STATE OF WASHINGTON
DEPARTMENT OF LABOR AND INDUSTRIES
PO Box 44000 • Olympia, Washington 98504-4000

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November 25, 1998

Representative Cathy McMorris
Chair, Joint Legislative Audit and Review Committee
506 16th Avenue SE
Olympia, WA 98504-0910

Dear Representative McMorris:

Thank you for the opportunity to provide comments on the Workers' Compensation System Performance Audit. We appreciate the close cooperation among committee members, legislative staff, audit team members and stakeholders. We believe this cooperation has resulted in a solid product that will guide the management of this vital service.

We especially valued our interaction with Professor Edward Welch, and the insights he and his team provided.

We were pleased the audit found that our state provides superior benefits to injured workers while costs are well below the average in other states.

We agree with most of the recommendations. You will see in the response that we concur or partially concur with the vast majority of the recommendations. And we look forward to obtaining additional clarification and possible further study of the remaining recommendations.

Some recommendations will have great impact on our workers' compensation system. We are eager to move forward to implement these changes. At the same time, we must be careful to avoid making changes that could upset the successful balance of the system's low costs and high benefits.

Two other matters that will bear on the timing of the implementation of the audit recommendations are:

- The agency's efforts to achieve Year 2000 computer systems compliance. Making sure our systems work at the end of next year is an absolutely essential effort. The

"Y2K" effort reduces the opportunities to make other computer system changes and refinements. Many audit recommendations include computer system changes.

- The agency's current initiative to improve timeliness and fairness of service and to provide better communication with employers and claimants. Groups of agency employees last year identified a number of ways we can make improvements. As a result, we created 83 new claims management-related positions. New or reassigned staff are either in training or have completed training. Caseloads are being reduced and significant changes are being made in the way work is organized and in claims managers' duties.

  These changes are targeted toward the agency's commitment to a significant reduction in long-term disability and duration of time-loss by the year 2000. The past year's work is part of a long-term strategic plan. We believe these current efforts have set the groundwork for dramatic improvement and complement the audit recommendations. Timing is an important consideration in implementing the recommendations.

We strongly support Mr. Welch's suggestion that business, labor, other interest groups and the department work together to implement these recommendations. The Workers' Compensation Advisory Committee will be discussing the audit recommendations in early January. We feel that will be an appropriate forum in which to seek consensus on changes.

We appreciate the opportunity to provide these comments, and we look forward to meeting with the committee December 11.

Sincerely,

Gary Moore

Gary Moore
Director

JLARC Performance Audit Recommendations

Recommendation 1

The Department should consider the possibility of having a board that would oversee its activities related to insurance services.

Legislation Required:	Yes
Fiscal Impact:	Would depend on the board's duties, frequency of meeting and size of staff
Completion Date:	
Agency Response:	Non-concur

We believe setting up a board to appoint the head of workers' compensation and direct its activities would make this important function of state government less accountable to the voters of the state. Currently, an elected Governor appoints the director. The audit proposal adds another layer between the voters and the head of workers' compensation. It would also weaken the Legislature's ability to hold the agency accountable.

A board composed of management and labor representatives can provide valuable perspectives for the workers' compensation system. We believe the existing statutory Workers' Compensation Advisory Committee plays this role. The agency will work with business and labor to strengthen the effectiveness of this committee.

Recommendation 2

The Department should adopt an alternative system for the reporting of injuries. The worker would report to the employer, and the employer would report to the Department. An educational effort should be launched to promote this method of reporting.

Legislation Required:	Yes
Fiscal Impact:	Significant. Depends on extent of changes
Completion Date:	January 2001
Agency Response:	Concur

We believe this recommendation represents a positive improvement to the workers' compensation system by involving employers earlier in the claims process. However, significant policy questions regarding alternative reporting methods and failure-to-report requirements should be addressed by the Workers' Compensation Advisory Committee in the design of the new reporting system.

Recommendation 3

The claims functions should be organized into units that include five to seven claims adjusters, clerical support and a claims supervisor.

Legislation Required: No
Fiscal Impact: Significant
Completion Date:
Agency Response: Non-concur

The agency has launched a major initiative to improve timeliness, fairness of service and provide better communication with employers and claimants. We have created 67 new claim manager positions and added 16 other workers' compensation staff. New staff are either in training or have completed training, and appointments must be made to a number of vacant positions. Caseloads are being reduced, and we established three new units to reduce the span of control for supervisors, though not to the level recommended in the report.

In addition, claims administration recently implemented significant changes in the way work is organized and in claim managers' duties. A coach-mentor unit has been set up to provide technical advice to claim managers. These changes are targeted toward the agency's commitment to a significant reduction in long-term disability and duration of time-loss - - by the year 2000. The past year's work is part of a long-term strategy and has set the groundwork for significant improvement. We believe moving to even smaller units would disrupt this ongoing effort.

The current effort should be implemented and the results measured before a decision is made on whether to again reorganize the claim units. We believe this approach will achieve the same improvements to claims processing without the need to create additional supervisory positions for the smaller units.

Recommendation 4

To the greatest extent possible, employers should be assigned to an individual claims adjuster.

