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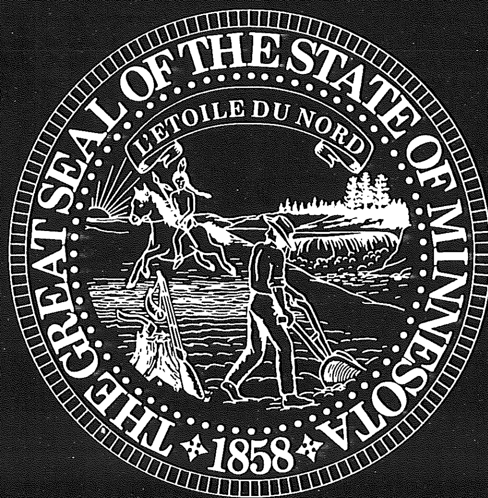
MINNESOTA WORKERS' COMPENSATION INSURANCE STUDY



STATE OF MINNESOTA
DEPARTMENT OF COMMERCE
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OFFICE OF THE COMMISSIONER

STATE OF MINNESOTA

DEPARTMENT OF COMMERCE

500 METRO SQUARE BUILDING
ST. PAUL, MN 55101
612/296-4026
FAX: 612/296-4328

EXECUTIVE SUMMARY

At the end of the 1989 Legislative Session Governor Perpich vetoed a Bill relating to workers' compensation insurance. The Bill, which at least one legislative author stated he could not explain and had not read, instituted several benefit cuts but did not regulate insurance rates. Governor Perpich requested that the Department of Commerce conduct a study concerning rate regulation and the Minnesota workers' compensation system. The study contains three parts.

PART I

Part I discusses the history of insurance regulation and workers' compensation insurance. The state-by-state evolution of workers' compensation systems results in different approaches in each state. Wisconsin, which has a strong system of rate regulation, has rates which on average are 36 percent less than Minnesota, one of approximately nine states that deregulated rates in the early 1980s.

Part I states that the goals of a workers' compensation regulatory system should be:

1. To encourage market stability and predictability.

2. To achieve the most efficient net cost to employers.

3. To ensure equitable allocation of cost among competing businesses.

4. To instill public confidence in the system.

Part I notes that the Minnesota system of deregulation has resulted in:

1. Tremendous instability of rates in Minnesota (and in other deregulated states), with rates rising and dropping with greater frequency than in regulated states.

2. Little relationship between the rates and the loss ratios of insurers.

3. Basic errors in the calculation of loss reserves by insurers.

4. A subsidy of high risk employers by small companies in the assigned risk pool.

5. A loss of public confidence in the system.

Part I concludes that rates should be regulated in Minnesota.

PART II

Part II is a survey of consumers and agents on the workers' compensation system. It is designed to find out if, in a deregulated system, employers aggressively shop around for rates and whether insurers respond to this by efficiently pricing their product.

In at least one instance, insurance executives advised the Department that, in the area of workers' compensation insurance, insurers can be rewarded for inefficiently pricing their policy. They reported that better risk clientele are less likely to shop around for competitive prices, but merely continue to pay the premium to the insurance agent with whom they have worked in the past. They displayed graphs to the Department which documented that, as insurance rates were increased, higher risk clientele leave the insurance carrier for competing companies. In contrast, the lower risk clientele stay with the insurer. As a result, the insurer is rewarded, not penalized, for inefficiently pricing its product.

Accordingly, a survey was conducted to find out the degree to which insurers are subjected to market discipline by employers who shop for efficient prices.

The Department surveyed 325 randomly selected Minnesota employers. It found that a majority of employers do not shop around for workers' compensation coverage and that at least 60 percent of the employers thought that workers' compensation rates are regulated. It concluded that the employer's misconception of the insurance market effectively limits actual competitiveness within the system. For instance, at least one-third of the employers were not aware that workers' compensation rates may vary from one insurer to the next. Further, nearly half of the employers had not switched insurers over the past five years.

The study then conducted a survey of 137 of the agents from whom the 325 employers had purchased coverage. The survey revealed that many agents do not aggressively shop for the best rate, with over 50 percent contacting only one insurer. Indeed, the survey also found that at least half of the workers'

compensation insurance is sold by agents who can only sell for one company. Interestingly, at least 57 percent of the agents disagree that aggressive shopping for premiums involves negotiation with the insurer. In contrast, 39 percent of the agents agree that insurers will negotiate the rate.

The survey also found that agents are sharply divided, on a 51%-49% basis, over whether they have an obligation to purchase insurance from the insurer with the lowest rate.

Part II essentially concludes that deregulation does not always lead to competitive pricing among insurers. It notes that this is particularly true when consumers obtain their information from one agent, who often represents only one insurance company.

PART III

Part III is a comparative study of the Minnesota and Wisconsin workers' compensation systems. It describes the basic changes that occurred in Minnesota as a result of enactment of the 1983 law.

The study then reviews the differences between the Minnesota and Wisconsin workers' compensation laws. It compares 5,982 claim files of a leading workers' compensation insurer in Minnesota with 2,221 files of the same insurer in Wisconsin.

The tabulation of these claim files then breaks out in a benefit-by-benefit comparison the cost of each benefit in Minnesota and Wisconsin.

The study has a schedule of benefits, together with an indicator as to which state is more liberal in its benefit structure.

The survey concludes that at least 20 percent of the 55 percent difference in rate structures can be attributed to the strict rate regulation which exists in Wisconsin.

The study then notes that a breakout of the Minnesota benefits which are not present in Wisconsin total at least 16 percent of premium and thereafter, breaks out the cost of each benefit.

The study concludes that Minnesota should adopt a Wisconsin system of regulation, and with regard to any Bills that are enacted, certain Minnesota benefits should be included in it.

WORKERS' COMPENSATION

PART I

Workers' Compensation Rates Should be Strictly Regulated

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I. INTRODUCTION

Perhaps the most publicized initiative taken by the voting public over the past five years is Proposition 103 in California. Not since Proposition 13 and the property tax revolt of the early seventies, has an economic issue swept the country with such speed. In virtually every state, legislatures are debating the California initiative of 20 percent rollbacks, strict rate regulation and tighter controls on the insurance industry.

In Nevada, the legislature recently enacted a mandatory rollback in rates. Texas and Oregon are contemplating a special session on workers' compensation reform. A federal judge enjoined the State of New Jersey from further dissemination of a report describing the industry as a scandal. Florida is debating an overhaul of a system described as "haywire," and Maine recently had as many as 85 percent of its employers in an assigned risk pool. In Rhode Island, Liberty Mutual, the lead insurer, recently sought a 150 percent increase in rates.

In Minnesota, consumer dissatisfaction is also present and it is particularly acute in the area of workers' compensation, where rates have significantly increased since the industry was deregulated in 1983. A comparison of 25 of the largest employee classifications shows that Minnesota's rates are consistently higher than Wisconsin's rates. The chart on page two compares the average Minnesota rate charged for a particular employee category to the fixed rate set by the State of Wisconsin. The Minnesota rates are a combined average using a combination of filed rates and actual rates charged to Minnesota employers.

In preparing for this report, the Department reviewed the rates charged in Minnesota and other states, recent rate filings, recent commentary by the judicial branch, commentary by officials of business and industry, interviews of other regulatory officials, and various resource materials.

II. ORIGIN OF INSURANCE REGULATION

Most of the laws regarding regulation of the insurance industry were adopted by individual states during the 19th century.[1] The insurance commissioner was originally

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1/ Hanson, Dineen and Johnson, "Monitoring Competition: A Means of Regulating the Property in Liability Insurance Business," National Association of Insurance Commissioners, 1974, p.16.

TABLE 1: Minnesota-Wisconsin Workers' Compensation Insurance Rate Comparison

Employee Classification	Average Annual Salary*	Rates per $100 Payroll: Minnesota Rate	Rates per $100 Payroll: Wisconsin Rate	Annual Dollar Difference Per Full-Time Employee MN vs. Wisc.	Minnesota Rate as a % of Wisconsin Rate	Wisconsin Rate as a % of Minnesota Rate
Dental Lab	$ 16,640	$ 1.16	$ .93	$ 38	125%	80%
Auto Repair	23,400	4.72	4.42	70	107	94
Printing	13,936	4.40	2.46	270	179	56
Clerical	15,288	.36	.27	14	133	75
Office Machine Installation	22,110	2.56	1.54	226	166	60
Carpentry	31,304	11.66	10.97	216	106	94
Plastics Manufacturing	18,772	7.30	4.25	573	172	58
Contractor Supervisor	32,926	4.19	2.62	517	160	62
Lumber Yards	15,600	7.98	7.24	115	110	91
Salesperson	21,996	1.04	.73	68	142	70
Restaurants	12,480	2.87	2.18	86	132	76
Machine Shop NOC	24,778	5.50	3.19	595	177	56
Building (Contractor Operated)	29,058	7.06	5.30	512	133	75
Hardware Retail	10,427	2.70	1.78	96	152	66
Auto Sales	22,110	1.41	1.20	46	118	85
Trucking for Hire	24,960	19.98	11.26	2,177	177	56
Retail Grocer	8,912	4.94	3.24	152	152	66
Gas Station	9,880	4.08	2.46	160	166	60
Bakery	16,557	5.64	4.09	257	138	72
Retail Store NOC	10,427	2.40	1.14	131	205	49
Retail Clothing	10,427	1.85	1.19	69	155	64
Barber Shop	10,400	1.12	.50	64	224	45
Plumbing NOC	37,960	9.47	7.20	862	132	76
Paper Manufacturing	27,144	6.07	2.37	1,004	256	39
				Simple Average	155%	64%

* Source: Minnesota Salaries by Industry & by Employer Size 1988, Minnesota Department of Jobs & Training

responsible for licensing insurance companies, holding deposits of the companies in the event of insolvency, and reviewing company operations. The regulator was primarily concerned with the net worth of insurance carriers' investments, the types of policies sold, and the rates that were established.

The primary purpose of rate regulation was insurer regulation. Insurance companies originally were small cooperatives, described as mutuals, which had a tendency to underprice their policies in an effort to attract a greater number of policyholders, thereby maintaining sufficient cash flow to support their operations. As time passed, the insurer's ability to pay for expected or likely losses as projected by their reserves was jeopardized, and eventually the insurer became insolvent. Since none of the companies were large enough to have sufficient data from which to calculate appropriate reserves, insurers would join together to form "compacts" to set minimum rates.[2] These compacts were determined to be lawful and not subject to the antitrust laws on the basis that an insurance company is not engaged in interstate commerce and is therefore exempt from such laws.[3]

These compacts continued through the 19th century until 1912, when the state of New York enacted a law which required that rates be first reviewed by the insurance commissioner.[4] This authority was upheld by the United States Supreme Court on the basis that insurance is "affected by the public interest" and thus a reasonable object of state regulation.[5] Thereafter, many states enacted laws regulating such rates.[6]

In the meantime, the insurance industry evolved in terms of its structure, with mutual companies competing with "for profit" stock insurance companies. By the 1940s, there were many large insurance companies, multi-state

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2/ U.S. General Accounting Office, Office of Chief Economist; "Workers' Compensation," p.11 (1986).

