# Report to the Legislature

# and to the Governor

**On the**

# Special Compensation Fund

# ARP Settlement Project

**October 15, 2002**

# Minnesota Department of Labor and Industry

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## Background

During the 2000 legislative session, the Legislature required the Department of Labor and Industry to report to the Governor and the Legislature on the status of its efforts to reduce the unfunded liabilities of the second injury and the supplementary benefits programs. This report is to include an updated projection of the remaining long-term liabilities for these programs and must make appropriate recommendations. (Laws of Minn. 2000, Ch. 447, Sec. 24, Subd. 4).

## History

The Special Compensation Fund (SCF) is administered by the Department of Labor and Industry (DLI). The SCF assessment is levied on workers' compensation insurers and self-insured employers, based on the amount of workers' compensation indemnity payments (wage-replacement and permanent disability payments) made by each such insurer or self-insured business. This assessment funds the state's workers' compensation programs.

The largest single component of the SCF's expenditures (and therefore, the largest cost-driver for the assessments employers and insurers must pay) are the Second Injury (SI) and Supplementary Benefit (SB) programs, which account for more than half of the SCF's expenditures each year. Although these programs were ended by the Legislature in 1992 and 1995 respectively, payments will continue for a number of years until the disabled workers receiving benefits die or otherwise become ineligible. Between 1987 and 2000, the assessment rate has fluctuated between 28 and 31 percent of paid indemnity.

On July 10, 2000, $325 million in "excess surplus" was transferred from the Minnesota Assigned Risk Plan to the SCF. The Legislature directed the money to be used to reduce long-term liabilities in both the SI and SB programs. In February 2000, there were nearly 7,000 open claims, with future liabilities estimated at nearly $1.365 billion.

The Legislature intended that DLI use these monies to liquidate or settle a significant portion of the ongoing SB and SI claims in order to reduce the ongoing assessments paid by insurers and employers in the state. The assessment rate subsequently dropped from 30% to 20% for indemnity payments made after July 1, 2000. This unprecedented reduction in the rate was made in anticipation of settlement of a substantial portion of these claims, and also due to the increased investment income provided by the appropriated funds.

The rate remained at 20% throughout 2001. However, in its 2002 session, the Legislature reallocated $250 million from the SCF to the state's General Fund, to help resolve a quickly-developing budget crisis (Laws of Minn. 2002, Ch. 220, Art. 13, Sec. 9, subd. 2, and Ch. 374, Art. 8, Sec. 6). This reallocation has necessitated a return to the previous assessment rate of 30% in order for the SCF to continue to meet its obligations to reimburse employers and insurers in a timely fashion for benefit payments.

## Project

Following the 2000 legislative appropriation, the DLI Special Compensation Fund established the Assigned Risk Plan (ARP) settlement project. The project's goal was to provide lump-sum payments to injured workers to pay off or "settle" their ongoing workers' compensation benefits claims under the SI and SB programs. Four claims staff were hired for the project in fall 2000. Further assistance has been provided to the project team by other DLI staff members.

The team began its work by creating databases and reports to track settlement information and outcomes. A spreadsheet was also developed to assist team members estimating the present value of open claims. The team then started reviewing open cases for settlement potential.

The SI and SB programs include a wide variety of cases, with dates of injury ranging from the 1960s to 1995, and claimant ages ranging from the 30s to the 80s. Health issues can be as serious as end-stage cancer or chronic vegetative states. Approximately 1,000 of the open claims were eliminated for consideration of settlement due to such factors.

Workers' compensation benefits are paid to injured workers by insurance companies and self-insured employers. When the state has liability for some or all of those benefits under the SI and SB programs, insurers and self-insured employers must submit claims to DLI for reimbursement. All settlements involve three parties: the injured worker, the insurer or self-insured employer, and DLI.

## Phase I

Phase I of the project focused on working with the insurers and self-insured employers who had the highest number of claims. During fiscal year 2001, more than 65 insurers and self-insured employers were contacted by the team. Through these insurers or employers, 600 injured workers were contacted to determine their interest in settlement. In addition, as new claims were presented to DLI by insurers or employers, DLI staff members reviewed those claims for settlement potential prior to establishing a weekly benefit stream for the individual.

During fiscal year 2001, 335 claims were settled, at a total cost of $17 million. These settlements reduced the long-term liability by an estimated $161 million.

## Phase II

The project team began Phase II in December 2001 and renamed it the "ARP Settlement Action Project" (ASAP). Claimants were contacted directly to discuss fair and reasonable settlements of the ongoing SI and SB claims. Settlement offers reflected current financial marketplace conditions and life expectancy tables in assessing the fair present value of these claims.

This phase required the development of a new database that allowed merging address information with a letter to be mailed directly to claimants. Insurers and third-party administrators (TPAs), starting with those with the largest file counts, were contacted and asked to supply a current address and other information about each claimant, in a format that can be readily loaded to the ASAP database.