Legislation Required: No
Fiscal Impact: Minimal
Completion Date: July 2002
Agency Response: Partially concur

The agency has previously considered this option and decided to wait until other changes were completed. Considerable computer programming would be required, and the agency's resources now are centered on complying with year 2000 requirements. Employer assignment of cases could benefit large employers and their employees. Appropriate assignment of claim managers to small employers, who may have one claim every few years, may best be done on an industry basis. Further analysis is needed to determine the optimum size and how the accounts would be distributed.

Recommendation 5

Claims management duties should be changed as follows:

A. There should be a personal contact with the three key parties involved in a claim as soon as possible and no later than 48 hours after a report is received.

Legislation Required:	No
Fiscal Impact:	Minimal
Completion Date:	July 1999
Agency Response:	Concur

The agency will need to make other changes in workers' compensation processes to allow the additional time claim managers will need to make these personal contacts.

B. All new claims should be reviewed by a claim supervisor within three days after the report is received.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	Pilot will be completed by July 1999
Agency Response:	Partially concur

The agency is will pilot a "triage" system to identify potentially difficult compensable claims when they are filed. Experienced claim managers will immediately review these claims so that quick action can be taken. The "triage" approach will allow critical judgments to be made about potential problems when a claim is filed.

C. The people handling claims should set reserves on those claims.

Legislation Required:	No
Fiscal Impact:	Moderate
Completion Date:	Pilot will be completed by January 2001
Agency Response:	Partially concur

Claim managers previously set reserves on claims. In the mid-1980s, however, the Department established a claims reserve unit for greater consistency and accuracy. The Department will test this recommendation with a claims unit.

D. The people handling claims should be required occasionally to visit the workplaces involved.

Legislation Required:	No
Fiscal Impact:	Moderate
Completion Date:	Ongoing
Agency Response:	Concur

E. Claims adjusters should have sufficient support for clerical and investigative tasks.

Legislation Required:	No
Fiscal Impact:	12 FTEs
Completion Date:	July 1999
Agency Response:	Concur

The Department agrees that this would be helpful to claim managers. To investigate 3 percent to 5 percent of claims as recommended, the agency will need 12 additional staff.

Recommendation 6

The measurement of claim management performance should be changed to emphasize prompt payment, three-party contact and successful return to work.

A. Prompt payment.

Legislation Required:	No
Fiscal Impact:	Programming costs
Completion Date:	July 2000
Agency Response:	Concur

We agree with the goal of prompt payment. According to statute, the agency currently measures and is accountable for timeliness of payment within 14 days of when we receive the claim. We pay approximately 94 percent of the claims in a timely manner. Many states do not measure timeliness based on injury date as the audit recommends. Clearly, we need to improve the prompt payment standard and will work with the Workers' Compensation Advisory Committee to develop a better measure.

B. Three-party contact.

Legislation Required:	No
Fiscal Impact:	Minimal
Completion Date:	July 2000
Agency Response:	Concur

C. Successful return to work.

Legislation Required:	Yes
Fiscal Impact:	Significant
Completion Date:	July 2000
Agency Response:	Partially concur

The Department agrees that one performance measure should be the percent of injured workers who successfully return to work. Calculations of return to work would require extensive use of the Employment Security database, rather than creating a new database at Labor and Industries. Any measurement of return to work would be affected by factors such as a worker's level of education, local economic conditions, a worker's motivation to return to work, the success of the attending physician and vocational rehabilitation. The Department will work with the Workers' Compensation Advisory Committee to develop the appropriate measure.

Recommendation 7

There should be less reliance on the formal claim closure process.

Legislation Required:	Yes
Fiscal Impact:	Yes
Completion Date:	January 2000
Agency Response:	Partially concur

The agency will undertake a review of many aspects of its claim closure process, including the use of independent medical exams, to streamline the closing process. We recently have improved communication related to claim closure as a result of adding claim staff and revising the letters and notices we send to employers and claimants. The Department will continue to use formal claims closures to preserve claimants' rights to be notified of this important decision to close a claim and retain the worker's right of protest.

Recommendation 8

There should be a compliance unit within the Department that monitors the operation of the Insurance Services Division and self-insured employers.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	July 1999
Agency Response:	Partially concur

The Department will strengthen its Quality Assurance (QA) unit as part of the current improvements to claim management. The QA unit will monitor the State Fund claim management activities for consistency, fairness and accuracy. We believe this will most appropriately meet the goals set in this recommendation. The agency believes the existing oversight of self-insured employers should continue. (See response to Recommendation 10.)

Recommendation 9

The Department should offer some form of ongoing refresher training for all individuals who manage claims.

Legislation Required:	No
Fiscal Impact:	Minimal
Completion Date:	Ongoing
Agency Response:	Concur

Recommendation 10

Once the Department has in place a compliance unit and a system of ombudsmen or mediators, the current oversight of the claims processes of self-insured employers should end.

Legislation Required:	Yes
Fiscal Impact:	Yes
Completion Date:	
Agency Response:	Non-concur

The agency believes this proposal would remove an important protection for the employees covered under self-insurance. We believe the agency's self-insurance regulatory effort has performed well and should be continued.

Recommendation 11

When the Department begins sending monthly checks through an attorney or when it sends any lump-sum payment through an attorney, it should notify the claimant of the rate or the amount of the payment or payments sent to the attorney and the statutory limit on attorney fees.

Legislation Required:	No
Fiscal Impact:	Minimal
Completion Date:	1999
Agency Response:	Concur

Recommendation 12

When the Department sends dividends to a retro group, it should notify the member employers of the amount of the dividend and the basis for its calculation.