3/ Paul v. Virginia, 8 Wall 168 (1869).

4/ N.Y. Laws 1912, Ch. 175.

5/ German Alliance Insurance Company v. Lewis, 233 U.S. 389 (1919).

6/ See, e.g., N.J. Acts 1917, Ch. 178; Wis. Laws 1917, Ch. 637; Minn. Laws 1921, Ch. 85; Pa. Laws 1921, Chs. 284 and 654.

in nature, which had sufficient data to establish their own rates. Nonetheless, insurance companies would continue to exchange data through "compacts." With respect to workers' compensation, the industry established the National Council of Compensation Insurance (NCCI) in 1921.[7]

In 1944, the Supreme Court reversed its 1869 decision and ruled that insurance did constitute interstate commerce, that it was a business, and that insurance companies were not exempt from the federal antitrust laws.[8] This decision prohibited insurers from exchanging data.

In response, the industry attached a "midnight amendment" to an unrelated bill in a Congressional conference committee, which essentially exempted the insurance industry from various sections of the federal antitrust laws as long as there was "adequate" state regulation.[9] This bill, known today as the McCarran-Ferguson Act,[10] is the foundation of modern insurance regulation. At the time of the bill's passage, only 18 states regulated fire insurance premiums, 36 states regulated workers' compensation and seven states regulated auto insurance.[11]

Accordingly, in order to fall within the exemption pertaining to adequate state regulation, the insurance industry, through the Association of Casualty and Surety Executives and the National Association of Mutual Casualty Companies, presented "model" regulatory bills to the National Association of Insurance Commissioners (NAIC) in 1945.[12] Thereafter, the NAIC presented these "model" bills to the states and, by 1949, almost all states had adopted some variation of the model bills.

7/ Risenfeld, Modern Social Legislation, The Foundation Press; p.372 (1950).

8/ United States v. Southeastern Underwriters Association, 322 U.S. 533 (1944).

9/ Orfield, Improving State Regulation of Insurance, 32 Minn. Law Rev. 219 (1948).

10/ 59 Stat. 22, 15 U.S.C. § 1011 (1945).

11/ Mertz, The First Twenty Years, NAII, June, 1965, p.3.

12/ Risenfeld, supra, at 372.

III. WORKERS' COMPENSATION REGULATION

A. BACKGROUND

Workers' compensation followed a similar historical pattern. It was originally proposed in modern form in Germany in 1881 as a means of social welfare. In 1893, future Prime Minister Joe Chamberlin proposed an English system which would provide prompt compensation for loss of income and medical expenses arising from work-related injuries. Fault was not to be considered.[13] After the turn of the century, various states, beginning with Wisconsin, adopted statutes which provided compensation for injured workers. Most states had adopted such laws by 1920; all had by 1948.[14] In all but two states, South Carolina and New Jersey,[15] such insurance is compulsory and considered to be a public necessity.

Due to its compulsory nature, workers' compensation insurance has always been more closely regulated than other forms of liability insurance. In at least six[16] states the insurance is considered such a necessity that it is exclusively issued by a state monopoly fund.

While auto insurers operate in an open competition system where each company is free to establish its own rates, most states, through regulators, establish the workers' compensation rate for approximately 640 occupational classifications. Through this system of regulation, known as "administrative pricing," insurers compete only on the basis of underwriting, and accordingly, profitability is determined by an insurer's ability to choose the best risks.

Much of the rate data submitted to the regulator is prepared by an association of the insurance industry. In most cases, the NCCI, which is made up of approximately 515 insurance companies, gathers loss data to determine "pure premium." ("Pure premium" is the premium required to cover losses only.)

13/ Risenfeld, *id.*, at 128.

14/ U.S. General Accounting Office; Office of Chief Economist, "Workers' Compensation," p.9 (1986).

15/ State Workers' Compensation Laws, Table 1, U.S. Department of Labor, Employment Standards Administration, Office of State Liaison and Legislative Analysis, January, 1989.

16/ North Dakota, Ohio, Nevada, Washington, West Virginia, Wyoming.

In addition to "pure premium," the NCCI also calculates "manual premium" which includes expenses such as administrative costs, defense costs (loss adjustment expense), commissions and profits. Generally, the NCCI supplies the data to a rating bureau in each state, which then files a rate schedule. Typically, the regulator then reviews the filing, holds a hearing, and sets a rate for each of the employee classifications. This system of workers' compensation has generally continued unchanged through the twentieth century.

Exceptions to the system of "administrative pricing" began to occur in states where companies were permitted to establish "retrospective rating" as a means of adjusting the premium of an employer depending upon its experience during the year. Some states also permitted insurers to issue "schedule credits" as a means of reducing the rate for employers who adopted certain safety measures. Other states allowed "experience rating," where an employer's claim experience would result in an adjustment of the premium. Still other states permitted "premium discounts" for employers with large payrolls. Individual insurers or agents could inject a competitive element by changing the job classifications for a particular policyholder. As a result of a change in the employee classification, an employer could be charged a substantially different rate.

By the early 1980s, several states allowed "deviated rates," as long as they were filed and approved by the commissioner. In 1979, Minnesota adopted a law permitting insurance companies to deviate 15 percent from the rate that was established by the commissioner. The more types of deviations, discounts, credits, and other adjustments that are allowed, the less meaningful the filed rate becomes.

A striking example of how meaningless filed rates have become in light of schedule credits and premium discounts, is provided by the following comparison of two quotes given by the <u>same insurer</u> for the <u>same employer</u> in consecutive policy years. The employer is a building materials dealer with several different employee classifications. The chart below shows the rates charged in 1988 as listed on the policy form. No schedule credits were applied to the 1988 rates. The second column of figures shows the rates for the same employee classifications as they appeared on the employer's 1989 policy. These rates seem to indicate a substantial increase in the filed rate.

However, the last column of figures shows the actual rates paid by the employer in 1989 after the 35 percent schedule credit was applied.

Employee Classification	1988 Rate	1989 Rate (Without Credit)	Actual 1989 Rate (With Credit)
Planing or Molding Mill	9.94	12.26	7.87
Carpentry	4.48	6.44	4.19
Building Material Dealer	2.11	2.49	1.62
Lumber Yards	6.96	12.93	8.40
Clerical	.35	.40	.26
Salespersons	1.07	1.15	.75
Restaurant	2.83	3.50	2.28

Although the insurer's filed rates indicated a significant increase in 1989, the insured actually realized a premium reduction because of the use of the schedule credit.

Competitive rating, or non-administered pricing, has been implemented in several states. The manner in which one defines "competitive rating" establishes the number of states that use it. Some believe competitive rating is present in those states which prohibit rating organizations from prescribing the manual rate, but permit the dissemination of a "pure premium" rate by the industry compact.[17]

Others define competitive rating to be only those systems which permit an insurer to establish its own rates independent of industry recommendations or administrative approval.

While Wisconsin and New York are restrictive in the pricing of workers' compensation insurance and allow few of the above discounts, dividends, and credits, other states have been very liberal. Some

17/ Richman, "A Different Way to Evaluate the Method of Regulation of Workers' Compensation Pricing" Vol.III, Issue I; p.57 (1987).

states, such as Oregon, require that the insurer file an individual rate, which thereafter must be reviewed by the insurance regulator. The most liberal state is Minnesota, which permits the insurer to file a rate, and thereafter sell insurance at any rate it deems appropriate.

On June 12, 1981, Arkansas became the first state to prohibit the issuance of manual rates by an industry compact organization. Other states adopted modifications designed to address the rising concern among employers about the cost of workers' compensation. In 1982, Oregon adopted a form of open competition, where insurance companies merely file their rates with the Department under a "file and use" system. Three states introduced competitive rating in 1982, two states in 1983, three in 1984 and one in 1985. In contrast, states such as California permitted dividends to be offered by insurers, but permitted no other type of discount. At the same time, states such as New York and Wisconsin did not allow deviations from the rates established by the commissioner.

As noted above, Minnesota has the most open form of pricing, now allowing the insurance company to deviate indefinitely from the rates filed with the Department.

B. REGULATORY GOALS

It is generally agreed that a workers' compensation regulatory system should have the following goals:

1. To encourage market stability and predictability.

2. To achieve the most efficient net cost to employers.

3. To ensure equitable allocation of cost among competing businesses which have similar types of risks.

4. To instill public confidence in the responsiveness of the system.

Most periodicals and treatises which are written on the subject promote competitive pricing. It is not by coincidence that almost all of these articles and treatises are written by insurance industry representatives, insurance industry "experts," and insurance company executives, all of whom receive substantial income from the industry.

A 1982 independent report by the U.S. General Accounting Office (GAO) developed a theoretical assessment of the potential effects of competitive ratemaking. It recommended that open competition be permitted. While the report stated that competitive rating seemed viable, it cautioned that there was no statistical evidence available on the actual effect. It expressed concern that such deregulation might result in an availability problem for smaller employers. Thereafter, in 1986, the GAO issued a second report, specifically addressing the issue of an adverse effect on smaller employers.[18]

This report noted that only one state, Michigan, had any evidence regarding the effect on small business. It stated that from 1982-1985, insurance premiums in all lines of coverage declined throughout the nation due to an extremely erratic swing in the underwriting pricing cycle. Since the rate decrease occurred throughout the country in all lines, the report concluded that it was "too soon to draw firm conclusions about longer run trends."

IV. REGULATION FOSTERS PREDICTABILITY AND STABILITY OF WORKERS' COMPENSATION RATES

A critical factor in projecting the income for a business is determining its cost of production; the ability to project income is directly related to the stability of the various component costs. While some production costs cannot be stabilized, it is important that as many of those component costs be as stable as possible. Workers' compensation insurance, being an essential expense item, ought not create surprises for business owners.

It is well documented that administrative regulation of rates tends to smooth out the peaks and valleys of the underwriting cycle. While a deregulated system will result in prices dropping more quickly during the valleys of the underwriting cycle, it also results in rates shooting upward much more rapidly during the tight period of the cycle.

