

## **MEMORANDUM**

**TO: Hon. James L. Seward  
Hon. Kevin A. Cahill**  
**FROM: Peter B. O'Connell**  
**RE: Self Insurance Trusts**  
**DATE: June 9, 2015**

I am counsel to the ESTRA Self -Insurance Trust (ESTRA SIT), which is currently in runoff and precariously close to being taken over by the Workers Compensation Board (WCB). Using my client's trust as a case study, this memorandum will attempt to explain the plight of Self-Insurance Trusts (SITs) and suggest legislative or administrative changes that are needed to provide relief to these SITs.

### **OVERVIEW**

Pursuant to WCB policy, the Board will take over a SIT if it has insufficient cash on hand (excluding security deposits) to pay 9 months of claims. Currently, there are 33 SITs that have not fallen below this threshold and are deemed to be in runoff. The WCB will also require a SIT to levy an assessment against its members if it has insufficient cash on hand to pay 18 months of claims. More than half of the SITs in runoff are currently assessing their members. These assessments impose considerable hardships on their members, most of whom are still in business and paying workers compensation premiums to other sources. Despite these assessments, the finances of many of these SITs continue to deteriorate – for reasons that are mostly beyond their control – to the point where WCB takeovers may become inevitable.

### **THE RISE AND FALL OF SITs**

In 1994, there were a total of 12 SITs in existence. This number grew to 65 by 2005 and declined to a mere 13 when most SITs were required to close pursuant to Chapter 57 of the Laws of 2011. This decline can be directly attributable to a lack of oversight from 1994 to 2001, when WCB enacted regulations that established enhanced and uniform programmatic and funding standards that could be measured in annual reports that were to be submitted by the SITs.

The first of these reports, which did not reach WCB until 2003, showed that more than a dozen SITs had “significant financial issues.” Seven SITs ceased operations in 2006 and 2007 and 8 more, managed by Compensation Risk Managers, defaulted in 2007 and 2008. It does not appear that there were indications that these SITs were in distress until their actual defaults. Twenty additional SITs discontinued operations in 2009 and, as stated above, there were only 13 SITs left standing on December 31, 2011.

The extent to which Governor Spitzer's much heralded Workers Compensation Reform Bill of 2007 (Chapter 6 of the Laws of 2007) contributed to this decline cannot be overstated. It doubled benefits to injured workers and promised benefits to employers by placing caps on permanent partial disabilities. On the basis of this promise, workers compensation premiums were slashed by twenty percent. As the result of a failure to institute these caps (which will be discussed below) hindsight now tells us that premiums should have been increased by at least twenty percent, which constitutes a swing of more than forty percent.

Today, the WCB lists sixty SITs in its data base. Three of these remain active, 33 are in runoff and 24 are insolvent. The WCB has purchased assumption of liability insurance policies (ALPs) for 14 of the insolvent SITs, which shift the liabilities of these SITs to commercial carriers.

### **THE ESTRA SIT**

The ESTRA SIT is fairly typical of the 33 SITs in runoff. Its Declaration of Trust was executed on November 19, 1994 and it grew to 74 members within its first year. Initially, it was governed by six trustees, who met at least twice annually and by conference call on an as-needed basis. The Trustees oversaw the hiring of Program Risk Management (PRM) as its plan administrator, the hiring of actuaries, accountants, claims administrators and attorneys, and the selection of depositories and investment vehicles.

Significantly, the Trustees also gave final approval to the acceptance of new members and the termination of unsatisfactory members. In so doing, they assisted in detecting members and potential members who were underreporting payroll and seeking classifications in improper classification codes.

In 1998, ESTRA SIT extended membership to members of the Automotive Recyclers Association of New York (ARANY) and added 5 ARANY members to its Board of Trustees. With the ARANY membership, ESTRA SIT grew to 211 members in 2000. It had 169 members when it was forced to close on December 31, 2011.

Although it was no secret to its trustees, ESTRA SIT had to be one of the "dozens" of SITs that the WCB deemed to be seriously underfunded in 2003. Among other claims, it suffered a serious head injury case that, according to a WCB administrator, went to the maximum liability of \$250,000 "faster than any claim that she had ever seen." A claim such as this can wreak havoc on a small SIT, and it caused ESTRA SIT to run a deficit for most of its early years.

ESTRA SIT responded voluntarily by suspending member discounts and by imposing a voluntary 10% surcharge on its members. The WCB intervened in 2002 by ordering the Trust to suspend business until independent actuarial and accounting audits could be performed (at a cost to the Trust of \$48,000). The Trust entered into a consent agreement with the WCB in

2003, wherein it continued to limit discounts and suspend the writing new business. Over the next several years, ESTRA SIT only had one year (2006) in which its losses exceeded income. It eliminated its deficit and accumulated surpluses. It was subjected to a Level II review in 2010 and was deemed to be fully funded by WCB.

