" or whether it should be homogeneous or heterogeneous.

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With respect to administration, Ms. O'Dell commented answers are needed on whether the regulation should be through statute or administrative rules, or a combination of both. Whether the oversight should be through the Department of Insurance, the Industrial Commission or a newly-created entity, and what the requirements would be for the composition of a Board of Trustees and a third party administrator.

With respect to financing, Ms. O'Dell questioned what form of financing would be the required security, including the types and amounts; if there would be a special guarantee fund for self insured; if there would be excess insurance coverage and a joint and several liability clause; and what the frequency would be in determining the accuracy of loss reports and financial reports and how often those reports should be filed.

With respect to authorization, Ms. O'Dell stated an answer is needed for the question of what kind of an affect private self-insurance groups would have on the current system, specifically the State Compensation Fund, and the affect on small business.

While commenting on the importance of directed care and safety program issues, Ms. O'Dell stated those items are not specifically addressed in the Questionnaire.

Referencing the Questionnaire (on file with original minutes), Ms. O'Dell explained that the opening paragraph is directed to the persons who will receive the Questionnaire, including each Committee member and members of the trade association, asking for input and feedback in order to assess the way in which private self-insurance groups would occur. Ms. O'Dell stated the opening question, dealing with authorization, asks whether or not the public believes there should be legislation that would allow private group self insurance.

Representative Conner stated he believes the Questionnaire follows many of the concerns and key issues expressed by Senator Burns at the previous meeting. He added he believes the Questionnaire will be beneficial to the Committee in terms of recommending or not recommending legislation. Representative Conner stated the Questionnaire will not be necessary if Committee members believe they are in a position today to make any type of recommendation to move forward with drafting legislation. He added it is necessary to have the forms completed as soon as possible, allowing enough time for staff to prepare a summary of the answers that can be presented at the next Committee meeting during the second week in November.

If the Committee recommends the Questionnaire be mailed out, Ms. O'Dell requested that it be completed and returned to staff by November 1, 1996.

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Cochairman Burns asked Cochairman Conner for his thoughts on allowing the Committee to offer input and suggestions on the Questionnaire form, such as including a question that may not be on the form, or rewording a particular question that is not clear. Inquiring of the composition of the mailing list for the Questionnaire, Cochairman Burns stated it is important to make sure everyone who has an interest in private self-insurance groups be asked to complete the Questionnaire. In conclusion, she stated she would like to see one question on the form that asks the participants if they would participate in the group self-insurance program if private group self insurance is allowed in Arizona.

Explaining his reasoning for adding an "Additional Comments" section, Cochairman Conner stated the Additional Comments section is a "catch all" for any questions or comments not addressed in the Questionnaire.

With respect to the mailing list of persons and trade associations, Cochairman Conner stated the database will be comprised of persons who have shown an interest in wanting to participate in group pooling by attending joint legislative meetings over the past three years. He added it is his desire to put the Questionnaire into the hands of as many persons as possible that can provide Committee members with additional input.

Representative Mortensen inquired of the process used to mail out the Questionnaire.

Referring to the Questionnaire form in the physical possession of each Committee members, Cochairman Conner asked that it be completed and given to staff before November 1. He stated the mailing process would be handled by staff with respect to industry persons. Cochairman Conner encouraged Committee members to make known their thoughts relative to making additions to the Questionnaire or suggestions on how the Questionnaire form can be more beneficial in collecting necessary information.

Having taken a few minutes to silently read the Questionnaire, Cochairman Conner asked for comments and questions of Committee members.

As one of the requirements of self-insurance groups, Representative Mortensen asked Committee members if it would be wise to have an underwriter who underwrites the insurance for the self-insured program.

Referring to question #9 of the Questionnaire, Ms. O'Dell stated she believes Representative Mortensen's concern is addressed in question #9. Cochairman Conner asked Committee members if they were of the opinion that the wording of question #9 addresses Representative Mortensen's concern.

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Ms. Williamson explained that an underwriter is normally considered to be an insurance company because they are underwriting the risk. In a self-insurance situation, she added it is a misnomer because there is no insurance company at risk. In self insurance, it is generally handled through a third party administrator. Ms. Williamson explained that if, at some point in time, an insurance company might act as a third party administrator, it would collect the premiums and pay the claims but would not assume the risk.

Senator Peña asked if it is necessary to complete the Questionnaire if the participant answers, "no" to the first question of whether or not they believe the Arizona Legislature should authorize private group self insurance within the workers' compensation system.

If the answer is "no," Representative Conner stated he is hopeful those persons will respond to the remaining questions and add suggestions of what things could be beneficial in making group self insurance a good program.

In light of Mr. Klinker's previous testimony on behalf of Farm Bureau members, and referring to question #3, Mr. Casadei questioned whether the members of the group should be homogeneous to include all employees from the same general business. Referring to Mr. Klinker's testimony that Farm Bureau members are in the same general business but are not homogeneous from a risk standpoint, Mr. Casadei stated he believes the Committee is looking for similar risks within a self-insurance group.

Representative Conner asked Mr. Casadei to suggest how question #3 could be clarified. While suggesting that the word "general" could be stricken to make the membership more specific, Mr. Casadei stated he did not know if that change would be "too limiting."

Expressing caution, Senator Burns stated she believes question #3 is difficult to reword. By way of example, she mentioned that a homogeneous group could have within each like group warehouse persons using forklifts as well as receptionists performing duties in an office, i.e., a very diverse group within companies made up of the same type of employees considered to be homogeneous.