This is particularly true in the area of workers' compensation insurance. Since policy coverages are statutorily mandated, and therefore uniform, price becomes the only variation from one insurer to another. Since

18/ U.S. General Accounting Office, Office of Chief Economist, "Workers' Compensation," p.12-13 (1986).

insurers cannot vary the terms of coverage or the range of service provided, there is even more pressure for pricing to produce an unstable market.[19]

All forms of property and casualty insurance experience cyclical swings as to availability and affordability. These fluctuations, known as the underwriting cycle, have historically had a seven year life span. Property and casualty insurers, like all financial companies, work with principles of leverage. These insurers generally will receive about twice their net worth each year in net premiums. They generally do not want to exceed a 3-to-1 ratio of premiums to net worth. If investments are not as profitable as anticipated, or if claims are higher than expected, the net worth of the industry grows substantially slower than the demand for increased capacity. As demand for coverage brings insurers closer to the 3-to-1 ratio, the insurers enter a capacity crisis where they are limited in the amount of insurance they can sell. In order to decrease risk, they substantially increase rates for their existing policyholders. As a result of increasing premiums, the insurer reaches its capacity of business with fewer policyholders, thus causing the insurer to cancel policyholders who otherwise could have purchased coverage at the lower premium level.

When these events occur, the insurance cycle becomes "tight" and profit-taking occurs. New capital is attracted to the industry and, at the same time, the high premiums earned by the industry begin to flow down the balance sheet and create a larger net worth. The process to convert increased premium income to increased profits takes at least one year. As a result, as new companies and new capital enter the market, the industry enters a "soft" cycle where insurers compete and seek new policyholders to fill up their greater capacity. The rates drop in the competitive rush to obtain accounts.

The investment cycle will also have an effect on the underwriting cycle. If a recession occurs, investment income falls short of expected return and there is less demand for insurance from a limited economy. If losses are taken, the industry then loses net worth in relation to premium income, thereby causing the market to tighten again.

While historically underwriting cycles have been predictable in terms of duration and extremes, the more recent experience with financial deregulation has caused a much more volatile underwriting cycle.

19/ Richman, "A Different Way to Evaluate the Method of Regulation of Workers' Compensation Pricing," NCCI DIgest Vol. IV, Issue II, p.62 (1986).

During the high inflation era of the late 1970s and early 1980s, the return of investment hovered near the 20 percent range on annual yield. Insurers would appropriately build in such expected rates of return in calculating premiums. For instance, an auto insurer holds the premium dollar for an average of 15 months, and in 1982 would anticipate charging substantially less than it would in a normal period and make up the lesser premium with increased investments. In 1982, this discounting on auto insurance was as much as 12 percent more than in a normal period. This discounting factor increases for workers' compensation insurers which, on average, hold onto the premium for over three years. An insurer of workers' compensation could write coverage in 1981 for a fraction of what it would normally charge during a recessionary period.

From 1981 until 1984 the market was extremely soft. Insurers were discounting premiums in an effort to get more cash to use for investments at the 20 percent return level. The problem, however, was that inflation dropped and so did the rate of return. This resulted in expected profit from investments falling through the floor, causing several insurers to become insolvent. By mid-1985 the industry entered a very tight market, with some types of insurance even becoming unavailable. Premiums shot up and residual markets, such as the Workers' Compensation Assigned Risk Pool, ballooned in size. By 1988, the market stabilized as more insurers entered the market. Premiums earned from 1985 through 1987 resulted in profits which increased the existing market's net worth.

It is well documented that those areas of insurance which were deregulated experienced the largest fluctuation in premium during this time period.[20] In many cases, commercial insurance policyholders suffered sticker shock as they witnessed 200-300 percent increases in premium.

Those states which regulated workers' compensation premium saw substantially less premium volatility. In fact, insurance policies were underpriced even though the insurer took a loss.[21] It became evident that the industry would increase premiums where the market would bear. With respect to workers' compensation, that market was in the six states that had deregulated activity.

20/ Richman, *id*.

21/ Ryan and Fain, "A Forecast for Workers' Compensation," NCCI Digest, Vol. III, Issue IV, p.48 (1988); Ryan, "Long and Short Term Challenges Before the Workers' Compensation System," Vol. III, Issue II, p.4-5 (1988).

Minnesota is no exception. In 1983, the Minnesota legislature enacted several changes in the workers' compensation system. Included in those changes were benefit cuts with regard to temporary total disability and permanent partial benefits. In spite of these benefits cuts, the workers' compensation rates in Minnesota have almost doubled.

From 1979 through 1983, the workers' compensation costs in Minnesota were reduced by 1.9 percent. From 1984, after workers' compensation rates were deregulated, to 1987, the rates increased approximately 91 percent.[22]

This dramatic increase in rates is directly related to two factors: (1) the insurance industry experienced a very tight underwriting cycle from 1985-1987, and (2) the industry was restrained from raising rates in other states by virtue of the fact that their premium structure was tightly regulated.[23] In order to increase gross premium income, the industry raised rates to whatever extent allowed in a given state. During the mid-1980s, no more than six states, including Minnesota and Oregon, had open competition in workers' compensation. The rate increases in these six states were significantly higher than those in regulated states. Various proponents of the deregulated system have attempted to justify the increase in Minnesota rates (in comparison to other states) on the basis that rates in Minnesota had declined between 1978 and 1983, and therefore, the industry had to raise rates faster here than in other states in order to make up for lost income.

This explanation, however, fails to address the industry pricing mechanism. Rather than isolating profit margins in this state, insurance companies, like all other commercial corporations, first determine their profit or loss on a countrywide basis. After determining this overall profitability, the insurer will establish, on a line-by-line (auto, homeowner, collision, commercial, etc.) basis, its profitability for each type of insurance coverage. After determining its profit or loss in the

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22/ Workers' Compensation Program, Office of Legislative Auditor (St. Paul, 1988), p.24.

23/ Ryan and Fain, "A Forecast for Workers' Compensation," NCCI Digest, Vol. III, Issue III, p.49-50 (1988); Ryan, "Long and Short Term Challenges Before the Workers' Compensation System," Vol. III, Issue II, p.4-5 (1988).

area of workers' compensation, the company computes the gross income it needs in that line of coverage on a countrywide basis and then apportions it among the various states.

As one can see by this process, an insurer's losses in one state may very well be apportioned to another state. This process is widely acknowledged as the basis for the expected increase in rates of property and casualty insurers after the catastrophic losses resulting this year from Hurricane Hugo and the San Francisco earthquake.

Further, an insurer's profitability in one state directly affects rates established for another state. Indeed, the major concern by many states since passage of Proposition 103 has been the effect of the rate reduction in California with regard to increased premiums in other states. Every state has attempted to prohibit insurers from making up for cutbacks by increasing rates in its jurisdiction. In spite of these attempts, however, it is obvious that such loss allocation can occur. As a result, states such as Nevada are adopting similar mandatory reductions in rates.

While it is common for an insurance carrier to file 30 percent or 40 percent increases in all states, in virtually every regulated jurisdiction, the state insurance commissioner will reduce the requested increases substantially. In Minnesota, the commissioner has no such authority, and price increases occur in an unfettered fashion.

For instance, most of the insurers listed below report a loss ratio under 75 percent. It is readily conceded by the industry that such a loss ratio in workers' compensation is attractive and profitable. Nonetheless, these insurers filed increases of up to 69.8 percent.

Insurer	Reported Loss Ratio	Percent Increase
Newark Insurance Co.	71.1%	36.7%
Safegard Insurance Co.	71.1	36.7
American and Foreign Insurance Co.	54.7	23.0
Royal Indemnity	54.7	23.0
Globe Indemnity	51.9	6.6
State Fund Mutual	76.0	6.1
National Union Fire of Pittsburgh	71.0	2.2
Western National Mutual	74.5	25.0
Lumbermen's Underwriting	69.9	11.2

If the filed rates had any meaning, and if a competitive market would discipline an inefficiently priced policy, such increases would not occur.

The lack of discipline of a deregulated market is also reflected in the calculation of loss ratios by insurers. All insurers in Minnesota are members of the Workers' Compensation Reinsurance Association (WCRA), established to insure catastrophic claims over $200,000 (a few insurers have selected a higher insurance level of $400,000). Since insurers should not post reserves for claims which are assumed by reinsurance, Minnesota workers' compensation insurers should not post reserves for claims exceeding this reinsurance level. The comparative survey in Part III of this report, however, notes that Wausau posted over $6 million in reserves for claims over their reinsurance level, even though the WCRA is responsible for them. When asked why Wausau posted reserves for which they are not responsible, the vice president responded that "all insurers do it."

V. REGULATION IS NECESSARY IN ORDER TO ELIMINATE THE SUBSIDY OF HIGH RISK EMPLOYERS BY SMALLER COMPANIES

As with other insurance products, there is a segment of the policyholder population which is so high a risk that no insurer desires to insure them. Workers' compensation insurance, a mandatory coverage that must

be purchased by almost all employers, is no exception.[24] Since some industries, or businesses within industries, are high risk but still function as an integral part of our commercial system, each state authorizes the formation of a high risk pool from which insurance is available. The policyholders who purchase coverage from the pool pay a premium that, due to their higher risk and subsequent losses, is in part subsidized by an assessment on the industry. Policyholders need only be denied coverage by one insurer in order to participate in the pool.

When Minnesota had a regulated system prior to 1983, the premium rate paid by policyholders in the Workers' Compensation Assigned Risk Plan ("Pool") was the same as the premium rate established by the private sector. The size of the Pool was dictated by the rate set by the commissioner. If the commissioner set the rate too low, the private market would not sell coverage and the Pool would grow in size. If the rate was set too high, however, there would be little need for access to the Pool as private carriers would willingly sell the coverage.

In December 1982, under a regulated system, the population in the Pool was 15,700. In December 1983, the size of the pool was $14 million in annual premium, which was approximately three percent of the estimated total market of $500 million. The number of policies issued by the Pool was 16,330. The cost per policy was approximately $857.

In 1984, deregulation was implemented with a requirement that the rate charged by the Pool be established above the prevailing rate sold in the marketplace. By December 1987, the size of the Pool increased almost sevenfold to $100 million in premium, which was almost 11 percent of the estimated market of $900 million. The number of policies issued by the Pool was 36,000; the cost per policy was approximately $2,778.

24/ Workers' compensation insurance is elective in two states. In nine states, employers with fewer than three employees are exempt (Alaska, Arkansas, Florida, Georgia, Michigan, New Mexico, North Carolina, Virginia, Wisconsin); in two states, employers with four employees are exempt (Rhode Island and South Carolina); and in three states, employers with less than five employees are exempt (Mississippi, Missouri, Tennessee). Several states have exemptions for particular occupations (i.e. truckers with less than three employees in Illinois; builders with less than two employees in Arkansas; loggers with less than ten employees in North Carolina; and farmers in at least 14 states).