Claimants were contacted by a letter and invited to participate in the program. ASAP team staff members handled the negotiations directly with the claimants and the insurer or TPA. Mediation services, provided by DLI staff mediators, were used to assist in negotiations and draft the settlement agreements. All agreements are submitted as a settlement stipulation to the Office of Administrative Hearings for final approval.

The procedure implemented by the team required an initial inquiry into whether the employee was represented by counsel in the matter. If not, negotiations are undertaken directly with the employee. An investigation into the health status of the claimant is conducted. Medical records are obtained and reviewed. If a serious health condition is noted (whether related to the claimant's work injury or not), the life expectancy assumptions are adjusted, and the present value of the claim is adjusted accordingly.

After the claims manager has the information needed to assess the fair present value of the claim, an offer is conveyed to the claimant (either directly, or through an insurer or attorney, depending on the circumstances). If agreement is reached, a stipulation is drafted, submitted to a compensation judge for approval, and an award is issued if the judge approves of the settlement. Payment is then issued to the claimant by the insurer, and the SCF's share is subsequently reimbursed to the insurer.

Phase II of this project represented a more aggressive settlement strategy in order to overcome some of the challenges that the department faced during Phase I. The Department of Labor and Industry anticipated improved settlement results during this phase by performing administrative tasks internally, rather than burdening the insurance community for this service.

## Wind-down

In its 2002 session, the Minnesota Legislature reallocated $250 million from the Special Compensation Fund to the state's General Fund, in order to solve a rapidly-developing budget crisis. This required the settlement team to scale back settlement efforts and begin to wind down the program.

Since the project's inception, some 1200 claimants have been contacted (roughly half in each phase of the project) to explore whether they would be interested in settling their claims. A total of 741 claims have been settled under the program, at an average SCF payout of $58,506.68 per settlement. The SCF has expended a total of $43.4 million thus far in the project to liquidate an estimated $382.5 million in future payments.

In the early spring of 2002, there was an additional $30 million committed in settlement authority extended to claimants and insurers. Roughly one-third of those settlement negotiations have been terminated without an agreement, but ongoing negotiations with other claimants will continue during the wind-down phase until the appropriation is exhausted. The settlement process can be lengthy, lasting anywhere from 90 days to 18 months. It is anticipated that the project will be concluded within the next six months.

## Conclusion

As a result of the 2002 legislative reallocation of $250 million to the state's General Fund (effective in July, 2003), there was a total of $74 million available (of the original $325 million appropriation) to liquidate the long-term unfunded liabilities of the SB and SI programs. When these funds are finally expended for this purpose, it is anticipated that the SCF's exposure for annual benefit payments will be reduced by approximately $475 million over the lifetime of these claims, assuming present rates of benefit adjustments continue.

The reductions resulting from the efforts of this project have been partially offset by an increase in the projected liability for SI and SB claims. Recent data indicates these claims are occurring for a longer period of time than previously projected, resulting in a higher estimated long-term liability cost. New claims did not end with the repeal of these programs, but continue to be filed, although at a diminishing pace as time goes on. While the 2002 reallocation necessitated a return to the previous 30% assessment rate, it is anticipated that the rate will begin to fall in the coming years.

It is difficult to quantify with precision the long-term impact the settlement project will have on SCF assessment rates, but we do expect that this settlement activity will hasten a reduction in assessments. The attached chart shows that the settlements reached thus far have already impacted the benefit payments under the SB and SI programs, which will result in a future reduction in the assessment.

Although the 2002 reallocation has shortened the project and reduced its impact, the original goal of accelerating the reduction of the SCF assessment in future years has been realized. If additional funds become available for this purpose in the future, it is felt that further settlement efforts would result in continued reductions in the SCF assessment rate.

## Updated Estimation
## of Supplementary Benefit and Second Injury Liabilities
## of the Special Compensation Fund

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October 7, 2002

### Introduction

Estimates of the outstanding liabilities of the Special Compensation Fund (SCF) for supplementary benefit (SB) and second injury (SI) claims were produced in February 2000 using data through FY 1999 and in September 2001 with data through FY 2001. New estimates have been produced with data through FY 2002. This paper describes the estimation procedure.

### Description of Estimation Procedure

The estimation is performed separately for SB and SI claims and the results are then combined. The method is to project (1) the number of SB or SI reimbursement claims by year of claim receipt ("receipt year") and (2) the amount of reimbursement paid per claim, also by receipt year. The product of these two items is projected reimbursements by receipt year.

The payment stream is projected as it would exist without any settlement activity. This is a cleaner measure than payments reflecting settlement activity, since under the latter, assumptions have to be made about the rate of settlements and the terms under which future payment streams are incorporated into settlements.