Discussion followed between Mr. Casadei, Senator Burns and Representative Conner regarding the need to better identify the business. Representative Conner suggested identifying a business by "belonging to a trade association." Further discussion followed.

By making the point in the question that there are homogeneous and heterogeneous considerations with regard to types of businesses or risk factors, Senator Burns suggested posing a broader question that would result in the information desired.

Representative Conner posed for the Committee's consideration whether the pools should be narrowly defined or widely defined and what the better benefit would be to the business and employees. As previously mentioned by Senator Burns, Representative Conner questioned what type of restrictions are being sought and what benefits could be gained.

Referring to the construction industry, Mr. Johnson questioned whether the group should be narrowly defined, such as just concrete layers only, or whether a contractor in a trade association should include everyone from sheet rockers to tapers that wanted to join the pool. In summary, Mr. Johnson questioned whether it is the intent of this Committee to narrowly define the participants in the pools or to open the pools up to the trade associations. In either situation, Mr. Johnson questioned what restrictions should apply, if any.

Representative Mortensen stated he did not believe restrictions should be placed on the group. Concurring with Mr. Casadei, Representative Mortensen stated he does not believe question #3 is clearly worded. He suggested rewording the question, absent restrictions, and to open the pool to the entire industry at this point in time.

Senator Burns suggested that staff reword question #3 for review by Mr. Casadei, Representatives Mortensen and Conner and herself prior to mailing out the Questionnaire. Representative Conner concurred with the suggestion.

Cochairman Conner asked Representative Mortensen and Mr. Casadei to work with staff to make question #3 more acceptable.

Senator Burns stated she is hopeful the Questionnaire will produce a great deal of input and perhaps items which the Committee has not yet considered. She added she believes the questions will draw out some really thoughtful comments from the participants that can be helpful and useful to the Committee in making its decision.

Mr. Newsome expressed concern for the amount of time an employer or participant of a self-insurance group would be required to participate. He questioned whether the participant should be required to participate three to five years or whether they should be allowed to "jump in and out" of the plan on an annual basis.

Recognizing Mr. Newsome's question as a good question, Cochairman Conner asked that the question be included under the membership heading in the Questionnaire form.

Ms. Williamson expressed the Department of Insurance's concern that insurers are not impacted negatively by any kind of self-insured situation. Commenting that while she

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recognizes the Questionnaire speaks of a special guarantee fund for self-insured groups, Ms. Williamson suggested it would be useful to send the Questionnaire to the independent insurance agents who often act for the self insured, as well as some of the independent agents' insurance company associations. She suggested that a question be included that would specifically address the issue of whether insurance companies should or should not be in the same solvency pool as self insureds.

Recognizing Ms. Williamson's comment as a good comment, Cochairman Conner asked that Ms. Williamson's question be included in the Questionnaire under the proper heading.

Cochairman Conner asked Ms. Williamson if his understanding is correct that she is suggesting the Questionnaire be mailed to all independent insurance agencies.

Ms. Williamson suggested the Questionnaire be mailed to the Independent Insurance Agents Association.

Cochairman Conner asked Ms. Williamson if she mentioned one or two organizations. Ms. Williamson replied, "two organizations." She added she believes the Independent Insurance Agents Association is the largest of the two trade associations and will include most of the independent insurance agents. She volunteered to provide staff with the names and addresses of contact persons for both organizations.

Cochairman Conner asked Mr. Etchechury to present his findings from conversations with other states that allow private self-insurance groups.

Because of concerns expressed by Committee members at the September 23, 1996 meeting regarding the impact of group self insurance on existing state funds, Mr. Etchechury stated he called several states, attempting to quantify the impact of self-insurance groups on state funds. He referred Committee members to his written summary of the conversations he had with representatives of the States of Louisiana, Maryland, Michigan, Minnesota, Montana, New York, Oregon, and Pennsylvania (on file with original minutes). He explained that with the exception of Michigan and Montana, during the years 1991 through 1993, states had a proliferation of self-insurance groups. Mr. Etchechury commented that initially, there was an impact on the state funds because the self-insurance groups were pulling membership from the state funds; most of the self-insurance groups were political subdivisions that were heavily insured by the state funds. Shortly thereafter as a result of some reform legislation throughout the states, Mr. Etchechury stated premium rates increased. He added it was reform legislation that increased the competitiveness in the industry resulting in competitive rating laws and other reform legislation. Citing Pennsylvania and Maryland, he stated the competitiveness

tremendously overshadowed any impact that the self-insurance groups had on the state funds.

Mr. Etchechury remarked that the ability to survive with the ability to compete was proportional in terms of how much flexibility the individual state funds had; the more flexibility the state funds had, the more they were able to lessen the impacts created from the self-insurance group and the competitive environment they were in. He added that those state funds that were not as competitive were hurt significantly such as the State of Pennsylvania that went from annual premiums of about \$490 million to \$190 million during that period of time. The State of Pennsylvania is now in the process of building up their state fund. Mr. Etchechury commented that other states, such as Oregon, that had significant rate decreases as well as a very competitive state fund, were able to "weather the storm" and stay competitive.

In terms of regulation of the fund, Mr. Etchechury stated there is no consistency. He added that the State of Montana has absolutely no financial threshold criteria whatsoever. Commenting that regulation deals primarily with three or four areas, Mr. Etchechury explained that the minimum pool has to have 100 employees; the pool has to be created for other purposes of self insurance which means it predominantly has to be an association; and consideration of individual members is significantly based on their financial background and status with no minimum financial criteria. He added that other states such as Minnesota have two different types of funds, one for larger companies and one for smaller companies. He pointed out that the smaller funds have a larger threshold than the larger funds.