During the first four years of deregulation the Pool grew almost fourfold in terms of marketshare and doubled in terms of the number of employers. The increase nationwide was similar over the same period, with pools increasing in premium by 549 percent and in policyholder count by 137 percent. By 1988, only five states had a residual pool with less than 11 percent marketshare.[25]

A review of the Minnesota Pool's performance during this time, however, indicates that its growth probably was not attributable to high risk business. In 1985, the Pool had earned premium of $45,405,000 and incurred a deficit of $17,334,000. During 1986, the premium rate did not increase nor was there an assessment. In spite of this, the earned premium nearly doubled to $86,900,000, but the deficit was only $20,975. During this time period, the policyholder count almost doubled from 17,497 to 29,033. One could assume that the doubling of policyholders and premium without an appreciably increased deficit was due to low risk business entering the Pool.[26]

Low risk businesses of small size and, consequently, small premium volume, are not attractive risks to private carriers. As a result of being denied coverage in the private market, small businesses are forced to purchase coverage from a Pool composed of high risk employers. These businesses are in effect penalized for being small by having to pay a higher than market rate to subsidize higher risk businesses in the Pool.

This phenomenon of "reverse subsidization" of high risk businesses by smaller, low risk companies, is documented by the underwriting policies of many private carriers. Several companies have "unofficial" minimum premium requirements, below which the insurer will not issue a policy unless there is a compelling reason, such as the policyholder purchasing other coverage from the insurer. Agents state that these unofficial minimums generally range between $2,500 to $5,000. Further evidence of the premium benefits associated with being a larger-sized business are documented by the premium discount structure used by many insurance carriers. Most insurers give no discounts to accounts under $5,000. Accounts which generate a premium between $5,000 and $100,000 generally receive an automatic premium discount of nine or ten percent. Accounts of over $100,000 in premium may receive between a 12 and 15 percent discount.

25/ Fromm, "Depopulating the Residual Market," NCCI Digest, Vol. IV, Issue II, p.18 (1989).

26/ *Id.*

The survey of Wausau Insurance Company in Part III confirms this differential. Appendix B to Part III shows that in 1982 the average premium per Wisconsin employer is approximately $12,500 and the average premium per Minnesota employer is $17,850. By 1988 the gap had substantially widened. The average premium per policyholder in Wisconsin is $37,000 with the average in Minnesota is $123,177. In 1988 Wausau insured 2,373 Wisconsin businesses and only 194 Minnesota businesses.

This reverse subsidization of risk by small, low risk businesses is also documented by a policyholder count in the Pool. According to the Assigned Risk Plan contractors, two-thirds of the businesses in the Pool are there solely because of their low premium volume. Over 80 percent pay a premium under $2,000 per year. The profile of these companies appears to be one to five person professional offices such as counseling offices, law offices, real estate agencies, and accounting firms, as well as small retail establishments, restaurants and distributorships. Table 2 below shows the composition of the Minnesota Pool as of December 31, 1988 according to annual premium size.

TABLE 2: Minnesota Assigned Risk Plan
Policy Distribution by Premium Size

ANNUAL PREMIUM RANGE FROM	TO	POLICY COUNT	PERCENT OF TOTAL COUNT	AMOUNT OF PREMIUM	PERCENT OF TOTAL PREMIUM
0	200	263	12.11%	40,609	0.74%
200	400	479	22.05	142,649	2.59
400	600	412	18.97	207,262	3.76
600	800	158	7.73	115,888	2.10
800	1,000	127	5.85	113,196	2.05
1,000	2,000	270	12.43	386,839	7.02
2,000	3,000	153	7.04	373,013	6.77
3,000	4,000	68	3.13	236,586	4.29
4,000	5,000	55	2.53	243,011	4.41
5,000	6,000	24	1.10	131,808	2.39
6,000	7,000	22	1.01	142,921	2.59
7,000	8,000	18	0.83	136,421	2.47
8,000	9,000	10	0.46	83,283	1.51
9,000	10,000	10	0.46	94,311	1.71
10,000	25,000	67	3.08	992,877	18.01
25,000	50,000	12	0.55	372,543	6.76
50,000	100,000	9	0.41	672,227	12.20
100,000	AND OVER	5	0.23	1,026,564	18.62

MEAN	$ 2,537.76
MEDIAN	$ 550.00
MINIMUM	$ 98.00
MAXIMUM	$224,918.00
COUNT	2,172

In most states which have regulated pricing, the rates for the Pool and the "private market" are the same, with the only difference being the application of underwriting criteria based on risk.[27] In a deregulated market, the companies will base their rate on economies of scale, economies of scope, and other market factors. A larger company will receive tremendous discounts because administrative costs drop as premium levels increase (scale economy). It also will receive discounts because expenses per premium dollar decrease for other forms of insurance coverage, including commercial general liability (CGL) coverage, commercial auto coverage, umbrella coverage, directors and officers liability coverage, fire coverage, and bonds (economies of scope). Smaller companies which, for example, rent space, do not have the leverage to negotiate a lower rate because they do not have a need for certain other types of insurance. As a result, the rates charged for smaller companies have substantially fewer discounts, credits and incentives.[28]

Reverse subsidization is well documented in other deregulated industries as well. Prior to bank deregulation, institutions offered minimum deposits, free checking accounts, and even product inducements, such as appliances, in an effort to lure retail customers. Ten years after deregulation, banks offer free checking accounts only to those who can maintain a $500 minimum balance, a figure that under 10 percent of Americans can maintain. In addition, banks pay interest on the average monthly balance of these "free checking" accounts. These incentives are subsidized by smaller accounts which pay higher service charges and receive no interest.

Bank regulators have also observed that as the size of institutions increase with deregulation, more pressure is placed on institution personnel to place loans with larger businesses. The effort involved in underwriting a large loan involves the same analysis and effort given to underwrite a small business loan.

Airline deregulation followed the same course of reverse subsidization. Airfares to distant and larger cities are much cheaper than those to closer and smaller cities due to the efficiency presented by passenger per mile cost ratios. While such economies of scale make sense, aberrations in economic demand occur. The fare of a trip

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27/ Fromm, supra, note 25, at 20.

28/ Butler, "Profitability in Workers' Compensation: The Role of Scale, Scope and Covariance Economies;" Presented at NCCI Seminar "Economic Issues in Workers' Compensation," New York, November, 1964.

to a distant city, with a layover in an intermediate city, may be cheaper than the fare to the intermediate city alone. This is not the result of passenger per mile efficiency, but solely market demand. In the same way, a low risk, smaller company may end up paying a higher premium rate than a high risk larger company.

It is inappropriate that such subsidization occurs with a product that is deemed a necessity by the state. Smaller companies should not be required to pay a premium for a mandated product, which is higher due to losses caused by high risk businesses in the Pool, merely because of their size. These companies, in many cases, compete with much larger companies. Due to their size, the larger companies are able to lower their per unit cost of production as a result of reverse subsidization in the acquisition of business necessities, such as workers' compensation insurance, business loans and other financial products.

This reverse subsidization exemplifies the trend over the last decade where the middle rungs of the economic ladder are being eliminated. Financial deregulation has joined flat taxes and lax enforcement of the antitrust and securities laws to create an hour glass curve of company size in America. In the long run, such activities are anti-competitive and frustrate entrepreneurial initiative.

VI. REGULATION IS NECESSARY TO ENSURE PUBLIC CONFIDENCE AS TO RESPONSIVENESS OF SYSTEM

Perhaps even more important than the high cost of workers' compensation insurance is the public perception that the Minnesota system is unfair. The overall difference between the cost of workers' compensation insurance in Minnesota versus Wisconsin is shown on Table 3 below.

The total insured payroll for each state was calculated by subtracting the self-insured payroll in each state from the total payroll covered by unemployment compensation insurance in each state.

TABLE 3

	TOTAL INSURED PAYROLL (1988)	TOTAL WORKERS' COMPENSATION PREMIUM (1988)	AVERAGE COST OF WORKERS' COMPENSATION INSURANCE PER $100/PAYROLL
Minnesota	$37,193,961,980	$694,000,000	$1.87
Wisconsin	35,465,049,170	629,000,000	1.77

The attention directed at the issue is the main source of the business climate frustration in Minnesota. An overwhelming number of respondents to the survey reported deep frustration with the rising cost of workers' compensation premiums. This is interesting because the growth in payroll over the last two years has exceeded the growth in workers' compensation premiums in Minnesota by 8.8 percent. Therefore, as a percent of total payroll, workers' compensation premiums have actually decreased.

There are five basic components in the calculation of the insurance premium: claims payments (including reserves for future losses), administration (overhead), loss adjustment (defense costs), agent commissions and investment income. The largest component, claims payment, also is the most difficult to calculate due to the length of time it takes (up to ten years) to ascertain the true cost of a claim. As a result, if there is excessive profit-taking by an insurer, it can be easily disguised by calculating reserves in a conservative fashion. The high decibel level of the debate concerning workers' compensation is in large part due to lack of knowledge with respect to the factors that cause rate increase. Various interest groups are more than willing to provide anecdotal evidence of price gouging by insurers, feigned disability by employees, and overutilization by health providers. Virtually everyone is critical of the administration of the system.

If benefit levels are to be modified, the savings that result must be immediately passed on to employers. Any delay will increase public cynicism toward the current system. An immediate bestowal of savings upon employers from benefit modifications, however, is not likely to occur in a deregulated environment. Most changes in premium level appear to be caused more by changes in the underwriting cycle than by any change in the law. The 1986 GAO study prematurely referred to premium reductions in 1983 and 1984 as perhaps being caused by competition. While such a shake-out usually occurs in any environment that is initially deregulated, it more likely was reflective of the soft underwriting cycle during those years. The reductions in workers' compensation premiums during these years paralleled the reduction of premiums in other lines of coverage.

Perhaps the best example of this lack of industry responsiveness can be seen with respect to the Parsons decision.[29] From 1983 until 1988, the insurance industry

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29/ Parsons v. Holman Erection Co., 428 N.W. 2d 72, 41 W.C.D. 129 (1988), rev'g 41 W.C.D. 118.

based its premiums upon the assumption that temporary partial disability benefits would be paid for as long as there was a disparity between a worker's pre-injury wage and his current wage, whether or not the employee returned to work. In 1988, the Minnesota Supreme Court, in Parsons, ruled that temporary partial benefits terminate 90 days after "maximum medical improvement." As a result, according to at least one industry spokesman, the insurance industry saved at least $50 million. When the Parsons decision was announced, observers assumed that the insurance industry would credit or reduce premiums because it had saved substantial sums of money over that five year period. In fact, the industry did not reduce its premiums, nor did it give any credit to policyholders as a result of the decision. There is no indication in the rate filings that occurred after the Parsons decision that any credit for the benefit change was factored into the filed rate. One can only assume that the savings which resulted from the benefit reduction were not passed onto the employer, but rather retained by the insurer.