ESTRA SIT was one of seven SITs that were forced to cease operations on December 31, 2011. At that time, the trust had \$3,836,828 in assets and \$2,994,767 in liabilities, for a surplus of \$148,258. It had 75 open claims and 27 months of cash on hand. As of December 31, 2014, it had \$2,086,715 in assets and \$3,846,113 in liabilities, for a deficit of \$1,759,398. It had 34 open claims (14 of which were capped) and approximately 10 months of cash on hand.

This rapid decline in revenues was caused, in part, by the fact that ESTRA SIT had \$1.2 million in claims during its final year of operation and did not generate revenue in subsequent years to offset these losses. To suffer losses of this magnitude is not uncommon. ESTRA SIT had multi-million dollar losses in four of its 17 years of existence. This is what SITs are all about. They experience occasional bad years and depend upon surpluses from good years to even things out. This aside, the primary cause for ESTRA SIT's decline were for reasons that were beyond its control – and these factors affect all of the 33 SITs in runoff. These factors and proposed legislative or administrative solutions to cure these problems are as follows:

#### **A FAILURE TO TIMELY CLASSIFY CLAIMS**

**PROBLEM:** This factor is perhaps the biggest problem facing the entire Workers Compensation system. It is causing unnecessarily high premiums in the active market and decimating the reserves of SITs in runoff. As stated earlier, the problem stems from Governor Spitzer's Workers Compensation Reform bill.

Although benefits increased as of July 1, 2007, passage of the law was followed by years of bickering to establish medical guidelines that would enable WCB to determine the existence and extent of permanent partial disabilities. Guidelines for the treatment of neck, back, shoulder and knee injuries were completed in 2010, carpal tunnel injuries in 2013 and non-acute pain injuries in 2014.

Currently, ESTRA SIT has 15 post-reform cases and only 4 of these cases have been classified. Depending upon the extent of a partial disability, classification could possibly limit ESTRA SIT's liability to between 225 and 525 weeks of payments, as opposed to lifelong payments up to its current policy limit of \$400,000. These claims are being paid at a rate that is 22% higher than amounts paid for pre-reform claims. It is also virtually impossible to settle a claim in the absence of a proper classification.

A claim may be classified once a claimant reaches a point where physicians determine that he or she is as well as they are going to get. Called “maximum medical improvement” (MMI), it is now taking an average of 6.4 years for a claimant to reach this stage, whereas it took less than four years prior to the Spitzer reforms. A post MMI hearing process to determine the existence and extent of a permanent partial disability creates even further delays.

Assessing blame for these delays is difficult to do. Two years ago, WCB Chairman Robert Beloten issued a scathing report alleging that carriers, claimants’ attorneys and treating physicians engage in “bad faith” delays in the process. Quite naturally, others point the finger back at the Board. Although the Board claims that it hears 1,000 cases per month in an expedited hearing process, it would appear that the delays persist.

**SUGGESTED SOLUTION;** This is an issue that spreads across the entire workers compensation spectrum – with everyone clamoring for special attention. Despite this, classifying claims for closed SITs should receive the highest priority. Failures to timely classify impose a far greater burden on SITs in runoff because they can no longer deal with them through increases in premiums. As mentioned previously, the WCB has purchased ALP policies for 14 of the 24 SITs that it has taken over. In all likelihood, failures to classify claims have caused the members of these SITs to pay far more than necessary to achieve this relief. Lastly, it must be noted that the vast majority of SIT members are still in business. Any payments that they are making on SIT assessments or ALP payments are on top of premiums that they are also paying on their current WC policies.

### **REIMBURSABLE CLAIMS**

**PROBLEM:** ESTRA SIT has ten outstanding claims that are fully reimbursable from other sources. Three of these claims are paid by the Liquidation Bureau, which pays claims that were the responsibility of the bankrupt Reliance Insurance Company, which provided several SITs with excess insurance coverage. The remaining claims are paid by the Special Disability (15-8) Fund, which was closed as part of the Reform bill. SITs are required to pay these claims and seek reimbursement from the two reimbursement sources, which is a time-consuming process. Currently, ESTRA SIT has been waiting for over a year to be reimbursed for more than \$365,000 from these sources and is in jeopardy of being taken over by the WCB because of these delays. It is particularly ironic to be forced out of business by a state agency because another state agency is slow in paying its bills.

**SUGGESTED SOLUTIONS:** ESTRA SIT, for one, needs immediate relief in the form of prompt payment of its reimbursable claims. If delays such as these persist, the State should be required to pay interest to claimants. For the long term, administration of reimbursable claims should be transferred to the State Insurance Fund, which is more capable of weathering delays

or for the State to hire a third party administrator (TPA) or create a separate agency to administer these claims. The cost of administering claims should be borne by the reimbursing agencies.