Regarding membership, Mr. Etchechury stated some states allow homogeneous groups, some allow heterogenous, some have had problems with heterogenous, some have not had problems with heterogenous.

In summary, Mr. Etchechury stated that his findings determined that each state is little different with respect to allowing group self insurance.

Senator Burns expressed appreciation to Mr. Etchechury for his research. Referring to Mr. Etchechury's testimony regarding the importance of state funds' flexibility, Senator Burns asked if the state funds were treated exactly like private carriers in those states where group self insurance was working.

Mr. Etchechury replied yes. He added that those state funds were using outside agents and cited the State of Oregon with 50% of their business coming from outside agents. He added Oregon paid commissions to outside agents; had the ability to discount claims

tremendously; and provided a lengthy list of discounts such as a discount for policies in excess of \$100,000, a discount for a managed care program and so forth. Mr. Etchechury stated those state funds that had ability to pick and choose, create plans, retro rating plans and so forth, did not have a problem such as the States of Michigan and Kentucky.

Senator Burns asked Mr. Etchechury if he knew of the state fund's tax liability in the states that he conversed with. She added it is her recollection that the Arizona State Compensation Fund is at a competitive advantage to private carriers with regard to their tax liability in the State.

Mr. Etchechury replied he did not know.

Mr. Murphy asked Mr. Etchechury if he was able to determine what affect self insurance groups has on workers' compensation rates.

Mr. Etchechury replied no. Commenting that while most states believed group self insurance was a good element to put into the mix because they were able to deal with it, Mr. Etchechury restated that almost each state was independent of itself in terms of the criteria that gave rise to the self-insurance group. He added he does not believe conclusions can be drawn in terms of other states' criteria applying to the State of Arizona.

Representative Conner asked Mr. Etchechury whether the Industrial Commission or Department of Insurance was the regulatory agency for the self-insurance groups in the states that he interviewed.

Mr. Etchechury replied that some states named the Industrial Commission, others named the Department of Insurance, and others named the Department of Commerce. He added that some states had guarantee funds and other did not. Referring to Mr. Newsome's previous question about group self-insurance participants opting in and out of the program, Mr. Etchechury stated that as states became more competitive and as the prices went down, the insurance companies were competing with the self-insurance groups. Consequently, self-insurance groups were becoming private; the transition from group to private became a major issue. He added that the larger an employer is, greater is the likelihood that the larger employer will have people opting out of self-insurance groups and going into private insurance if the rates are there.

**Dwayne Richard, President, Arizona Food Marketing Alliance (formerly known as the Retail Grocers Association of Arizona)**, stated he visited with Jim Hopper of the Grocers Association of Oklahoma (Grocers Association) and wanted to clear up some facts that were testified to at the September 23, 1996 meeting. Referencing testimony that there are

24 members in the Grocers Association pool, Mr. Richard stated there are 24 "active claims" still operating in the pool. He added there were over 200 members in the pool at the time that it closed down one year ago.

Mr. Richard stated he believes the Grocers Association pool is a prime example of greed -- an organization that put together a pool because they wanted to save money and money savings was the only thing they looked at. He added that as the pool continued to operate through the good and bad years, the group failed to take into account what would happen down the road when all the claims had to be paid, and distributed the leftover monies among its members. The association came to the point where their debt was greater than the premiums they were receiving. If a workers' compensation self-insurance pool is going to take place in Arizona, Mr. Richard cautioned Committee members to make sure there are mandates on those pools that provide for the financial stability needed for those members and their employees.

He added that the Grocers Association of Oklahoma is going back to members who have not been part of the pool since 1989 and assessing them to pay for the outstanding claims. As an association executive, Mr. Richard stated he would not want to have to do what Oklahoma is doing. He characterized that scenario as the worst public relations tool. At the conclusion of going through the court process of assessing all members and suing them for the money, Mr. Richard stated that if there is still not enough money left over, the employees or persons not receiving their benefits, have the right to sue "any member" of that organization, not just "members of that pool."

Aside from the Grocers Association difficulties, Mr. Richard stated there are some good self-insurance groups operating in Oklahoma including the Restaurant Association. He added that he believes the Retailers Association is in the process of going private.

As an organization, Mr. Richard stated he is personally excited about the prospect of group self insurance in Arizona. He added that his organization's decision to participate will not be when legislation is passed, but rather when the timing is right for the membership and when the membership believes the organization can be protected by group self insurance.

Mr. Richard described his involvement and experience with a retailers group self-insurance fund in the State of Missouri. Because Missouri's laws were so strict with respect to membership and because the laws were so narrowly defined by statute and regulation, Mr. Richard stated his organization took some poor risks in reaching the premium level required by law. He commented that retailers were lumped into the same category as garbage collectors under the strict guidelines of the State. During the first year of operation, Mr. Richard added there was a death, the organization could not get

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reinsurance, and the fund went broke. He stressed the importance of determining who will and who will not be allowed to participate in a pool. Mr. Richard cited the State of Arkansas as another example where the retailers and grocers are combined together into one organization, however Arkansas law does not allow all of them to pool together for workers' compensation because of the mixed risks. He stated he is of the understanding that there is a pool for the grocers in that organization and that the organization is in the process of establishing another pool for the rest of the membership.

Based on conversations with retailers and grocers in Oklahoma, Mr. Richard stated he has been told that self insurance has not been a major impact on the state fund, but that the market place has been a major impact on the state fund; when things get tough and when there is no competition, the state funds and self insurance both benefit. When the market becomes highly competitive, such as what is presently occurring in Arizona, state funds and self insurance groups both suffer. Referring to his communications with Oklahoma, Mr. Richard stated he has been told it is not a matter of one organization dragging down the other but rather a matter of competition dragging down both of them.