The lack of responsiveness by the insurance industry to Parsons has elevated public cynicism. Speeches by trade union representatives, lawyers and politicians frequently cite the Parsons experience as evidence of price gouging by insurers.

Rate regulation would ensure that such benefit modifications are immediately passed on to the employer. The proposal in Part III assumes that Minnesota would adopt, with some exceptions, the Wisconsin system, and with it adopt the Wisconsin premium schedule in such a fashion as to factor in any exceptions that are made.

An alternative to administered rate regulation is a statutory rollback on rates combined with an adoption of a "prior approval" system. Such a proposal was contained in the legislative act vetoed in 1989. The Act would have imposed a 10 percent rollback. Prior approval regulation, however, is tantamount to no regulation. Under this type of regulatory structure, which is used in the health insurance area, each insurer files separate rates. Those rates are adjusted with regard to employee classification, experience modifications, and payroll credits, as well as the insurer's own experience to the degree that any premium can be justified based upon the insurer's individual estimates as to claims experience.

While the regulator can review the rate prior to its implementation in a prior approval system, the review is ineffective since each insurer's data differs. Due to the long-tailed nature of workers' compensation claims, an insurer is able to rationalize any filed rate by use

of a conservative actuarial opinion. As a result of the cost of an administrative hearing for each insurer, and the cost of an actuarial study of each company, it would not be economically feasible for the Department to contest a rate unless it adopts uniform standards of rate calculation. If the Department adopted such standards, they probably would be unresponsive to changes in the law. Further, such a process would effectively create an "administered rate."

Individual rate filings by competing insurers on a long-tailed insurance product such as workers' compensation also runs contrary to the very purpose of the McCarran-Ferguson Anti-Trust Exemption. The insurance industry asserts that the exemption is necessary so that it can exchange loss data through the NCCI and affiliated bureaus. The industry states that it must exchange this data because no one insurer has sufficient loss experience upon which it can make an actuarially sound projection of claim costs. If insurers need uniform loss experience data as compiled and supplied by a rating bureau, which data is the most intricate part of the rate, the rate should be established on a uniform basis as well. This is particularly the case in workers' compensation, where the terms of coverage are established by statute and the insurer cannot modify or tailor coverage as a means of competition. If companies are able to justify separate rates they should be prohibited from exchanging the data.

In a deregulated environment, insurers, due to the uncertainty created by the long duration of claims resolution, are reluctant to factor in benefit modifications until such time as claims have matured under the current system. At least one NCCI employee stated that the NCCI adopts a "Missouri attitude" and waits to see the effect of a benefit change, instead of immediately adjusting its rates. Because of this reluctance, rate regulation is necessary to ensure that employers see reduced premiums as a result of any modification in benefits.

VII. CONCLUSION

The insurance reform movement which manifested itself as Proposition 103 in California reflects more than consumer dissatisfaction with insurers. It reflects a demand for a new era of regulation to guarantee fair treatment. Consumers beleaguered by rate shock are saying "no" to rates that are out of control. The reform movement should not be dismissed as mere sound and fury, for it reflects in unmistakable terms the insurance industry's loss of public trust.

The insurance industry holds the unique position, along with professional baseball, of being exempt from certain federal antitrust laws. This allows insurers to share information, meet, adopt uniform policy forms, make rate recommendations, and generally act through "compacts." The McCarran-Ferguson Act was adopted in 1945 and stands for the proposition that such compacts are permitted as long as the states regulate the industry to ensure the public trust is not violated and that there is public confidence in the industry. The current system of workers' compensation in Minnesota does not have such credibility. Each time the Department has undertaken a significant study of a line of insurance, whether in a niche market with few carriers or in a larger market with multiple insurers, rate increases by the insurers were not substantiated by an increase in either severity or frequency of claims.

In 1989, the Minnesota Medical Malpractice Claim Study noted that the 300 percent increase in premium charged over a six year period had virtually no relationship to loss experience. The insurance industry initially contested the report's accuracy by stating that premiums were appropriately set. When the Department initiated a lawsuit based upon the study, the industry argued that the report was flawed and that premiums were appropriate. In less than a month, however, the primary malpractice insurer reduced its rates by 25 percent in the state of Minnesota and by a similar margin in 34 other states. While it is the Department's belief that such a rate reduction is insufficient and that the company should reduce its rates by at least another 25 percent, it is noteworthy that the insurer, when confronted with the report and lawsuit, still insisted that its figures were correct and that it was responding to competition. It is apparent that the industry was not responsive to the market and that open competition in such a niche market does not work.

This credibility gap extends to all forms of property and casualty insurance. When the Department undertook a rate study of automobile insurance, it found that Minnesota's rates were the second most profitable in the country, and that there was a 300 percent difference among insurers for identical automobile insurance coverage. If the industry were competitive, one could assume that the rate differential would be substantially closer. In no other field are competitors selling identical products at a cost that varies by a threefold margin. The Department's survey of homeowner's insurance revealed a similar disparity of an approximate threefold difference for identical policies.

One need only look to the opinion of the Eighth Circuit Court of Appeals concerning the behavior of the workers' compensation insurance industry. In a case decided in February, 1989, a three judge panel stated:

> We find sufficient evidence... that would clearly justify a jury finding that during the relevant time period an illegal boycott agreement existed between the Workers' Compensation Insurers' Rating Association of Minnesota (WCIRAM) and its members in violation of the federal antitrust laws...
>
> Plaintiff's evidence supports a finding of private cooperative price fixing (admitted by defendants for purposes of summary judgment). Additionally, we find sufficient evidence that a jury could reasonably find that an express agreement existed to exclude insurers from WCIRAM membership if the prescribed rates were not utilized, as well as acts of intimidation and coercion to maintain uniform rates by all workers' compensation carriers. All carriers knew that expulsion from WCIRAM carried with it the threat, if not the express statutory requirement, that a carrier could no longer underwrite workers' compensation insurance in Minnesota.[30]

At least a portion of the workers' compensation controversy crisis relates to the fact that employers, employees and public policymakers have little belief in statements made by the insurance industry concerning the cost of the coverage. Rate regulation would at least make the figures used more credible in that they would be filed with a state agency which would be responsible for developing a rate reflective of actual data.

30/ Austin Products Co., et al v. The Workers' Compensation Insurer's Rating Association of Minnesota, et al, 867 F.2d 1552 (8th Cir. 1989).

WORKERS' COMPENSATION

PART II

Consumer and Agent Survey:
The Customer is Not Shopping Around
For a Competitive Rate

I. INTRODUCTION

In the workers' compensation insurance market, employers are the consumers, insurers are the suppliers, and the insurance policy is the product. Minnesota is an "open competition" state in which the discipline of the competitive market theoretically ensures that the product is efficiently priced. If a supplier prices the product too high, the consumer will switch suppliers. Similarly, if a supplier lowers its price, consumers will "shop around" and reward the supplier by buying its product. This theory is so prevalent in the insurance market that states such as Michigan have issued reports stating that, as long as several insurers are in the workers' compensation market, competition is presumed to exist and be an efficient regulator of rates.

An open competition system presumes that competition in the marketplace will make rates responsive. The assumption is that: (1) an insurance company that retains a profit will reduce its premiums in order to expand market share and thereby, while reducing its profit margin, increase its net profit, and (2) consumers will aggressively shop and compare insurance rates, thereby disciplining the inefficient and rewarding the efficient.

While such presumptions may work well in theory, in practice they are not prevalent in the insurance marketplace. In 1985, the Department interviewed executives of a Wisconsin insurance company which was one of the major workers' compensation carriers in Minnesota. At that time, the company had financial difficulties on a countrywide basis which were affecting its ability to continue to underwrite insurance. When asked what they would do to regain the company's financial stability, the executives responded that they had undertaken a "workout" operation whereby rates were substantially increased.

When Department personnel inquired whether an increase in rates would result in adverse selection (where higher risk policyholders would remain with the company while the lower risk policyholders would go elsewhere for a more favorable rate), the executives responded that, in practice, the opposite occurs. The company documented how it had dramatically increased its rates approximately five months before the meeting and thereafter, compared the total loss ratio of the clientele that had left the company with the total loss ratio of the clientele that had renewed business during that period of time. The documents confirmed that higher risk policyholders left the company while lower risk policyholders remained with the company, even though they could have obtained a more favorable rate elsewhere.

When the Department inquired as to the cause of this phenomenon, the executives responded that the better risk clientele are not insurance wise. In other words, rather than shop for the best price, they merely continue to pay the premium to the insurance agent with whom they have worked in the past. Ironically, the agent may place the coverage with an insurer which requires the agency to maintain a certain level of business in order to maintain its agency contract.

In contrast, the insurance executives noted that higher risk clientele are insurance smart. By virtue of having been involved in litigation, filing claims, and switching insurance carriers in the past, the high risk clientele are cognizant of any change in dividend schedules, scheduled credits, surcharges, safety plan discounts, etc. These clientele are very price-sensitive. When an insurer increases the premium, they are more likely to leave the company.

The agent-insurer relationship also may inhibit a competitive environment in the workplace. Agents are sometimes unable to select companies on the basis of the lowest rate. In many cases the agent is forced to place business with a certain "lead" insurer which requires that at least a minimum percentage of the agent's business be placed with it. Many agents can place workers' compensation with only two insurers. In other cases agents may place business with the company which pays the highest commission rather than that which charges the lowest rate. In either case, the agent-insurer relationship does not enhance the competitive process and can inhibit the employer's ability to obtain the lowest rate. The survey documented that employers were unaware of this incentive.

Another indication that competition is not disciplining inefficient pricing is found in the results of the Minnesota Automobile and Homeowners Insurance Surveys conducted by the Department in Spring 1989. When the surveys were publicly announced, the Department received thousands of telephone calls from consumers who were outraged that their company was not charging a low rate. One major auto insurer had approximately 10 percent of the automobile insurance business in Minnesota, yet its rates were considerably higher than the other top four insurers who had approximately 50 percent of the business in Minnesota. The Department received numerous calls from the carrier's agents, who are prohibited from selling policies of other companies, requesting that the Department regulate automobile insurance so that they could remain competitive. Several agents reported that the current system results in an inability to place insurance at the most attractive rate and, given the fact that they could only place insurance with one insurer, they would be financially penalized if they were to refer their clients elsewhere.

Accordingly, the Department conducted a survey to determine how consumers make their buying decisions in this area.

The Department conducted a two-step survey of Minnesota employers and their insurance agents. The purpose of the employers' survey was twofold: first, to determine whether employers consider the workers' compensation insurance market to be competitive and treat it as such; second, to poll their opinions on issues relating to workers' compensation regulation.