Legislation Required:	No
Fiscal Impact:	Minimal
Completion Date:	1999
Agency Response:	Concur

Recommendation 13

The Department should collect and publish information about the performance of third-party administrators to the extent it becomes available through audits and otherwise.

Legislation Required:	Yes
Fiscal Impact:	Yes
Completion Date:	
Agency Response:	Non-concur

The recommendation does not include any regulatory authority for the agency to oversee the performance of third-party administrators. We believe it would be inappropriate to audit performance of third-party administrators without legislative authority. Nor does the recommendation clarify what information concerning third-party administrators should be collected and published. The current system holds employers responsible for the actions of their third-party administrators.

Recommendation 14

The Department should develop a system of allocating indirect costs among its funding sources and publish financial statements that clearly indicate where its funds come from and how they are spent.

Legislation Required:	No
Fiscal Impact:	Small ongoing costs
Completion Date:	July 1999
Agency Response:	Concur

Recommendation 15

The Department should create a system of mediators or ombudsmen to provide assistance to workers and employers.

Legislation Required:	Yes
Fiscal Impact:	Significant
Completion Date:	
Agency Response:	Non-concur

The agency has launched a major initiative to improve timeliness, fairness of service and provide better communication with employers and claimants. We believe this is the preferred use of claim management resources and can help achieve the same goal. We have created 67 new claim manager positions and added 16 other workers' compensation-related staff. New staff are either in training or have completed training. Caseloads are being reduced and the agency's claims administration program recently implemented significant changes in the way work is organized and in claim managers' duties. We believe these changes will be sufficient to meet the underlying concept of improving response to claimants' and employers' concerns. The past year's work has set the groundwork for significant improvement.

In addition, two staff members presently review claim disputes on a full-time basis for inquiries or complaints submitted to the Director's office.

Recommendation 16

The Department should adopt a policy that all protests and reassumptions are resolved within 30 days.

Legislation Required:	No
Fiscal Impact:	Yes
Completion Date:	Ongoing
Agency Response:	Partially concur

The Department agrees that timely resolution of protests and reassumptions is needed. We also agree that too much time is spent on the process of re-doing a claim. However, a 30-day response time would not be realistic for resolution of the majority of protests and reassumptions. We believe the time needed to adequately resolve these reassumptions is within 90 days of the protest or reassumption. Under rare circumstances, an additional 90 days might be warranted to fully resolve complex issues.

Recommendation 17

Superior Court review of decisions by the Board of Industrial Insurance Appeals should be eliminated.

Legislation Required:	Amend RCW 51.52.102; 51.52.110, 51.52.115; 51.52.130; 51.52.132; 51.52.140 (as they pertain to industrial insurance appeals)
Fiscal Impact:	No
Completion Date:	
Agency Response:	Non-concur

We believe workers and employers should have the right to trial by jury in the Superior Court to review decisions of the Board of Industrial Insurance Appeals. The agency will concentrate on providing better service and communications, and streamlining its claims processing. We feel this will result in fewer appeals of cases to Superior Court.

Recommendation 18

The primary goal of vocational rehabilitation as formally stated and as observed in practice should be successful return to work of the injured worker.

Legislation Required:	Yes
Fiscal Impact:	Increase
Completion Date:	One year after legislation is enacted
Agency Response:	Non-concur

We agree that return to work is the optimum outcome for both workers and employers. This is a complex issue, and the goal for vocational rehabilitation must be clearly defined in statute. Otherwise, there could be unintended consequences that may be extremely costly. This could significantly change the delicate balance of our current workers' compensation system's high benefits and low costs. Negotiations on this issue, as well as an appropriate performance measure, should continue within the Workers' Compensation Advisory Committee.

Recommendation 19

The standard for employability should be wages at the time of injury, not the federal minimum wage.

Legislation Required:	Yes
Fiscal Impact:	Substantial
Completion Date:	One year after legislation is enacted
Agency Response:	Non-concur

Returning a worker to employment at the wage rate at time of injury is the preferred outcome. We agree that the current standard of employability at the federal minimum wage is inadequate. The agency believes, however, that the recommended standard of employability would be costly if eligibility for vocational rehabilitation is not properly defined. Negotiations should continue on this topic, as well as Recommendation 18, within the Workers' Compensation Advisory Committee.

Recommendation 20

Increase the current monetary and time limitations on retraining.

Legislation Required:	Yes
Fiscal Impact:	Moderate
Completion Date:	Within one year after legislation is enacted
Agency Response:	Concur

Negotiations on this topic should be continued within the Workers' Compensation Advisory Committee in conjunction with discussions concerning Recommendations 18 and 19.

Recommendation 21

There should be an increased professionalism with regard to vocational rehabilitation within the Department, specifically:

A. The Department should move toward requiring higher standards of private vocational rehabilitation providers.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	December 1999
Agency Response:	Concur

B. There should be better availability of qualified, professional vocational rehabilitation counselors to assist and advise claim managers within the Department.

Legislation Required:	No
Fiscal Impact:	8 FTEs
Completion Date:	Ongoing
Agency Response:	Concur

L&I recently converted positions for professional vocational rehabilitation counselors to claim manager positions. This change was made to meet demands from employers, workers and the Legislature to increase the speed, accuracy and fairness of claims processing. Implementing this recommendation will require the addition of eight vocational rehabilitation counselors.