Senator Petersen asked Mr. Etchechury and Mr. Richard if either of them were able to ascertain the length of time a group had to stay in the self-insurance arena and whether the groups were allowed to "jump in and out" of the plan.

Mr. Etchechury stated that while he was not able to make that specific determination in terms of percentage, he knows for a fact that "that experience" is ongoing now that the rates are down in a lot of those state. He added those states are seeing participants opting out of self-insurance groups and going into the private insurance market.

Mr. Richard stated that while "that experience" was not an issue that was raised in his conversation with Mr. Hopper, he assumes Oklahoma has some protection. With the groups' ability to go back to the members who participated in 1989 and are still financially responsible, even if they opted out of the plan, the group would still have the protection with that financial responsibility of the members. He added he is of the opinion that a self-insurance group would want the stability of the fund in order to prevent the draining of the fund or "cherry picking."

Referencing the Grocers Association of Oklahoma incident, Mr. Casadei asked Mr. Richard if his understanding is correct that the self-insurance group had to sue former members for claims of prior pools, as far back as 1989.

Mr. Richard answered that the self-insurance group is taking legal action, under court order, to hold former members responsible for payment of the claims; the court is

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mandating that the group collect those funds from those members that have not made payment to the group's fund. He stated he was told it is a "a court-mandated assessment."

Mr. Casadei asked if the Grocers Association had a Joint and Several Liability Agreement in place with their self-insurance pool.

Mr. Richard replied yes. Adding that even though the pool had a "piece of paper," Mr. Richard stated the pool had to turn to the courts to enforce the agreement. He commented that the Oklahoma incident is a "public relations nightmare."

Even with the Joint and Several Liability Agreement, Mr. Casadei asked if his understanding is correct that the group has to take legal action to get the funding for the claim costs. Mr. Richard replied yes and added even though the group has the legal right, the matter of collecting is much more difficult in almost all instances.

Referring to Mr. Richard's testimony regarding the self-insurance group that had the misfortune of one death, could not obtain reinsurance and subsequently went broke, Mr. Newsome asked if that group had reinsurance prior to formation.

Mr. Richard replied yes. He stated that while the company had reinsurance through Lloyds of London, after one and possibly two years later, that reinsurance was no longer available to the group. Mr. Richard stated the group was unable to obtain reinsurance from another company and subsequently closed the fund because Missouri law requires that self-insurance groups have reinsurance.

Mr. Newsome asked Mr. Richard if he knew what the starting premium was for self retention at that point in time. Mr. Richard stated he did not know the specific figure but believed the cost was approximately \$2 million for a fund to be established 15 years ago.

Referring to Missouri laws governing self-insurance groups, Mr. Allen asked Mr. Richard if there were any guidelines established with respect to requirements for financial stability of a particular fund that would permit the group, within a set amount of years, to go back to previous members to acquire monies.

Mr. Richard replied that while the "Missouri incident" occurred in 1984, he cannot recall the specifics of the incident. He recalled that it took approximately one year to get the program up and running. Mr. Richard added that the State of Missouri has just recently begun the process of reestablishing a workers' compensation fund with better control and a better understanding of what things can and cannot go wrong.

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**Johnny Haggard, owner, Haggard Land & Cattle, Buckeye, Arizona**, testifying in support of self-insurance groups, stated he farms approximately 1,000 acres of cotton in the Gila Bend area and has actively followed the issue of group self insurance. Referring to testimony heard at the September 23, 1996 Committee meeting, Mr. Haggard stated he believes the affect private self-insurance groups will have on the State of Arizona will be determined by (a) the aggressiveness that the private sector uses in soliciting and organizing new pools and (b) the response of the State's current system to the demands of competition. With respect to testimony regarding "bad apples" and "good apples" and "cherry picking," Mr. Haggard stated he does not believe that issue should be a determining factor in deciding whether private employers should be given the same equal opportunity as public agencies in forming pools. Mr. Haggard stated that even though many farmers are satisfied with the current workers' compensation system, he believes there are many farmers that would choose to join a pool if given that option. Rather than focusing on whether or not the current system is broken, Mr. Haggard stated he believes the real issue is whether the current system is allowing public agencies an unfair economic advantage over private industry.

**Jerry LeCompte, President, Arizona State Compensation Fund**, stated he wished to address Committee members because of the concerns expressed at the previous meeting with respect to the impact that group self insurance would have on the State Compensation Fund. He commented that Mr. Etchechury's research is correct that the major impact upon state funds and self-insurance groups depends dramatically upon the competitive nature of that state's workers' compensation system and the kinds of reforms that have taken place over a period of time. While speaking with experience of reforms in other states, Mr. LeCompte stated he does not believe Arizona needs a major reform.

Because of the Arizona Legislature and the persons and agencies involved in the control and operation of the workers' compensation system over past decades, Mr. LeCompte stated the system is working well. However, he remarked that other states have not had that success with their systems, ultimately choosing many different kinds of corrections such as creating state funds, primarily competitive state funds; creating self-insurance groups without state funds; and creating self-insurance groups and state funds. Briefly describing the workers' compensation system in Louisiana, Mr. LeCompte pointed out that with 97% of the state's employers in the assigned risk pool and self-insurance group insurance in place, a state fund was created despite the opposition of self-insurance groups. He added that today, the Louisiana program is well on its way of having over 100 private carriers competing for that marketplace. Mr. LeCompte described a similar situation in the State of Maine where virtually the entire state's employers were in the assigned risk pool. He added it was reform in Maine that dealt with not only how classifications were

developed, but how premiums were charged, how claims were accepted or denied and how they were processed.