The employer survey identified the insurance agent used by each business. Thereafter, each agent was surveyed to determine how an agent places coverage in the workers' compensation market. The collective results of these two surveys provide a clear picture of the market, namely that on relatively few occasions is the product subjected to the discipline of competition.

II. EMPLOYER SURVEY PROCEDURE

A. SAMPLE

The Department surveyed 325 employers selected randomly from the telephone yellow pages of the following communities: Minneapolis and suburbs; St. Paul and suburbs; Rochester; Brainerd; Sauk Rapids; Ely; St. Cloud; Redwood Falls; St. Joseph; Austin; Albert Lea; Hibbing; Bemidji; Duluth; Grand Rapids; Mankato; Two Harbors; Virginia; Eveleth; and Alexandria.

The businesses included manufacturing, construction, sales and service companies.

B. EMPLOYER SURVEY FORM

The survey form used is found on pages 28 to 31 of this report. Following is a brief explanation of the basis for each survey question.

Questions one through four record basic identifying information regarding the employer being surveyed. The information included a brief description of the type of business, the size of the business, and the length of time in existence.

Questions five and six identify the employer's current insurance agent. These agents were surveyed as described on pages 35 to 41 of this report.

Questions seven and eight identify the employer's current insurer and how many years the employer has

NAME: ______________________
DATE: ______/________/______

Company Name: ______________________

Phone Number: ______________________

Person Contacted: ______________________

Hello, my name is ______________________ and I am calling from the Minnesota Department of Commerce. We are conducting a survey on workers' compensation issues among employers. Your company was selected at random. May I speak to the person at your company who handles insurance matters? I'd like to take a minute of your time and ask several questions on workers' compensation insurance.

1. What type of business are you in?

   ______________________ 1. ________

2. How many employees to you have? 2. ________

3. Approximately how much do you pay annually in workers' compensation premiums? (Skip if they don't know.) 3. ________

4. How long have you operated in this business? 4. ________

5. What is the name of the agent or agency from whom you purchased coverage?

   ____

   ____

6. Where is the agency located?

   ____

   ____

7. What is the name of insurer from whom you purchased coverage? 7. ________

   ____

   ____

8. To the best of your knowledge, how many years have you had coverage with this insurer? 8. ________

9. Have you ever switched agents in the purchase of workers' compensation coverage? 9. ___________

10. If so, approximately how many years ago? 10. ___________

11. When it is time to renew your workers' compensation coverage, how many agents do you generally contact for quotes? 11. ___________

12. Have you ever switched insurers for workers' compensation coverage? 12. ___________

13. If so, approximately how many years ago? 13. ___________

14. How many different insurers have you purchased workers' compensation from in the last five year? 14. ___________

15. I will read to you a list of statements and ask if you strongly agree, generally agree, have no opinion, generally disagree or strongly disagree:

    a) Workers' Compensation rates are subject to approval by state regulation.

    _____Strly. Agree
    _____Gen. Agree
    _____No Opinion
    _____Gen. Disagree
    _____Strly. Disagree

    b) Workers' compensation rates should be subject to approval by state regulation.

    _____Strly. Agree
    _____Gen. Agree
    _____No Opinion
    _____Gen. Disagree
    _____Strly. Disagree

    c) Workers' Compensation rates for an employer may vary depending upon the insurer.

    _____Strly. Agree
    _____Gen. Agree
    _____No Opinion
    _____Gen. Disagree
    _____Strly. Disagree

    d) Insurance agents have an obligation to purchase workers' compensation insurance from the insurer which offers the lowest rate.

    _____Strly. Agree
    _____Gen. Agree
    _____No Opinion
    _____Gen. Disagree
    _____Strly. Disagree

e) Insurance agents can calculate the workers' compensation rate for most businesses by referring to information available in the agent's own office.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

f) Insurance agents must obtain the workers' compensation rate for most businesses by contacting the insurer and having the company quote a rate.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

g) Insurance companies will negotiate with an insurance agent over the workers' compensation rate to be established for an employer.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

h) I don't know if benefits are too high or too low, but I believe that workers' compensation premiums are too high in relation to other states.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

i) I don't know if premiums are too high or too low, but benefits ought to be changed.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

j) Companies move to or from Minnesota based upon workers' compensation rates.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

k) An agent may obtain two different quotations from two different insurers for the same employer.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

l) An agent may not have access to the insurer with the lowest rate for some employers.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

m) It is important to shop around and make competition work to produce the most efficient rate in workers' compensation insurance.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

16. Please rank on a 1 to 5 scale the importance of the following factors affecting the cost of workers' compensation insurance with 5 being the most important and one being the least important.

A. Excessive claims by workers. 1 2 3 4 5

B. Claims are appropriate, but excessive benefits are paid. 1 2 3 4 5

C. Insurance carriers take too much profit and are inefficient. 1 2 3 4 5

D. Other states have smaller premiums due to lower benefit levels. 1 2 3 4 5

E. Insurers are inefficient in their administration of claims. 1 2 3 4 5

F. The state is inefficient in its administration of claims. 1 2 3 4 5

G. Medical providers charge too much. 1 2 3 4 5

purchased coverage from the insurer. The purpose of this question was to determine whether employers tend to stay with the same insurer from year to year.

Questions nine and ten were included to determine whether employers tend to shop around for agents, an indication of whether agents are actually forced to compete with each other for workers' compensation business. Similarly, question 11 inquires as to whether employers, by contacting a number of agents, in effect make the system competitive.

Questions 12-14 address the issue of whether competition actually takes place at the insurer level. Conceivably, even if an employer goes back to the same agent year after year, they may still switch insurers, although they would be limited to the companies with whom their agent has contracts.

Questions 15 (a-m) are opinion questions. They are designed to determine what employers think about the system overall in terms of its strengths and weaknesses, and to determine whether employers' opinions have been accurately characterized during past legislative debates on this issue.

The first two statements in the section (15a and 15b) deal directly with the issue of rate regulation: do employers believe rates are currently regulated by the state and do they feel they should be regulated?

Statements 15c-g again relate to the issue of competition. The questions are designed to determine employers' perceptions of how the system works.

Question 15c was included to identify how many employers realize that workers' compensation rates are not standardized, but rather vary from one insurer to another.

Question 15d measures employers' understanding of the market incentives which may cause an agent to quote one company's rate over another's, even though it is more expensive.

Questions 15e, f and g test an employer's awareness of the quotation process. Do employers know that companies may and do deviate considerably from their filed rates when quoting a particular employer? In some cases, these deviations may be negotiated with the agent, particularly if the agent places enough business with the insurer.

Questions 15h and 15i were included to measure whether employers feel that benefits are out of line or whether their focus is simply that premiums are out of line in relation to other states, regardless of the cause.

Question 15j asks whether employers agree or disagree with the commonly heard argument that businesses actually make decisions to move to or from Minnesota based on workers' compensation rates.

Questions 15k and l return to the issue of the employers' knowledge of competition among agents. Do employers realize that different agents have access to different insurance companies who charge varying rates? Without that knowledge employers are unlikely to "shop around." Question 15m asks employers whether they believe that their actions affect the competitiveness of the system.

Question 16 asks employers to rank the importance of a series of factors in terms of the effect each has on the cost of workers' compensation insurance.

III. EMPLOYER SURVEY FINDINGS

FINDING 1: Most employers do not shop around for the best rate when purchasing workers' compensation insurance.

Fifty-three percent of survey respondents indicated they have never switched agents in the purchase of workers' compensation coverage. Further, 44 percent of the respondents indicated they contact only one agent when it is time to renew their workers' compensation coverage and 70 percent indicated they contact two or fewer agents at renewal time. If the discipline of a competitive market is the loss of a customer when a product is inefficiently priced, the insurer/supplier's pricing of its product is subject to the free market discipline. In a majority of workers' compensation insurance transactions, however, the insurance pricing mechanism is immune to free market discipline because little comparison shopping takes place. As discussed in Part I, insurers are aware of this inelasticity in the demand.

Further, one-half of the remaining customers only contact two agents. Since most agents are representing only one workers' compensation insurer, insurers are fully aware that little discipline will take place if their product is not efficiently priced.

FINDING 2: Employers believe that workers' compensation rates are regulated.

It is clear that most employers believe that the state currently regulates workers' compensation rates. Sixty-two percent of the respondents agreed with the statement "Workers' compensation rates are subject to approval by state regulation." This perception that rates are currently regulated explains in part the fact that many employers are not aware that rates may vary considerably from one insurer to another. This misperception, combined with the contact of a single agent, explains why insurance prices are not competitively priced. Again, unless the price of a product is subject to free market discipline where the consumer will purchase from a more efficiently priced supplier, competition will not work to produce an efficient rate.

FINDING 3: Employers favor state regulation of workers' compensation rates by a margin of 3 to 1.

While most employers believe that the state currently regulates workers' compensation rates, it is clear that a substantial majority of employers want such regulation to occur. Sixty-five percent of employers surveyed agreed with the statement "Workers' compensation rates should be subject to approval by state regulation." Only 22 percent disagreed; 13 percent had no opinion.

FINDING 4: Employers' misconception of the insurance market effectively limits actual competitiveness within the system.

The survey results also indicate that most employers (58%) believe an agent has an obligation to purchase coverage from the insurer which offers the lowest rate. Employers are unaware that there are often other factors which influence an agent's decision to place an account with a certain insurer. For example, at least 50 percent of the workers' compensation insurance market is divided among insurance companies which require that the agent only sell insurance for that particular company. Accordingly, in at least 50 percent of the insurance transactions, the consumer will only obtain a quote from one company.

Even agents who are "multiple carrier" agents may be required to meet a certain premium threshold in order to maintain a contract with the insurer or to qualify for an agent sales bonus. Also, if an agent is aware that a client is not likely to shop around, there is a disincentive for the agent to look for the least expensive coverage and an incentive to place greater weight on other factors such as size of commission, percentage of business

written with the insurer, personal relationships with the insurer's executives, etc.

FINDING 5: A surprising number of employers are unaware that workers' compensation rates vary from one insurer to another.

A significant number (34%) of the survey respondents were unaware that workers' compensation rates for a given employer vary depending upon the insurer.

FINDING 6: Nearly half of the employers surveyed have not changed insurers in the last five years.

The survey results indicated that 45 percent of the respondents have purchased workers' compensation coverage from the same insurer for more than five years. In addition, 43 percent of the employers switched workers' compensation insurers only once in the last five years. This lack of turnover is another indication that the system is not competitive.

FINDING 7: Although employers feel strongly that workers' compensation premiums are too high, they do not believe that excessive benefits are to blame.