C. There should be more effective training of claim managers and vocational rehabilitation providers concerning best practice methods for achieving the Department's hierarchy of return-to-work objectives, including the appropriate goals for and effective use of vocational rehabilitation services.

Legislation Required:	No
Fiscal Impact:	Moderate
Completion Date:	July 2000
Agency Response:	Concur

D. The sections within the Department charged with evaluating, contracting, managing and setting policy for vocational rehabilitation should include managerial leadership by individuals who are qualified and experienced vocational rehabilitation professionals.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	Ongoing
Agency Response:	Concur

The Department agrees that vocational rehabilitation professional expertise is important in the management of the agency's vocational rehabilitation program. To this end, the Department will make every effort to include such professionals in management policies and decision-making related to vocational rehabilitation services for injured workers, and to recruit such professionals to appropriate management positions in the program as they become available.

Recommendation 22

With regard to a performance-based referral system:

A. Performance standards of quality and effectiveness in vocational rehabilitation practice should be adequately defined to determine the appropriate indicators to be used and how best to measure them.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	December 1999
Agency Response:	Concur

The terms "quality" and "effectiveness" have not been defined by the vocational rehabilitation profession or in this audit report. We will develop improved performance standards to better manage Washington's vocational services through negotiations within the Workers' Compensation Advisory Committee. Recommendation 18, 19 and 20 will be discussed in conjunction with this recommendation.

B. Measures of satisfaction should include and focus primarily on injured workers and employers.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	December 1999
Agency Response:	Concur

C. The evaluation mechanism should include a minimally acceptable threshold for referral.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	December 2001
Agency Response:	Concur

D. The full range of the provider's activity in serving State Fund cases should be considered in evaluating performance.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	Ongoing
Agency Response:	Concur

The Department agrees that the performance measures should incorporate additional outcomes.

E. All of the parties involved should be assured that once the evaluation is established, it would be used in making referrals. This assurance should be accomplished by formalizing and announcing the procedures that will be used to accomplish it.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	Ongoing
Agency Response:	Concur

Recommendation 23

We recommend a series of changes in the Department's safety-related activities. These changes are designed to:

- Expand emphasis on the prevention and control of musculoskeletal disorders. (Appendix 23-1)
- Develop methods for more closely integrating service involving hazard identification and control, with service aimed at controlling workers' compensation losses. (Appendix 23-2)
- Improve the customer-focused orientation of service content and delivery. (Appendix 23-3)
- Improve service communications and recordkeeping. (Appendix 23-4)
- Provide more detailed information to employers about the availability of specific services. (Appendix 23-5)
- Improve responsiveness and timeliness of service delivery. (Appendix 23-6)
- Better coordinate services among various consulting entities and eliminate redundancy. (Appendix 23-7)

Legislation Required:	No
Fiscal Impact:	Yes
Completion Date:	June 2000
Agency Response:	Concur

We agree that prevention of musculoskeletal disorders needs to be emphasized, and we have begun to address prevention in a comprehensive manner. We support increased cross training and information sharing among staff. The Department is already evaluating this issue. We also believe that an objective internal review can effectively address overlaps and inefficiencies in program services. We will work with the WISHA Advisory Committee to accomplish this task.

Recommendation 24

We recommend that the Department produce (either through its own actuaries or through an outside independent consulting company) a well-documented, exhaustive actuarial rate-filing report detailing all assumptions and methods used. It should be similar to reports that are submitted to regulatory authorities by a licensed insurance company in states that use a "prior approval" rate-filing procedure.

Legislation Required:	No
Fiscal Impact:	Moderate
Completion Date:	
Agency Response:	Non-concur

Well documented information on the development of rates is currently available. In addition, we provide customized information on request.

Recommendation 25

Adopt a plan by which excess premiums are returned as dividends to prior contributors – both employers and employees – that generated the excess premiums, rather than to future policy holders/contributors as reduced rates.

Legislation Required:	Yes
Fiscal Impact:	Major programming costs
Completion Date:	First quarter, 1999
Agency Response:	Partially concur

We currently are providing a dividend to employers from the Accident Fund. We believe it would be practically impossible to provide dividends to the more than 1 million employees who contribute to the Medical Aid Fund. The Department receives no information concerning individual employees' contributions to the Medical Aid Fund. The contributions are collected by employers and submitted to the Department for deposit in the Medical Aid Fund. We believe lowering rates is the only practical way to distribute excess Medical Aid Fund premiums.

Recommendation 26

Adopt changes in the rate-setting process that are discussed in detail in Appendices P and Q and which are designed to minimize cross-subsidies.

26 a. (No. 1 Appendix P) Adjust Accident and Medical Aid funds premium rates the same percentage as for Retro refunds.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	
Agency Response:	Non-concur

Retrospective rating adjustments are not considered in setting Medical Aid Fund premium rates because Medical Aid Funds are not being used to pay for these refunds.

26 b. (No. 2 Appendix P) Eliminate the adjustment for Retro refunds in the determination of classification rates.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	
Agency Response:	Non-concur

Retrospective rating adjustments must be considered in setting Accident Fund premium rates because Accident Fund dollars are being used to pay for these refunds.