Referring to the State of Arizona and market share, Mr. LeCompte stated the market place is always moving and is not going any one direction. He stated that in terms of market share, the State Compensation Fund writes more market share in percentage terms. At the beginning of 1995, he stated the State Compensation Fund had 46.8% of the market; at the end of 1995, it had 48.4% of the market. He pointed out that the market has now shrunk, prices have gone down, more employers have chosen group self insurance, and large deductibles are in place. Stressing the fact that the market is continually changing, Mr. LeCompte pointed out that even though the market share in total dollars goes down, the market share goes up in percentage terms.

With respect to tax liability, Mr. LeCompte stated the tax liability issue is a "mixed bag" across the country. He stated most of the funds are being created with specific language that says the funds are not an instrumentality of the state that is creating the funds to make sure that the programs being developed are not necessarily guided by governmental decisions such as freezing rates, changing benefit levels for or against employers or employees and so forth. Mr. LeCompte noted that the state funds of Minnesota and New Mexico pay federal income tax. He added that to his knowledge, all state funds pay the state premium tax -- a premium tax on the premium, in the same way the private carrier pays premium tax on the premium in lieu of paying a state income tax.

With respect to exemption of federal taxation, Mr. LeCompte pointed out that the states of Utah, Maine and others are seeking verification from the federal government. He added he personally believes the federal government's determination will be that those states owe federal income tax. Mr. LeCompte stated that the State Compensation Fund in Arizona does not pay federal income tax, nor do most of the older funds created five or six years ago because (a) the funds "came out" of the creation of the workers' compensation industry and (b) the funds do not deny any coverage to an employer that is seeking coverage. Referring to those states with exclusive state funds, he named a few including: Ohio, Washington, Nevada, and West Virginia.

Referring to the State of Oregon, Mr. LeCompte stated Oregon does not pay federal income tax, is seeking a federal legislative exemption from federal income tax, and is asking other states to "join in" on their appeal to Congress for the exemption.

Referring to the State of Michigan, Mr. LeCompte stated that Michigan sold their fund to Blue Cross/Blue Shield who is now paying the federal income taxes. Because Blue Cross/Blue Shield has non-profit status and because it bought the Michigan Accident Fund

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from the State of Michigan, a profit-making organization, Mr. LeCompte stated a new issue has arisen with respect to Blue Cross/Blue Shield's corporate umbrella being non-profit or profit.

Referring to Mr. Etchechury's testimony about self-insurance groups successfully working in other states because the programs contain flexibility, Representative Conner asked Mr. LeCompte to name the things that would be needed by Arizona's State Compensation Fund, in terms of fairness, if private self-insurance groups are initiated in Arizona.

Commenting that competition in Arizona is relatively fierce, Mr. LeCompte stated the State Compensation Fund has a simplistic outlook to competition, meaning it will charge the same price to the same customer with the same loss experience. The State Compensation Fund does not care whether the applicant is a logger or a fisherman, grocery store owner or farmer, or a large or small employer because the pricing from the State Compensation Fund is the same, based on loss experience. Mr. LeCompte discussed the Safety Incentive Plan initiated by the State Compensation Fund approximately three years ago to benefit the employer. Commenting that he believes underwriting is a good thing in the insurance industry, Mr. LeCompte remarked that the State Compensation Fund will write anyone that comes through their door, with very few exceptions. He added the State Compensation Fund has the authority to refuse coverage in Arizona. He described the Ice Capades situation where they were denied coverage.

With regard to marketing, Mr. LeCompte commented the State Compensation Fund is one of the few state funds that markets their products with their own sales personnel. He added the State Compensation Fund believes it provides a superior product with its own personnel. While recognizing that the State Compensation Fund may not have the same relationship with an employer that a private agent may have by writing the rest of the insurance needs for that employer, he stated the State Compensation Fund believes it has the kind of program that brings about the best benefit at the least cost.

In summary, Mr. LeCompte stated nothing comes to his mind directly as a necessary component that the State Compensation Fund would need in order to compete with group self insurance.

Representative Conner asked if he understands Mr. LeCompte to say that Arizona is already flexible and that flexibility is already built into the legislation that gives the State Compensation Fund the power to do what is needed to compete in the group self-insurance markets. Mr. LeCompte replied yes.

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With this type of competitiveness in the workers' compensation industry, Mr. Allen asked Mr. LeCompte if he believed a change like this would provide more competitive rates and more effective claims review and evaluation with quicker turnaround time.

Commenting that he did not believe it was a given, Mr. LeCompte answered that a change like this may make claims management processing more efficient but it would not be a given just because it is available through a group self-insurance program. He added it will require either third party administration or the ability to be built right into the system. Commenting that workers' compensation claims are "long tailed," Mr. LeCompte pointed out that the State Compensation Fund's oldest claim is a 1935 injury resulting in a death benefit to a widow, and that it has an active medical treatment on a claim that occurred in the 1950s. With respect to this change providing more competitive rates, Mr. LeCompte stated there is a certain amount of rate making that deals with current projections of future costs.

In his conversations with other state's representatives that referred to the term, "competitive rating laws," Mr. Etchechury asked Mr. LeCompte to define the term.