Eighty-five percent of those surveyed agreed that premiums are too high regardless of their opinion on whether benefit levels are appropriate. A comparatively low 40 percent agreed that benefits should be changed. This finding was also confirmed when employers ranked various factors in terms of their importance to the cost of insurance. When asked how important excessive benefits were, the average response was a ranking of three on a scale of one to five, with five being the most important.

IV. AGENT SURVEY PROCEDURE

A. SAMPLE

The Department then surveyed the 137 agents identified as sellers of workers' compensation insurance in the employers' survey. A total of 18,209 workers' compensation policies are issued annually by the agencies surveyed.

B. AGENT SURVEY FORMAT

The survey form used is found on pages 36 to 39 of this report. The following is a brief explanation of the basis for each survey question.

Name: ______________________________
Date: ________/________/________

Agency Name: ______________________________

Phone Number: ______________________________

Agent Contacted: ______________________________

May I speak to an agent who handles workers' compensation accounts?

Hello, my name is ________________________. I am calling from the Minnesota Department of Commerce. We are conducting a survey on workers' compensation issues among insurance agents. I'd like to take a minute of your time and ask several questions on workers' compensation insurance.

1. How many licensed agents in your agency? 1. ____________

2. Approximately how many workers' compensation policies does your agency sell annually? 2. ____________

3. To which insurance companies is your agency appointed to sell workers' compensation insurance?

   ____

   ____

4. Approximately what percentage of your workers' compensation business is placed for each of the insurers you mentioned?

   Company ______________________________ 4. ____________%

   ______________________________ ____________%

   ______________________________ ____________%

   ______________________________ ____________%

5. In calculating a workers' compensation rate, does your agency calculate it itself or does the insurer make the calculation? 5. ____________

6. How many insurers do you normally contact to obtain a quote on a workers' compensation policy? 6. ____________

7. I will read you a list of statements and ask if you strongly agree, generally agree, have no opinion, generally disagree or strongly agree:

a. Workers' compensation rates are subject to approval by state regulation.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

b. Workers' compensation rates should be subject to approval by state regulation.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

c. Workers' compensation rates for an employer may vary depending upon the insurer.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

d. Insurance agents have an obligation to purchase insurance from the insurer which offers the lowest rate.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

e. Insurance agents can calculate the workers' compensation rate for most businesses by referring to information available in the agents' own office.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

f. Insurance agents must obtain the workers' compensation rate for most businesses by contacting the insurer and having the company quote a rate.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

g. Insurance companies will negotiate with an insurance agent over the workers' compensation rate to be established for an employer.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

h. I don't know if benefits are too high or too low, but I believe that workers' compensation premiums are too high in relation to other states.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

i. I don't know if premiums are too high or too low, but benefits ought to be changed.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

j. Companies move to or from Minnesota based upon workers' compensation rates.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

k. It is important to shop around and make competition work to produce the most efficient rate in workers' compensation insurance.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

7. The workers' compensation market tends to follow the same pricing cycle as the rest of the property/casualty market.

_____Strly. Agree
_____Gen. Agree
_____No Opinion
_____Gen. Disagree
_____Strly. Disagree

8. Please rank on a 1 to 5 scale the importance of the following factors affecting the cost of workers' compensation insurance with 5 being the most important and one being the least important.

A. Excessive claims by workers. 1 2 3 4 5

B. Claims are appropriate, but excessive benefits are paid. 1 2 3 4 5

C. Insurance carriers take too much profit and are inefficient. 1 2 3 4 5

D. Other states have smaller premiums due to lower benefit levels. 1 2 3 4 5

E. Insurers are inefficient in their administration of claims. 1 2 3 4 5

F. The state is inefficient in its administration of claims. 1 2 3 4 5

G. Medical providers charge too much. 1 2 3 4 5

Questions one and two are to determine the size of the agency being surveyed. Questions three and four are included to determine the size of the market to which any one agent has access.

Question five addresses the issue of flexibility in rates, specifically whether workers' compensation premiums are calculated by a fixed formula which the agent could apply or whether the risk must be submitted to the carrier for review and calculation of the rate. Presumably, if an agent has the authority to quote directly, the insurer is more likely to use a fixed rate schedule.

Question six is to determine how many insurance agents seek competitive quotes for a client. This question, in conjunction with questions three and four, is a determining factor in the competitiveness of the market.

Question seven is an opinion section. It contains 12 statements regarding the workers' compensation system in Minnesota and asks whether the respondent agrees, disagrees or has no opinion. The statements are identical in large part to those used in question 15 of the employer survey, as described on pages 28 to 35 of this report. In addition, the agent survey contained a statement (1) regarding the pricing cycle in the workers' compensation market, as compared to the property/casualty market in general.

Question eight asks agents to rank the importance of a series of factors in terms of the effect each has on the cost of workers' compensation insurance. These statements are identical to those used in the employer survey and each summarizes one of the various criticisms of the workers' compensation system.

V. AGENT SURVEY FINDINGS

FINDING 1: Most agents have access to two or fewer workers' compensation insurance carriers.

Indeed, over 40 percent of the workers' compensation market involves insurance agents who can sell only for one insurance company.

Over one-half (51%) of the agents surveyed have contracts with two or fewer insurers who write workers' compensation coverage. Seven percent of the respondents write only through the Minnesota assigned risk plan.

FINDING 2: Many agents do not aggressively shop for the best quote.

Over 50 percent of the agent respondents contact only one insurer for a quote when placing a workers' compensation policy. Twenty-one percent of the respondents contacted two insurers for a quote and 19 percent contacted three. Only 10 percent of the agents contacted more than three insurers for quotes.

FINDING 3: Half of the agents do not realize that aggressive shopping for a rate involves negotiation with the insurer.

Fifty-seven percent of the agents who sold insurance coverage to employers in this survey disagree with the statement that insurers will negotiate with an agent over the rate. In contrast, 38% of the agents agree that insurers will negotiate with the agent.

Agents gave both of these factors an average rating of 3.9 on the scale of 1 to 5, with five being the most important. Agents ranked the costs charged by medical providers as the third most important factor with an average rating of 3.6. Insurance company inefficiency was believed to be of least importance with a ranking of 2.0.

FINDING 4: Over one-half of the insurance agents surveyed believe that workers' compensation rates should be subject to approval by state regulation.

Fifty-three percent of the survey respondents agreed that rates should be regulated, 11 percent had no opinion, and 36 percent disagreed. Clearly many agents are not aware of the current law, as evidenced by the fact that 77 percent believe rates are already subject to state approval.

FINDING 5: Agents are sharply divided over the issue of whether they have an obligation to purchase insurance from the insurer with the lowest rate.

Fifty-one percent of the respondents agreed that they have such an obligation while 49 percent disagreed or had no opinion. If the agent believes he or she can purchase a higher priced policy, no market discipline will result from the insurer having an inefficiently priced policy.

VI. CONCLUSION

The Legislative Auditor's Report in 1988 concluded that, as long as there were several insurers in the marketplace, competition was presumed to exist within the workers' compensation field. As can be seen by this survey, deregulation does not always lead to competitive pricing among competitors. This is particularly the case where, through restrictions in distribution by suppliers, a situation results where consumers obtain their information from one agent who often represents only one insurance company.

As noted earlier, at least one major insurer of workers' compensation noted the phenonemon of adverse selection where the insurer who charges the higher rate actually results in a book of business that has a lower loss ratio. The insurer advised that those employers who would "shop around" as the insurer increased its rates were also the employers with high claims ratios. Since the insurer desired to rid itself of such adverse claims experience, it was actually rewarded for having a less efficient premium. Such a phenomenon runs counter to the free market theory that consumers will shop and find a lower price if an insurer becomes noncompetitive.

WORKERS' COMPENSATION

PART III

Minnesota and Wisconsin: A Comparative Study

I. INTRODUCTION

The survey discussed in Part II found that the overwhelming issue in the Minnesota workers' compensation system is whether the system is too expensive in relation to the expenses incurred by similar employers in other states.

As noted on page 19, the cost of workers' compensation coverage, if one divides total payroll by the total reported premium, is $1.87 per $100 of payroll in Minnesota. This compares to an average reported cost in Wisconsin of $1.77 per $100 of payroll. Assuming that payroll composes one-third of the cost of a product or service, the cost per $100 of product is less than .6 percent. In some product lines, however, the cost is substantial and can place Minnesota employers at a competitive disadvantage with other states. Trucking companies are the most widely discussed example, where the premium per $100 of payroll is $19.98 in Minnesota and $11.26 in Wisconsin.

It should be noted that the above differential between Minnesota and Wisconsin is significantly smaller than the differential found between the two states when actual premium quotes were obtained. As shown on page two, the rates averaged approximately 36 percent less in Wisconsin.

The survey in Part II indicates that 85 percent of employers are primarily concerned about the amount of premium while the amount of benefits were a primary concern for fewer than 58 percent of employers.

II. THE 1983 MODIFICATIONS TO THE WORKERS' COMPENSATION LAW

As a result of such concerns, in 1983 the Minnesota Legislature made dramatic changes in the workers' compensation law, which affected benefits in many different ways.

First, the 1983 Act limited temporary total disability. Temporary total disability, adopted in all states, is a weekly payment, not to exceed the average wage in the state, to a worker when he or she has a work-related disability. The purpose of temporary total disability is to give the worker income while disabled. Prior to 1984, temporary total disability was payable during the period of time for which an injured employee was disabled from working and was diligently looking for work. The payment continued if the worker had reached maximum recovery from the injury but could not find employment. The 1983 Act terminates the payment when the employee reaches maximum medical improvement (MMI). This means that the employee's

temporary total disability could be ended earlier regardless of whether the worker is actually working or able to find a job.

Second, the 1983 Act dramatically changed the methods by which permanent partial disability is determined. Permanent partial disability determinations, adopted in all states, will result in a compensatory payment being made for the damage to the worker's body. Prior to 1984, permanent partial disability was paid for loss of function and use based upon a rating by a physician, who would use his or her expertise to estimate the extent of permanent damage on a percentage basis.

The 1983 law essentially abolished the existing permanent partial system and in its place, the legislature directed the Commissioner of Labor and Industry to adopt a schedule to pay out permanent partial disability in two levels: "Impairment Compensation (IC)" and "Economic Recovery Compensation" (ERC).

Impairment compensation is to be paid if an employee has returned to work. The ERC is paid if an employee did not return to work. The ERC was designed to be a higher payment than the IC as an incentive to employers to offer an employee a job and, therefore, pay the lower amount.

One of the notable oddities of the 1983 Act is the presumption that all human injuries can be fit into a "schedule" set by the commissioner. There are many cases where certain disabilities are not compensated because they are not listed on the schedule. In addition, the schedule all but eliminated the physician's ability to take into consideration factors affecting the individual's specific injury, background and occupation.