26c. (No. 2 Appendix Q) Evaluate loss development for serious and non-serious claims.

Legislation Required:	No
Fiscal Impact:	Programming required to develop actuarial database
Completion Date:	2001
Agency Response:	Concur

26d. (No. 3 Appendix Q) Implement a dividend program to release excess reserves.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	First quarter, 1999
Agency Response:	Concur

26e. (No. 4 Appendix Q) Incorporate an adjustment for the impact of experience rating by classification into a classification rate-making system.

Legislation Required:	No
Fiscal Impact:	Minimal (some programming, perhaps)
Completion Date:	
Agency Response:	Non-concur

The agency believes it would be actuarially incorrect to make such adjustments. Experience rating is a composite of an individual employer's total exposure to the risk classifications in which they report work hours. The effect of this recommendation would be the creation of cross subsidies between employers.

26f. (No. 5 Appendix Q) Provide a greater selection of Retro rating plans, which balance to the standard premium at the expected loss ratio.

Legislation Required:	No
Fiscal Impact:	Computer programming needed. Amount depends on further selections chosen
Completion Date:	1999
Agency Response:	Partially concur

The Department will ask our Retro customers if they would like to see a greater selection of Retro plans and implement this if the customers so desire.

26g. (No. 6 Appendix Q) Re-evaluate experience rating plan parameters to eliminate as much of the cross-subsidies as possible.

Legislation Required:	No
Fiscal Impact:	Programming and staff time
Completion Date:	2000
Agency Response:	Concur

The Department promised the Hop Growers Association that L&I soon will study and modify the experience rating system. We will also evaluate this recommendation at the same time.

26h. (No. 7 Appendix Q) Perform an analysis of the continued need for the Second Injury Fund.

Legislation Required:	No
Fiscal Impact:	Yes (Cost of consultant or FTE)
Completion Date:	2000
Agency Response:	Concur

Recommendation 27

As explained in Appendix R, the Department should adopt adjustments to its retrospective rating plan. These adjustments are designed to make the application more balanced actuarially.

Legislation Required:	No
Fiscal Impact:	Some programming
Completion Date:	
Agency Response:	Non-concur

If a bias exists, it is considerably less severe than stated and can be reduced without disrupting the Retro program. Our own studies do not show a bias of 5.6 percent for Retro employers as found by the actuarial consultants. The 5.6 percent calculation included the entire premium and loss figures for firms that were only partially enrolled in Retro, and failed to correct for the interest payments applied to overall Retro refunds. This method overstates any bias that may exist.

We will, however, evaluate our current methods and will eliminate any bias in our approach if any is found to exist.

The Performance Adjustment Factor (PAF) adds to the quality of the Retro program by making Retro refunds more stable over time. This reduces risk for our Retro customers and so allows them to properly staff and maintain their safety and loss control programs. Retro customers have indicated support for the PAF and its resulting stability.

Recommendation 28

The Department should establish underwriting guidelines to avoid adverse selection by employers in Retrospective Rating plans.

Legislation Required:	No
Fiscal Impact:	1 additional FTE
Completion Date:	1999
Agency Response:	Concur

Recommendation 29

As explained in Appendix R, the Department should institute a dividend plan that applies to both retrospectively rated and non-retrospectively rated employers. A properly designed dividend plan would eliminate the need for the performance adjustment factor, or a loss conversion factor of less than 1.0, and also would provide an appropriate mechanism to release excess reserves equitably.

Legislation Required:	No
Fiscal Impact:	Computer programming
Completion Date:	
Agency Response:	Non-concur

The Retro program provides a significant financial incentive for businesses to band together to provide safer workplaces. Safer workplaces reduce medical and time-loss costs to the entire workers' compensation system. We believe that the Retro plan provides greater incentives for both safer workplaces and cost reduction than a dividend plan.

Recommendation 30

We recommend that the Department produce (either through its own actuaries or through an outside independent consulting company) a well-documented and exhaustive actuarial reserve report detailing the assumptions and methods used. Such a report should be similar to those submitted to regulatory authorities by insurance companies.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	Done
Agency Response:	Concur

An extensive actuarial review of our agency is performed annually by actuarial consultants, currently Milliman & Robertson, Inc.

Recommendation 31

Case reserves, particularly in time-loss claims, should be set as early as possible by the claims adjusters responsible for handling each individual claim.

Legislation Required:	No
Fiscal Impact:	No
Completion Date:	Pilot will be completed by July 1999
Agency Response:	Partially concur

Claim managers previously set reserves on claims. In the mid-1980s, however, the Department established a claims reserve unit for greater consistency and accuracy. The Department will test this concept with a claims unit and evaluate the appropriate time for setting reserves.

Recommendation 32

As discussed in Appendix U, we recommend adjustments that are designed to more equitably distribute costs between Retro and non-Retro employers.

Legislation Required:	No
Fiscal Impact:	Some programming costs
Completion Date:	
Agency Response:	Non-concur

If a bias exists, it is considerably less severe than stated and can be reduced without disrupting the Retro program. Our own studies do not show a bias of 5.6 percent for Retro employers as found by the actuarial consultants. The 5.6 percent calculation included the entire premium and loss figures for firms that were only partially enrolled in Retro, and failed to correct for the interest payments applied to overall Retro refunds. This method overstates any bias that may exist.

We will, however, evaluate our current methods and will eliminate any bias in our approach if any is found to exist.