Mr. LeCompte explained that the competitive rating laws predominantly deal with the ability to "file" and "use," meaning that an insurance organization can file a rating plan that is automatically deemed approved as long as the rates are not egregious in some manner. He stated that typically rates cannot be excessive, cannot be unfairly discriminatory and cannot be inadequate. It is left up to the insurers to file their own rates; the state may have a basic rate filing that is advisory in nature; however, carriers are not limited to use the rates filed in their section. With respect to Arizona, Mr. LeCompte stated there is a rate filing and while all carriers have to start with that rate, they may move away from that rate with prior approval.

Having read the following statement from a construction industry publication: *"Some insurance companies, as well as self insured and captive insured companies, have managed to reduce their expense ratios to 15% or even lower. This stands in direct contrast to many large insurers who are carrying expense ratios in the neighborhood of 25% - 35% in premiums,"* Mr. Johnson asked Mr. LeCompte where the State Compensation Fund would be in that scenario.

Mr. LeCompte replied the State Compensation Fund currently runs, and has run, on an operating ratio of approximately 15%.

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If private group self-insurance legislation is passed in Arizona, Mr. Murphy asked Mr. LeCompte if the State Compensation Fund has an interest in administering group self-insurance plans.

Mr. LeCompte replied that the State Compensation Fund's Board of Directors has directed the State Fund to create third party administration capabilities to take advantage of what the State Fund believes are possible upcoming excess capacities. He added that the State Fund believes it could pass these capabilities on to any customers, including group self insurance. If private group self insurance becomes law, Mr. LeCompte commented the State Compensation Fund would be interested in that marketplace.

Concluding public testimony and referencing the agenda item entitled, "Panel Discussion," Cochairman Conner stated he is not in a position to make a recommendation at this point in time with respect to private group self insurance. At the conclusion of the September 23, 1996 meeting, Cochairman Conner stated that because he was personally interested in obtaining additional input on the subject matter, the idea of a Questionnaire was developed. Cochairman Conner suggested the Questionnaire be distributed, the input be analyzed, and the Committee be prepared to make a recommendation to the President of the Senate and Speaker of the House in the next meeting.

Mr. Newsome asked if the Committee will have an opportunity to review the completed Questionnaires before the next meeting.

With a deadline of November 1, 1996 for completion and return of the Questionnaire, Cochairman Conner explained that staff would gather the information and provide a summary of the information to all Committee members prior to the next meeting.

With respect to the key issue of oversight, Senator Burns asked panel members for their thoughts on problems that might exist if oversight authority is given to the Department of Insurance or the Industrial Commission. She also asked for their thoughts on whether private group self insurance should be in statute or be completely regulated by a regulatory agency. While not yet being comfortable with that issue, Senator Burns stated she would like to begin formulating some ideas in her own mind about where private group self insurance should be placed if the Committee recommends moving forward with private group self insurance.

Mr. Etchechury replied he cannot imagine group self insurance being put into statute. He stated that most of the states that have group self-insurance programs, whether it is with the Department of Insurance, Department of Commerce or Industrial Commission, implements the programs by regulation. He added the states have an "umbrella statute"

that says groups can be self insured and the process of developing regulations takes place within the agency. Mr. Etchechury stated he believes that scenario would work well in Arizona because of the current regulation process. Under the Administrative Procedures Act, the regulatory agency is mandated to get input from the Governor's Regulatory Review Council and the Attorney General's Office where each comment is required to be addressed by the regulating agency before those bodies. He pointed out that the regulating agency cannot pick and choose the comments they want to respond to; they have to address all comments. To avoid "sandbagging" in the middle of the process, Mr. Etchechury commented that a great deal of preparation work is undertaken by the regulating agency to be fully prepared to address all of the comments. Mr. Etchechury stated it is his recommendation to deal with the group self-insurance concept through regulation rather than statute.

Referring to Mr. Etchechury's conversations with other states, Senator Burns asked him where the various states received their regulatory direction with respect to group self insurance.

Mr. Etchechury answered the specific regulating agency depended on the structure of each respective state in the way in which group self insurance was handled. He stated the regulatory agencies varied from the Industrial Commission to the Department of Commerce and the Department of Insurance.

Ms. Williamson replied that the Department of Insurance has given the idea some thought and just recently sent out a survey to some of their fellow regulators in the other 50 states to determine specifically what authority the Departments of Insurance have, and does not have, over group self insurance. With the receipt of three completed surveys from the Departments of Insurance for Oklahoma, Michigan and Georgia, Ms. Williamson stated all three departments have indicated they have a dual situation. She added that the only regulation the Departments of Insurance have, are over the rates. In the states where there is some kind of rating making that the Departments of Insurance has, Ms. Williamson stated there is some statistical-keeping body that acquires the experience so that the rates can be made. She added by statute, the self-insurance groups have to report to a statistical-keeping body who in turn can make the rate for them or in some situations, they can make their own rates. They get the approval of the Department of Insurance to use those rates.

Referencing Arizona's Title 20 insurance code, Mr. Williamson stated the Department of Insurance is concerned that because the entire code is geared to insurance in terms of regulating insurance companies, insurance agencies, and third party administrators who are licensed health administrators, it does not include any language on regulation of self-

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insurance groups. She added that the regulation of self-insurance groups would be a whole new "ball game" for the Department of Insurance. Another concern of the Department is what the new oversight would mean in terms of additional employees.

Commenting that rate making is a very difficult process and rates are founded in time, Ms. Williamson stated the Department would have a concern with the adequacy of the rates. She stated she does not know, at this point in time, if the Department of Insurance would be geared up to handle a situation where the Department would have an inadequate rate with a self insured. Ms. Williamson stated the issue would need further study by the Department.