#### *Projecting the number claims by year of claim receipt*

The first step is to tabulate the number of claims by injury year and year of claim receipt, for paid (or not-yet-adjusted) claims involving injuries without settlements. This yields ratios that show, for any injury year, the proportionate change in the number of claims from each receipt year to the next. This calculation is limited to injuries without settlements to enable estimation of the time path of future payments as if there were no settlements.

For each injury year, these ratios are combined with the number of claims for receipt-year 2002[1] to project the number of claims for each future receipt year for that injury year. Then, the total number of claims for each receipt year is obtained by adding the numbers for that receipt year from the various injury years.

The projections of claims by receipt year for 2003 and beyond appear to be reasonable in that they mesh well with the trends in actual numbers through receipt-year 2002.

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[1]Actually, for each injury year, the "2002" number of claims was projected from the average for receipt-years 2000-2002 in order to reduce statistical fluctuations.

### ***Projecting payments per claim by year of claim receipt***

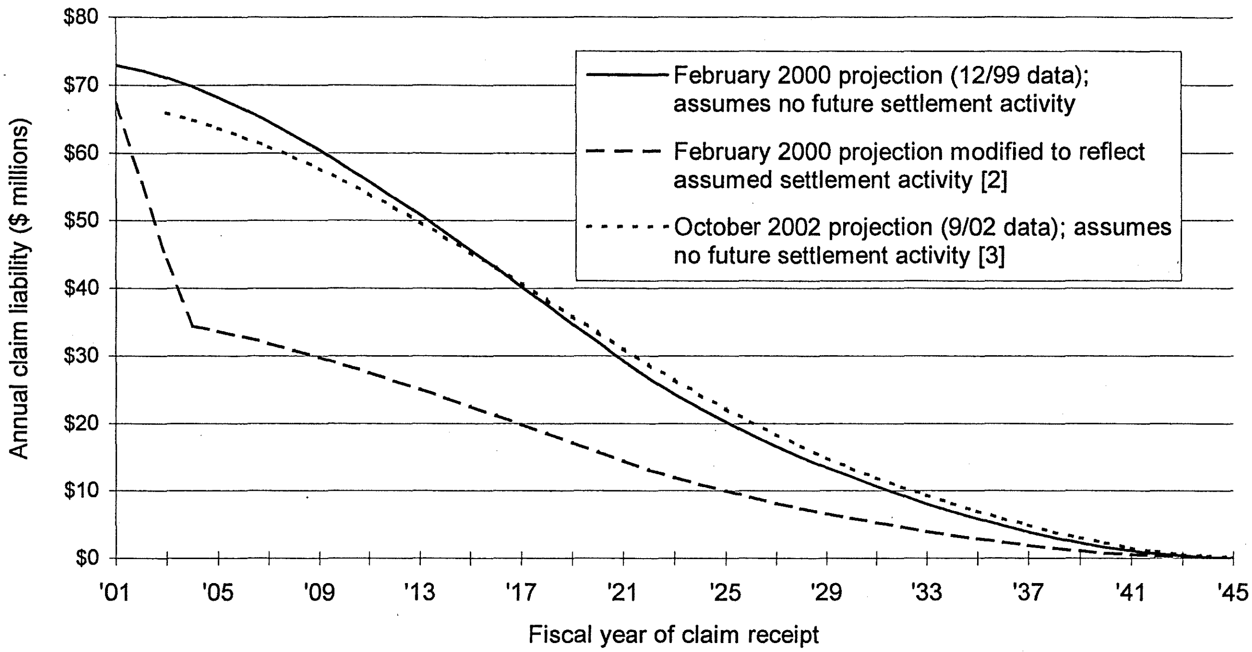
The second step is to project average reimbursement payments per claim by year of claim receipt. This is done by establishing a starting value for receipt-year 2003 and growing it at an assumed rate for future receipt years. The starting value is projected from the trend through receipt-year 2002 in payments per claim, using nonsettled claims that were paid or not yet adjusted (paid amounts were imputed for not-yet-adjusted cases).

For SBs, payments per claim are assumed to grow at 2.9 percent per year beyond receipt-year 2002. For SI benefits, the assumed growth rate is 1.5 percent. These rates are equal to the respective growth rates of SB and SI benefits per claim between 1996-1997 (two-year average) and 2001-2002 (two-year average), excluding settled cases. It bears further examination why this growth rate is less than that of general wages over the same period. (The answer may relate to interactions among social security, temporary and permanent total disability, and supplementary benefits.)

It is unclear why the growth rate is less for SI than SB benefits. One possibility relates to the fact that SI payments include indemnity and medical components while supplementary benefits are indemnity. If, on SI cases, the need for medical services decreases over time as the claimant's condition stabilizes, this would counteract the effect of medical inflation.