The Performance Adjustment Factor (PAF) adds to the quality of the Retro program by making Retro refunds more stable over time. This reduces risk for our Retro customers and so allows them to properly staff and maintain their safety and loss control programs. Retro customers have indicated support for the PAF and its resulting stability.

STATE OF WASHINGTON

BOARD OF INDUSTRIAL INSURANCE APPEALS

2430 Chandler Court SW PO Box 42401 • Olympia, Washington 98504-2401 • (360) 753-6823

November 19, 1998

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JLARC

The Joint Legislative Audit and Review Committee
Attn: Mr. Larry Brubaker
506 16th Avenue Southeast
Olympia, Washington 98501-2323
Campus Mail P.O. Box 40910

Dear Mr. Brubaker;

Thank you for allowing our agency the opportunity to state our position on recommendations made in the Washington State Workers' Compensation System and Performance Audit.

Although we were invited to comment on each of the Study's 32 Recommendations, I feel that it is more appropriate to comment only on Recommendation 17, which directly applies to the Board of Industrial Insurance Appeals and briefly regarding Recommendation 15, which might directly apply to the Board:

Recommendation 17

Superior Court review of decisions by the Board of Industrial Insurance Appeals should be eliminated.

AGENCY POSITION: Neutral

COMMENTS:

This is a recommendation that obviously could have major repercussions for the Board of Industrial Insurance Appeals and the entire Workers' Compensation system. Without more detailed explanation of how the auditors envision the Board's role and the process under this scenario, it is impossible to accurately gauge what the fiscal impact might be. It could be huge.

Although not entirely clear, the analysis for this recommendation implies that in conjunction with the elimination of Superior Court appeals, rules of evidence and procedure would be relaxed at Board proceedings. Because the analysis presents no model for what form and process would exist at the Board, the recommendation presents a myriad of questions without answers.

Eliminating Superior Court review, in and of itself, might have little impact on the Board's caseload. The Board would still be the only forum in which parties get to present evidence. However, if, in conjunction with eliminating appeals to Superior Court, the Legislature changed the Board process and eliminated application of Superior Court civil rules and evidence rules at Board hearings, the result could be a two or three fold increase in appeals filed at the Board. Certainly, making the process less formal and eliminating requirements for presenting live expert testimony would greatly reduce the expense and energy required to take an appeal through the hearing process. Whether increased workloads attributable to increased appeals would be offset by less formal hearings is problematic.

Additional judges and support staff might be required to keep up with increased workloads. If so, it is likely that the Attorney General's office would require additional staffing to represent the Department at the Board. At any rate, fiscal impact is impossible to predict although it could be significant.

Recommendation 15:

The Department should create a system of mediators or ombudsmen to provide assistance to workers and employers.

AGENCY POSITION: Neutral

COMMENTS:

Although this recommendation may have some merit, the suggestion that the office of ombudsman might be a function of the Board could present difficulties in cases appealed to the Board in which an ombudsman has been active prior to the appeal. I can anticipate many situations in which the ombudsman would be called as a witness for either side to testify about aspects of a case and the ombudsman's involvement in the case. This certainly would present appearance of fairness problems for both judges and ombudsmen in many instances as well as potential conflict of interest issues.

Once again, thank you for allowing our agency to respond to the audit.

Sincerely,

Thomas E. Egan

Thomas E. Egan, Chair

AUDITORS COMMENTS

We have received the response from the department and the board to our preliminary report. We are very pleased that they indicate openness to change and a willingness to accept many of our recommendations. We hope that after further consideration and consultation with the representatives of workers and employers, the department may be open to even more of the changes we have suggested.

Recommendation 1: The department should consider the possibility of having a board that would oversee its activities that are related to insurance services.

Agency Position: Non-Concur.

Auditor's Comments: Recommendation 1 only indicated that the department should "consider the possibility" of having a board. We are disappointed that the department rejects even this possibility. We would hope that the department would at least consider the possibility of expanding the role of its current advisory committee.

Recommendation 3: The claims functions should be organized into units that include five to seven claims adjusters, clerical support, and a claims supervisor.

Recommendation 4: To the greatest extent possible, employers should be assigned to an individual claims adjuster.

Agency Position: 3) Non concur, and 4) partially concur.

Auditor's Comments: The current initiatives undertaken by the department are good and will improve service. They are, however, different from the suggestions we make here. We recognize that there may be some costs in implementing these but we would encourage the department to at least try them out on a small scale before rejecting the ideas completely.

Recommendation 5E: Claims adjusters should have sufficient support for clerical and investigative tasks.

Agency Position: Concur.

Auditor's Comments: The department would probably need some additional staff to implement this. It is very difficult to estimate the exact amount.

Recommendation 7: There should be less reliance on the formal claim closure process.

Agency Position: Partially concur.

Auditor's Comments: We are pleased that the department is willing to undertake a review of the claims closure process. We would suggest that this begin with a dialogue that includes the department, the attorney general's office, and representatives of workers and employers. The aim of the dialogue should be to define exactly what is meant by "closing a claim," what is the statutory basis for this, and what are the benefits of it? We would suggest that the dialogue carefully distinguish between assumptions that are based on repeated practices of the department and legal principles that are based upon statutory or case law.

Recommendation 8: There should be a compliance unit within the department which monitors the operation of the insurance services division and self-insured employers.