Mr. Johnson asked Ms. Williamson how the regulation of small employer self-insurance groups would be different from current regulation of larger employer self-insurance groups.

Ms. Williamson replied that the larger self-insured groups are regulated by the Industrial Commission.

In terms of regulation differences, Mr. Etchechury added he did not know the answer because it would depend on what format the Committee would take in recommending private group self insurance.

Representative Mortensen asked if any revenues would come to the State as a result of the creation of self-insurance groups.

Representative Conner asked Mr. Etchechury if the Industrial Commission currently receives any proportionate share of the premiums and dividends, charged to the State Compensation Fund, to run the Industrial Commission, or if the Commission receives all of its funding from the State General Fund.

Mr. Etchechury answered that the Commission assesses a tax, based on the premium amount, that cannot exceed 3% per year. He added the current assessment is 1.46%.

Representative Conner asked if 1.46% is being assessed to the self insured in the political subdivisions.

Mr. Etchechury replied yes. He added their premiums are calculated and taxes are assessed in the same manner as private carriers. Those monies fund the Commission. Mr. Etchechury stated the Commission has a Guarantee Fund, a special fund, that the Commission is allowed to assess a tax up to 1.5%. He pointed out that the Guarantee Fund tax has been zeroed out for the last 4-5 years.

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Answering Representative Mortensen's question regarding revenue going to the State General Fund, Mr. Etchechury stated no monies would go to the General Fund unless the Legislature put an assessment on group self insurance.

If group self insurance is regulated by the Industrial Commission, the Department of Insurance, or some newly-created entity, Representative Conner commented there would have to be a means for funding the additional employees and administrative costs that would be needed to carry out the rule making functions. Representative Conner asked Representative Mortensen if his question pertained to this concern.

Representative Mortensen replied yes. He added he believes it is important that the Legislature give serious consideration to the matter so that there would be an increase in revenues to the State as opposed to a cost to the State for the implementation of a private group self insurance program in Arizona.

Senator Burns commented she is of the assumption that the persons who brought forward the idea of private group self insurance were of the thinking that the State would absorb the additional costs of implementing such a program. She added she believes the Committee needs to be in agreement now that the costs will be absorbed by the State. Referring to Representative Mortensen's question, Senator Burns stated she was of the opinion that he was having foresight that if Arizona had a good self-insurance group for the workers' compensation system, the State would attract more good industry that would result in increased revenues for the State.

Assuming the State Compensation Fund does not currently pay tax on investment income, and if self-insured groups would be required to pay tax on investment income, Mr. Johnson stated that requirement could make a difference.

Cochairman Conner asked Mr. LeCompte if Mr. Johnson's assumption was correct.

Mr. LeCompte replied that all insurance carriers in Arizona, including the State Compensation Fund, pay premium taxes, however, they do not pay investment income taxes. The premium taxes are by formula and in lieu of State income taxes. He added that private carriers pay federal income taxes in addition to the premium tax.

Cochairman Conner invited further questions and comments. There were none.

Cochairman Conner announced that changes would be made to the Questionnaire as discussed in the meeting, the Questionnaire would be mailed out as soon as possible, and

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another meeting would be scheduled after the Questionnaire information had been received and compiled by staff.

The meeting adjourned at 10:40 a.m.

Respectfully submitted,

  
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Nancy Boyd, Committee Secretary

(Tape and attachments on file in the Office of the Secretary of the Senate.)

ARIZONA STATE LEGISLATURE

Interim Meeting Notice

**Open to the Public**

**WORKERS COMPENSATION GROUP  
SELF-INSURANCE STUDY COMMITTEE**

**DATE:** Thursday, December 12, 1996

**TIME:** 3:00 p.m. to 5:00 p.m.

**PLACE:** House Hearing Room 2

**AGENDA**

1. Call to Order
2. Opening Remarks
3. Discussion of Questionnaire
4. Final Committee Recommendations
5. Public Comment
6. Adjourn

**MEMBERS:**

Representative Pat Conner, Cochair  
Representative Paul Mortensen  
Representative Ruben Ortega

Senator Brenda Burns, Cochair  
Senator David Petersen  
Senator Manuel "Lito" Peña

Michael Allen, representative of Trade Association  
Gregory Casadei, representing State Compensation Fund  
Larry Etchecury, representative Arizona Industrial Commission  
Donald A. Johnson, Organization of Employees  
Michael Murphy, Employer-provides self-insurance  
Bob Newsome, Employer-purchases workers compensation  
Deloris Williamson, Arizona Department of Insurance  
Wayne Wilson, Insurance Carrier

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# ARIZONA STATE LEGISLATURE

## JOINT LEGISLATIVE STUDY COMMITTEE ON WORKERS' COMPENSATION GROUP SELF-INSURANCE

Minutes of the Meeting  
Thursday, December 12, 1996  
House Hearing Room #2 - 3:00 p.m.

### **Members Present:**

Representative Pat Conner, Co-Chair  
Senator David Petersen  
Michael Allen  
Larry Etchechury  
Michael Murphy  
Wayne Wilson

Senator Brenda Burns, Co-Chair  
Senator Manuel Peña  
George Casadei  
Donald A. Johnson  
Deloris Williamson

### **Members Absent:**

Representative Paul Mortensen  
Representative Ruben Ortega  
Bob Newsome

### **Staff:**

Diana O'Dell, House Analyst  
Chris Thomas, Senate Analyst

**Representative Conner** called the meeting to order at 3:12 p.m. He asked Ms. O'Dell to bring the Committee up-to-date on the questionnaires that had been sent out.