### **FUND FOR REOPENED CASES**

**PROBLEM:** As part of the 2013, budget, Governor Cuomo touted what he called the “Business Relief Act”, which consisted, in part, of closing the Fund for Re-Opened Cases. Pursuant to this law, the Fund would not accept transfers of liability filed after January 1, 2014. In order to be eligible to transfer liability to the Fund, a claim must be at least seven years old with no payments made on the claim for at least three years. ESTRA SIT has had five claims reopen since the fund was closed, two of which meet the 3 year/7year criteria.

**SUGGESTED SOLUTION:** Reopen the Fund for Reopened Cases for closed SITs. Fifty-seven of the 60 SITs in the WCB database had ceased operations on or before December 31, 2011. During the course of their lifetimes, these SITs paid an assessment in the amount of five percent of their premiums to protect against reopened claims. Closure of the fund has deprived them of the protection that they paid for with these assessments.

According to the Governor, active insurers reaped \$300 million in savings in the form of reduced assessments as a result of the fund’s closure. Closed SITs, however, do not benefit from these savings because they no longer pay assessments that are based upon premiums. As it turned out, no one else benefited either because the reduction in assessments has been offset by an increase in premiums. In this regard, NYCIRB has recently sought a 4.4% increase in premiums to fund reopened cases. It is estimated that the unfunded liability caused by the closure of the Fund could exceed \$1 billion.

Closed SITs do not have the luxury of increasing premiums. Rather, the cost of funding reopened cases is borne by their ever dwindling reserves. Reserving for its reopened cases is a major factor that is driving ESTRA SIT toward a Board takeover. It is also a major factor that is driving up the cost of ALPs. ESTRA SIT, for example, serviced over 1,300 claims during its 17 year existence. It would now have to reserve for these claims in purchasing an ALP. Considering the assessments that it paid during its active years, it would be paying for them twice.

### **SECTION 32 PAYMENTS**

**PROBLEM:** Section 32 of the Workers Compensation Law promotes the settlement of claims. Either the carrier or the claimant proposes a settlement, which is reviewed by WCB, which will approve the settlement if it is deemed to be fair. This is actually a good thing because an old adage among claims adjusters is that “a claim is never going to be cheaper than today.”

The problem is that many SITs in runoff cannot enter into settlements without falling below or becoming precariously close to the nine months of cash that will trigger a Board takeover.

**SUGGESTED SOLUTION:** Allow §32 payments to be made from security deposits that are on file with the WCB. A fair and reasonable settlement benefits both SITs and the WCB because they shut off all future exposure from the claimant. For several years now, the WCB has not allowed these funds to be invaded for any purpose, but it is possible that there may be a softening of this policy within the Board for the purpose of paying Section 32 claims. Such a change in policy should be encouraged.

### **FORENSIC AUDITS**

**PROBLEM:** The WCB retains auditors to conduct a “forensic audit” upon taking over a SIT. Such an audit is intended to insure that members of SITs pay their fair share of claims and that plan administrators, actuaries and others have not engaged in negligence or wrongdoing in administering the trust. In so doing, the auditors attempt to examine every single transaction that was made during the lifetime of the SIT. It is estimated that a forensic audit of ESTRA SIT’s 169 member trust with 20 open claims would cost \$400,000.

Consider the necessity of this audit when applied to the ESTRA SIT. The WCB maintains that it is necessary to examine transactions that occurred during 1994 to 1998 (all losing years) because it is unfair for members during profitable years to bear responsibility for the losses – particularly with respect to members who may have left the trust prior to the profitable years. However, the vast majority of ESTRA SIT members belonged in good times and in bad. They participated in a voluntary surcharge and gave up dividends so that the trust could achieve full-funded status. The WCB now wants them to pay again. Moreover, the few members who left the trust are probably insolvent or retired. Although the WCB argues to the contrary, it is also likely that claims against them are barred by the statute of limitations. It is a costly exercise in futility.

The primary purpose in conducting a forensic audit is to determine if plan administrators, trustees, actuaries and accountants have engaged in negligence or wrongdoing. Clearly, there were fertile grounds to conduct such audits of the trusts managed by Compensation Risk Managers. However, the vast majority of the SITs in runoff today have been capably managed. Many of them, like ESTRA SIT, have lived under a microscope during their entire existence.

Among other things, ESTRA SIT acted under a consent decree and underwent three major audits. It also ran a profit during eleven of its seventeen years and, as noted above, many of its present financial difficulties have been caused by factors that are beyond its control. It is hard to imagine that the findings of a forensic audit would justify its \$400,000 expense.

**SUGGESTED SOLUTION:** The need for the WCB to accurately determine the finances of a closed SIT clearly justifies an audit of its reserves in order to determine that there sufficient funds on hand to close its open claims. However, the WCB should be required – at a minimum - to demonstrate probable cause before launching a full-blown forensic audit.

### **CONCLUSION**

The solutions suggested in this memorandum, if viable, represent a small step in a larger effort that is needed to bring much needed relief to the thousands of employers that have been victimized by the failure of the self-insurance system. Your assistance in alleviating some of the inordinate costs that this failure has imposed upon these employers – most of whom run small businesses - is greatly appreciated.