Agency Position: Partially concur.

Auditor's Comments: There are certainly similarities between a quality assurance unit and a compliance unit. There are, however, also many differences. For example, strengthening the quality assurance unit will not deal with the problem (or at least perceived problem) that the fund is held to different standards than self-insured employers.

Recommendation 10: Once the department has in place a compliance unit and a system of ombudsmen or mediators, the current oversight of the claims processes of self-insured employers should end.

Agency Position: Non-concur.

Auditor's Comments: We recognize that this is a sensitive and difficult issue. We believe, however, that the proposals we have made in this recommendation and Recommendation 8 and 15 (compliance unit and ombudsmen) would protect the interests of injured workers while allowing self-insured employers to manage claims in a more appropriate manner.

Recommendation 13: The department should collect and publish information about the performance of third-party administrators to the extent it becomes available through audits and otherwise.

Agency Position: Non-concur.

Auditor's Comments: We are not recommending that the department exercise regulatory authority over third-party administrators. We recognize that there may be some difficulties in implementing this. To a certain extent, however, the department must have available information about the performance of third-party administrators. To the extent it does, it should make this information available to the public.

Recommendation 15: The department should create a system of mediators or ombudsmen to provide assistance to workers and employers.

Agency Position: Non-concur.

Auditor's Comments: The initiatives launched by the department are good. They will solve some problems. We believe, however, that injured workers and small employers should have a place to go outside of the claims management division where they can get information and advice. They should not have to write a letter to the director's office. Instead, there should be an 800 number that is broadly advertised.

In states where benefits are paid by private insurers, workers can turn to a state agency for this type of assistance. A weakness of an exclusive state fund is that there is no separation of parties between the insurer and the state agency. This weakness could be remedied by an office of ombudsmen.

Recommendation 16: The department should adopt a policy that all protests and reassumptions are resolved within 30 days.

Agency Position: Partially concur.

Auditor's Comments: We are pleased that the department is willing to explore this issue. We are very disappointed; however, that it is not willing to set for itself a goal that is any better than that already allowed by the statute.

Recommendation 17: Superior court review of decisions by the Board of Industrial Insurance Appeals should be eliminated.

Agency Position: Non-concur.

Auditor's Comments: The board has pointed out that while this recommendation would result in the elimination of appeals to superior court, it might also result in an increased number of appeals to the board. In that case, the board points out that it would need additional resources. We agree that if the number of appeals increased, the board should be granted additional resources.

It is possible to interpret some of the comments from the board and the department to mean that the number of appeals are held down under the present system because it is formal and complicated and that it would be bad to reduce the formality and complexity because more individuals would exercise their right to appeal. We presume that is not the position the board or the department intends to take. We would certainly reject that approach.

Recommendation 18: The primary goal of vocational rehabilitation as formally stated and as observed in practice should be successful return to work of the injured worker.

Agency Position: Non-concur.

Auditor's Comments: We are glad that the department is open to evaluating these issues. However, we are disappointed that it will not at least agree that return to work ought to be the primary goal of vocational rehabilitation. We recognize that this cannot be achieved in every case and that not everyone is an appropriate candidate for these services. It nevertheless ought to be "the primary goal."

Recommendation 19: The standard for employability should be wages at the time of injury, not the federal minimum wage. (Note: In the proposed final report, recommendation 19 was revised to clarify its intent.)

Agency Position: Non-concur.

Auditor's Comments: As we understand the current system in Washington, if a worker is formally determined to be employable at the federal minimum wage, then benefits will terminate. This standard is to too low. This automatic termination of further benefits should only occur if a worker is found to be employable at the wages that he or she was receiving at the time of injury.

We recognize the need for further criteria for determining which claimants should be referred for vocational rehabilitation and encourage its development. To some extent, however, this must always be done on an individual basis guided by the best practices of the rehabilitation counseling profession. There is also a need to determine what benefits a worker should receive when he or she does not return to work but is not eligible for VR, and when a case is referred for VR but his or her final wage is not equivalent (at some specified proportion) to the previous wage or VR does not result in placement at all.

We agree that negotiations with the various parties are an appropriate and probably necessary way to work out these issues.

Recommendation 24: We recommend that the department produce (either through its own actuaries or through an outside independent consulting company) a well-documented, exhaustive actuarial rate filing report detailing all assumptions and methods used. It should be similar to reports that are submitted to regulatory authorities by a licensed insurance company in states that use a "prior approval" rate filing procedure.

Agency Position: Non-concur.

Auditor's Comments: Our understanding is that the full complement of a rate report (as indicated in the recommendation) is not routinely packaged as such. The department had, at our request, put together a rate filing report for our audit. We did not mean to imply that required documentation could not be produced. The gist of our recommendation is that such package be prepared whenever rates are developed. We see this as expedient and responsive to stakeholder interest, and others who review the department rate recommendations. Reference to a prior approval setting is to offer a type of standard as an example.

Recommendation 25: Adopt a plan by which excess premiums are returned as dividends to prior contributors—both employers and employees—that generated the excess premiums, rather than to future policyholders/contributors as reduced rates.

Agency Position: Partially concur.