**Diana O'Dell, House Analyst**, noted that results of the questionnaire had been mailed to Committee members on December 4, 1996. She distributed a revised list of the responses (filed with original minutes). She commented on two late responses, and made a correction to the list of providers.

Representative Conner noted he had asked the staff to draw up proposed final recommendations to be given to the Legislature, and requested the Committee study them. He noted the proposal was a consensus of the results of the questionnaire as to whether self-insurance should be allowed, who should regulate it and who should draw up the rules. He asked for discussion.

Senator Petersen asked if the percentage of groups that wanted self-insurance was known. He remembered there was not a large amount of interest in other states. Representative Conner said there were only a few that said they would definitely be interested. He said the idea was not how many would use it, but that it was a tool available in the workers' compensation arena for a single employer to utilize. Senator Petersen questioned if the issue of a company not having the assets to cover damages and requesting funding from the State had been resolved. Representative Conner said it had not been completely resolved, but the recommendations established that a company must be in business for five or more years, and must demonstrate \$750,000 or more in financial security in the aggregate. The Committee was recommending that the Industrial Commission draft the rule, regulate the insurance and

be the watch dog for this program.

**Senator Burns moved that the Committee adopt the proposed final recommendations as distributed. Mr. Michael Allen seconded the motion.**

**Larry Etchechury** said he did not have a problem with the proposed recommendations. He did have a concern in terms of the \$750,000 being an adequate figure for financial security. He would be willing to put forth the recommendations with the reservation that when models had been studied as to whether the \$750,000 was appropriate it be discussed in the Legislature. Representative Conner said they would depend on his expertise and asked him to recommend a different amount. Mr. Etchechury said that amount was in reference to gross premium which was different from financial security, and he wanted to make sure that was a workable amount.

Senator Petersen clarified the \$750,000 was gross premium. Mr. Etchechury said it was used in other states as gross premium which was different from what was stated in the recommendations. Representative Conner agreed.

**Mr. Etchechury moved the proposed recommendation be amended to read "The group must demonstrate \$750,000 or more in gross insurance premiums." Senator Burns seconded the motion. The motion was CARRIED by voice vote.**

**Senator Burns moved the Committee adopt the proposed final recommendations as amended. Mr. Allen seconded the motion.**

**Wayne Wilson** inquired about the responses on the questionnaire, noting that most of the respondents had indicated the groups should be fully funded to cover ultimate losses and administrative expenses, and that reserves should be reviewed by the regulator for adequacy. He was unfamiliar with procedures of the Industrial Commission, and wondered if those two conditions were being incorporated in recommendation #5. He questioned if they were not incorporated, would it still fall under recommendation #5. Mr. Etchechury said, speaking obliquely, if it were restricted to what was being done for self-insured he would have additional concern with recommendation #5. However, if it was in terms of public group self-insured across the country, he would not have a problem with it as it would allow for actuaries to do the analysis on the reserves. Mr. Etchechury said that would be an essential criteria to the program, although that was not done for self-insured companies. Currently, the financial data is analyzed but the reserve is not reviewed, and it is not a major concern with an individual self-insurer. With group self-insured, it would be a major issue.

Mr. Wilson then clarified that under current law the reserves were not reviewed, and there was no requirement that the individual self-insured be fully funded to ultimate loss or expense. He noted that a member of a group would want everyone to pay their fair share up front in case someone left the group. Mr. Etchechury interrupted to clarify that an individual self-insured employer is funded up to 125% of anticipated losses. He noted this is done on an annual

basis. Mr. Etchechury said the problem was reserving on future losses, which is critical in terms of the mechanism because they are a separate entity. It is necessary to have an actuary come in and analyze the books.

Mr. Wilson wondered if an amendment would be in order in terms of the reserves being reviewed by the regulator for adequacy. Representative Conner said it was being left to the Industrial Commission to exercise the rule making authority. Mr. Etchechury said a period could be placed after "self-insurance" in recommendation #5 and leave the remainder of the sentence out. He said there was no restriction effectively in terms of how it would be regulated. Representative Conner questioned if the Committee felt better with that wording. The Committee agreed changing the wording would give the Commission the appropriate latitude to regulate a group self-insured program.

**Mr. Wilson moved that a period be placed after the words "group self-insured" in recommendation #5, and the rest of the sentence be left out. Mr. Casadei seconded the motion. The motion CARRIED by voice vote.**

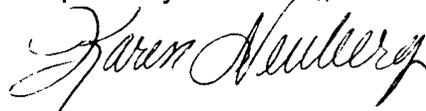
**Senator Burns moved that the proposed final recommendations be adopted as amended. Mr. Allen seconded the motion. The motion CARRIED by voice vote.**

Senator Peña questioned recommendation #4, asking if the language exempted self-insured from falling back on the Special Fund. Mr. Etchechury said the language said the individual members are going to be held liable for their losses with respect to that group. How that group is backed and funded is subject to the rule making, and there was no tie to the Special Fund. An independent self-insured employer is backed by the Special Fund.

Senator Peña felt those who paid into the Special Fund would be at risk if a company became insolvent. Mr. Etchechury said the plans were incomplete, but if the Special Fund was the fall back source for an insolvent group self-insurance, and there was a bad risk, then the Fund would be at risk to whatever liability that group created.

Representative Conner asked for further discussion. There being none, the meeting was adjourned at 3:35 p.m.

Respectfully submitted,



Karen Neuberg  
Committee Secretary

(Attachments and tapes on file in the Secretary of the Senate's office)