For both SBs and SIs, the future trend in payment liability by receipt year is derived by multiplying projected claims by projected payments per claim for each receipt year. The resulting liability streams represent what would arise without settlement activity. Settlements, however, will continue to occur. This will increase payments in the near term and reduce them in the longer term compared to the projections.

## Supplementary Benefit and Second Injury Projections: Comparison Between Current and Previous Projections [1]




1. The projections use data from the Minnesota Department of Labor and Industry. The amounts shown combine supplementary benefit and second injury amounts.

2. The total amount of settlements is assumed to be $40 million for FY 2001, $100 million for FY 2002, $100 million for FY 2003, and $84 million for FY 2004. Claims are assumed to be settled at an 8% discount rate. This projection is from the Department of Labor and Industry, Financial Services, July 6, 2000.

3. The September 2002 projection is lower than the February 2000 projection through 2015 because of settlements that occurred between the two projections. However, the difference between these two projections also reflects the fact that the more recent projection (more recent data) indicates higher levels of claims and payments than did the February 2000 projections, apart from settlement activity. This tends to raise the October 2002 projection, counteracting the effect of settlement activity between the two projections.

(See table on next page.)

Minnesota Department of Labor and Industry, Research and Statistics, October 7, 2002.

## Supplementary Benefit and Second Injury Projections: Comparison Between Current and Previous Projections (continued) (all Amounts in Millions of Dollars) [1]

| Fiscal Year of Claim Receipt | February 2000 Projection (Assumes No Future Settlement Activity) | February 2000 Projection Modified to Reflect Assumed Settlements ments [2] | October 2002 Projection (Assumes No Future Settlement Activity) [3] | Fiscal Year of Claim Receipt | February 2000 Projection (Assumes No Future Settlement Activity) | February 2000 Projection Modified to Reflect Assumed Settlements ments [2] | October 2002 Projection (Assumes No Future Settlement Activity) [3] |
|---|---|---|---|---|---|---|---|
| 2001 | 72.9 | 67.4 | | 2026 | 18.3 | 9.0 | 20.2 |
| 2002 | 72.1 | 55.7 | | 2027 | 16.5 | 8.1 | 18.4 |
| 2003 | 71.1 | 44.1 | 65.9 | 2028 | 14.9 | 7.3 | 16.6 |
| 2004 | 69.8 | 34.4 | 64.8 | 2029 | 13.4 | 6.6 | 14.9 |
| 2005 | 68.2 | 33.6 | 63.6 | 2030 | 12.1 | 6.0 | 13.3 |
| 2006 | 66.5 | 32.8 | 62.3 | 2031 | 10.7 | 5.3 | 11.9 |
| 2007 | 64.6 | 31.8 | 60.9 | 2032 | 9.3 | 4.6 | 10.6 |
| 2008 | 62.5 | 30.8 | 59.4 | 2033 | 8.0 | 4.0 | 9.3 |
| 2009 | 60.4 | 29.8 | 57.7 | 2034 | 6.9 | 3.4 | 8.1 |
| 2010 | 58.1 | 28.6 | 55.9 | 2035 | 5.8 | 2.9 | 7.0 |
| 2011 | 55.8 | 27.5 | 54.0 | 2036 | 4.9 | 2.4 | 5.9 |
| 2012 | 53.3 | 26.3 | 52.0 | 2037 | 3.9 | 1.9 | 4.9 |
| 2013 | 50.8 | 25.1 | 49.9 | 2038 | 3.1 | 1.5 | 3.9 |
| 2014 | 48.3 | 23.8 | 47.7 | 2039 | 2.3 | 1.1 | 3.0 |
| 2015 | 45.7 | 22.5 | 45.4 | 2040 | 1.6 | .8 | 2.2 |
| 2016 | 43.0 | 21.2 | 43.1 | 2041 | 1.1 | .5 | 1.5 |
| 2017 | 40.2 | 19.8 | 40.7 | 2042 | .7 | .3 | 1.0 |
| 2018 | 37.5 | 18.5 | 38.3 | 2043 | .4 | .2 | .6 |
| 2019 | 34.7 | 17.1 | 35.9 | 2044 | .1 | .0 | .3 |
| 2020 | 32.0 | 15.8 | 33.5 | 2045 | .0 | .0 | .1 |
| 2021 | 29.2 | 14.4 | 31.1 | | | | |
| 2022 | 26.7 | 13.1 | 28.7 | | | | |
| 2023 | 24.3 | 12.0 | 26.5 | | | | |
| 2024 | 22.2 | 11.0 | 24.3 | | | | |
| 2025 | 20.2 | 10.0 | 22.2 | Total, all years | 1,364.5 | 733.5 | 1,217.7 |

(See notes on previous page.)

Minnesota Department of Labor and Industry, Research and Statistics, October 7, 2002.