Auditor's Comments: We recognize that achieving equity is difficult in general and may be impractical in the case of the employee premium payers. However, since the department receives the individual employee's contribution to the Medical Aid Fund from their employers, the department could return the dividend to that employer for distribution to its employees. One way is to credit each dividend to premiums receivable and due from these employers so that they remit a net premium. Employees may be noticed of such dividend via poster in the employer's office.

Recommendation 26a: (No. 1 Appendix P) Adjust Accident and Medical Aid Funds premium rates the same percentage as for Retro.

Agency Position: Non-concur.

Auditor's Comments: The refund calculation is determined by using the combined experience of the Accident Fund and Medical Aid Fund. The refund is equal to the Standard Premium minus the Retrospective premium. Therefore the Medical Aid Fund does contribute to the size of the refund, even though paid from the Accident Fund. For example, in deriving the combined Retro premium, the Medical Fund losses will either increase or decrease the Retro premium. Except for the special case where the Accident Fund and Medical Fund premium and losses are identical, the Retro refund will be smaller if Medical Fund losses are higher than the Accident Fund and vice versa.

Recommendation 26b: (No. 2 Appendix P) Eliminate the adjustment for Retro refunds in the determination of classification rates.

Agency Position: Non-concur.

Auditor's Comments: We do not see the economic necessity of building back in the Retro refunds, as this ensures subsequent Retro refunds in the future, other things equal. In other words, by adding the Retro refund cost to the experience rate, there should be a similar refund next year. Assuming your retrospective rating plans are actuarially balanced, there is no need to adjust rates for the actual/anticipated refunds, since by definition, Retrospective plans would yield on the whole the appropriate premium, i.e., equivalent to the non-Retro premium. However, if a refund is the purpose, we have no problem.

Recommendation 26e: (No. 4 Appendix Q) Incorporate an adjustment for the impact of experience rating by classification into a classification rate-making system.

Agency Position: Non-concur.

Auditor's Comments: We disagree. In rate making, the overall rate indication implicitly corrects for the off-balance created by the experience rating plan by using Standard Premium as a benchmark, i.e., the manual premium multiplied by the experience modification factor. This is equivalent to first performing the analysis on the manual basis, then adjusting the result for the (overall rate) off-balance produced by the experience rating plan. This is accomplished by dividing the manual loss ratio by the average experience modification factor.

What we have proposed is a refinement of this process to a classification level. Classification rates are currently produced on the manual (rate) basis which assume the ratio of standard to manual premium is the same for each and every classification. Our analysis showed that there are significant and consistent differences in this ratio by classification. Some classifications produced rates by this process that are consistently excessive or inadequate. This consistency suggests a systemic bias and other factors are not being equitably distributed to the classification rate. In essence, we suggest reducing the overall off-balance calculation experience rating to the classification level.

Recommendation 27: As explained in Appendix R, the department should adopt adjustments to its retrospective rating plan. These adjustments are designed to make the application more balanced actuarially.

Agency Position: Non-concur.

Auditor's Comments: The Retrospective Rating plans do not incorporate the latest or current expense figures in their formulation, therefore, they are not actuarially balanced as to the cost difference between prior and current expense figures.

The statement that the 5.6 percent calculation included the entire premium and loss figures for firms that were only partially enrolled in Retro plans, is apparently incorrect based on our discussions with the department, they said this situation only applies to partially enrolled accounts that had a subaccount retrospectively rated but not the balance of the account. In addition, we understood this was an infrequent occurrence and not material dollar wise. As regards including the interest payments in the retro return, the department rate making process included these interest payments treated as a retro return in computing the Accident Fund rates. Therefore, it is appropriate to include it in this analysis.

If the Retro program consistently has a net return-refund, this implies the standard rating method consistently charges too much for these employers.

Recommendation 29: As explained in Appendix R, the department should institute a dividend plan that applies to both retrospectively rated and non-retrospectively rated employers. A properly designed dividend plan would eliminate the need for the performance adjustment factor, or a loss conversion factor of less than 1.0, and also would provide an appropriate mechanism to release excess reserves equitably.

Agency Position: Non-concur.

Auditor's Comments: We did not mean to imply in our recommendation that the Retro program should be replaced by a universal dividend program. Rather we recommend a dividend program that applies to both Retro and non-Retro employers where standard pricing mechanisms consistently generated too much premium. For example, a non-Retro employer that implements loss control measures will receive some benefit (dividend) if his program is effective in controlling costs. Under the current system, the non-Retro rated employer must either become retrospectively rated or wait until his loss data are included in the experience period used for his experience rating modification.

Recommendation 32: As discussed in Appendix U, we recommend adjustments that are designed to more equitably distribute costs between Retro and non-Retro employers.

Agency Response: Non-concur.

Auditor's Comments: As explained for Recommendation 27, we offer the same response here. The Retrospective Rating plans do not incorporate the latest or current expense figures in their formulation, therefore, they are not actuarially balanced as to the cost difference between prior and current expense figures.

The statement that the 5.6 percent calculation included the entire premium and loss figures for firms that were only partially enrolled in Retro plans, is apparently incorrect based on our discussions with the department, they said this situation only applies to partially enrolled accounts that had a subaccount retrospectively rated but not the balance of the account. In addition, we understood this was an infrequent occurrence and not material dollar wise. As regards including the interest payments in the retro return, the department rate making process included these interest payments treated as a retro return in computing the Accident Fund rates. Therefore, it is appropriate to include it in this analysis.

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