Third, the 1983 law significantly reduced temporary partial disability benefits. Temporary partial disability is payment of wage loss when, in a disabled condition, the worker cannot make the same wage that he or she did on the date of injury. Temporary partial benefits replace two-thirds of the difference between a workers' pre-injury wage and his or her current wage.

Prior to 1984, temporary partial benefits were paid even if the injured employee had not returned to work, but was diligently looking for work. In Parsons, the court ruled that temporary partial benefits could not be paid unless the disabled person was employed. Accordingly, since temporary total disability benefits terminate once the worker has reached maximum medical improvement (MMI), and since temporary partial disability are only paid if the worker is employed, the 1983 Act

effectively terminated all benefits for workers who have reached MMI but who are not employed.

Fourth, the 1983 Act postponed the time when supplementary benefits are paid for long term disability. The supplementary benefit program, first enacted in 1971, provided a basic benefit level to workers who are still totally disabled after two years and who receive less than 65 percent of the statewide average weekly wage (SAWW). Under current law the SAWW is approximately $391 per week, or just over $20,000 per year. The supplementary benefit raised such a workers' compensation benefit to the 65 percent level, or approximately $13,552 per year.

In 1983, the legislature postponed the eligibility period for such a supplementary benefit from two to four years.

When the 1983 legislative proposals were debated both the Department actuary and the NCCI agreed that such changes should stabilize the workers' compensation rates in Minnesota. Yet, in spite of these benefit cuts, the rates doubled over the next five years. As noted in Part I, the rate skyrocketed in large part due to other factors, such as rate deregulation and the cyclical nature of the property and casualty industry. Questions arise as to whether the benefit changes were taken into account by the insurance industry in calculating the premiums.

III. WORKERS' COMPENSATION LAWS FROM A NATIONAL PERSPECTIVE

The National Council of Compensation Insurance (NCCI) is the primary statistical gathering source for the insurance industry in the area of workers' compensation. Its statistics and recommendations are given strong weight by an insurer or regulator in setting a workers' compensation premium.

Thus, no matter what changes are made by a legislature, the administrative agency, or the courts, insurers will not adjust rates unless the NCCI, and other insurers who have a major market share of the business, are willing to do so.

In 1985 various personnel of the NCCI in New York were interviewed concerning the Minnesota workers' compensation climate. The personnel noted that Minnesota joined approximately 15 states as being a "problem area in workers' compensation." The personnel interviewed uniformly agreed that they give little weight to amendments that are enacted to laws in those "problem states" primarily because the effect of such amendments are not fully known until the judicial system interprets them and they have

a chance to observe "loss trends." As noted earlier, the loss trends for workers' compensation take many years to develop.

The NCCI personnel further noted that this "Show Me" attitude was particularly applicable to situations where state legislatures repeatedly enacted legislation and regulation, the cumulative effect of which was to destablize the whole system.

The beauty of the federal system is that the 50 states serve as separate incubators in which differing systems of social policy are administered and tested. Some systems work better than others. The Minnesota workers' compensation system is not the only such system under attack.

For instance, in Texas the legislature is currently in special session, where accusations of corruption are being made by various legislators.

In Oregon, the governor is contemplating a call of a special session on workers' compensation, where rates have rocketed since deregulation was implemented, at a time when the benefit level in Oregon is relatively minimal.

In Maine, almost 75 percent of the employers are purchasing insurance from the state assigned risk pool.

States such as Florida, Louisiana and Oklahoma have seen a 50 percent increase over the past two years.

Nevertheless, a few states do seem to get better reviews from insurers, business leaders and labor.

The Occupational Safety and Hazard Act (OSHA) of 1970 raised serious questions concerning the fairness and adequacy of workers' compensation laws. It noted that the growth of the economy, the changing nature of the work force, increases in medical knowledge, changes in hazards associated with various types of employment, new technology which creates new risks to health and safety, and a general increase in the level of wages and cost of living all combine to create substantial changes in the effect of a workers' compensation law. Accordingly, the OSHA Act established a National Commission on State Workers' Compensation Laws to evaluate the adequacy of state laws.

In July of 1972, the Commission issued its first report and found the following five major objectives to any workers' compensation program:

1. It should supply broad coverage to employees and to work-related injuries and diseases.

2. It should provide substantial protection against interruption of income.

3. It should provide for sufficient medical care and rehabilitation services.

4. It should encourage safety.

5. It should provide an effective system for delivery of the above benefits and services.

The Commission found a wide variance in the laws of the many states. Some states did not cover employees such as farm hands, domestic help, etc., while other states exempted employees based on the size of the employer. Some states required an "accident" to be the triggering event, while others also covered repeated stress or disease. Many states differed on the amount of maximum weekly benefits, the duration of permanent or temporary benefits, etc.

While the report recommended more uniformity in state laws, it is apparent in updated reports that such uniformity has not been achieved.

If one accepts the theory that competition between the states is a valid consideration in the debate of workers' compensation, then the system which should receive the most discussion in Minnesota is the system of its neighboring state, Wisconsin. Being a border state, its premium structure is most often used as a standard of comparison by Minnesotans. Both states have a similar mix of rural and metropolitan population, of manufacturing, agriculture and service industries and, of social and cultural mores. The Wisconsin system is consistently referred to as a preferable system by Minnesota employers. Further, the Wisconsin system has received national recognition for its efficiency and cost.

Accordingly, the Department compared the benefit structure of the two states and, where different, analyzed the claims payment history of the two states to estimate the difference in the cost of certain benefits between them.

The chart below briefly describes the differences between the two states:

TABLE III-A

SAWW=State's Average Weekly Wage

ISSUE	MINNESOTA	STATE MOST COSTLY	WISCONSIN
Maximum temporary total payment per week	Two-thirds of of gross wage up to 100% SAWW ($391 in 1989)	⟷	Two-thirds of gross wage up to 100% of SAWW ($363 in 1989)
Minimum temporary total payment per week	Below 50% of SAWW, employee receives actual wage but not less than 20% of SAWW ($78.20)	⟵	$20
Maximum permanent partial disability benefits	Dependent upon schedule (*)	⟷	$125.00/week for 1,000 week period maximum
Temporary partial disability	Paid while working at wage loss	⟵	Ends after healing period
Waiting period	3 days, compensation retroactive if disability continues after 10 days	⟶	3 days, retroactive if disability continues after seven days
Cost of living adjustments	Annually	⟵	None
Dependency benefits (death cases)	10 years maximum for spouse after no more dependent children	⟵	6 years maximum
Rehabilitation	Mandatory after 30 days for back injury, 60 days other injuries	⟵	Not mandatory
Supplemental benefits	Employee receives 65% of SAWW after 4 years of total disability	⟵	No supplemental benefits
Uninsured employers	Benefits provided		No benefits

(*) See Appendix A

IV. FIELD SURVEY

Department examiners reviewed 5,982 Minnesota workers' compensation files at Wausau Insurance Company's regional office in Edina, Minnesota. Wausau is the fourth largest workers' compensation insurer in Minnesota, having an approximate six percent marketshare. Wausau has a 14 percent marketshare in Wisconsin. In calendar year 1988, Wausau had earned workers' compensation premiums totalling $24,012,433 in Minnesota and $87,907,820 in Wisconsin. Appendix B contains a complete summary of Wausau's premium volume in the two states over the last nine years. The files reviewed included all open indemnity claims (claims where wage loss benefits were paid) for calendar years 1982-1986 and all closed indemnity claims for calendar years 1982-1987. Eighty-eight percent (5,258) of the Minnesota files were closed and 12 percent (706) were open. Although Wausau is an administrator of the Minnesota workers' compensation pool, the review did not include the assigned risk plan files.

The same examiners also reviewed 2,221 files at Wausau's regional claim center in Wausau, Wisconsin. The Wausau office is one of two regional centers that service Wisconsin claims. Examiners reviewed all closed and open indemnity claims for calendar years 1984-1987. Eighty-four percent (1,855) of the Wisconsin claims were closed and the remaining 16 percent (366) were open.

TABLE III-B: Claim Summary

	WISCONSIN				MINNESOTA			
LOSS YEAR	OPEN CLAIMS	PERCENT OPEN	CLOSED CLAIMS	PERCENT CLOSED	OPEN CLAIMS	PERCENT OPEN	CLOSED CLAIMS	PERCENT CLOSED
1982	---	--	---	--	74	8%	832	92%
1983	---	--	---	--	115	11	949	89
1984	69	11%	582	89%	168	13	1170	87
1985	110	17	522	83	177	16	907	94
1986	147	22	426	78	180	21	684	79
1987	40	11	325	89	---	--	726	100
TOTAL	366	16%	1855	84%	714	12%	5268	88%

For each file reviewed in both states, examiners completed a five-page survey form which is found on pages 50 to 54 of this report. Questions one and two record basic identifying information for each file. Item three records the date of injury which determines the policy year to which the loss is attributed. Questions four through six identify the employee in terms of job type, age and sex. Item seven is a total of the <u>assessable</u> workers' compensation benefits paid, which includes idemnity

MINNESOTA WORKERS' COMPENSATION CLAIM STUDY

INITIAL WHEN COMPLETED ____________
DATE COMPLETED _____/_____/_____
RECORD NO. ______________

1. Policy/Contract Number 1__________________

2. File/Claim Number 2__________________

3. Date of Loss/Injury Date 3__________________

4. Injured Employee's Payroll Classification 4__________________

5. Sex of injured worker: 5__________________
1) MALE 2) FEMALE

6. Age of accident date: 6__________________
1) under 18 4) 36 to 50
2) 18 to 25 5) 51 to 65
3) 25 to 35 6) Over 65

7. Total assessable workers' compensation benefits paid to date 7__________________

8. Reserve changes:

	Indemnity	Medical	Date Effective
Reserve 1	________	________	____/____/____
Reserve 2	________	________	____/____/____
Reserve 3	________	________	____/____/____
Reserve 4	________	________	____/____/____
Reserve 5	________	________	____/____/____

9. Was worker compensated for 3-day waiting period? 1) YES 2) NO 9__________________

10. How many weeks were compensated by insurer? 10__________________

11. Date notice received by insurer/ administrator 11__________________

12. First date of lost time 12__________________

13. Marital status 13__________________
1) MARRIED 2) SINGLE

14. Date of MMI 14_____/_____/_____

15. Describe personal injury involved in this claim:

____
____
____

16. Was employee: — 16__________________
1) FULL TIME 3) PART TIME
2) TEMPORARY 4) SEASONAL

17. Describe principal work or business of employer:

____
____
____

18. Date of first payment of lost time benefits — 18__________________

19. Actual gross weekly wage on accident date — 19__________________

20. Initial statutory workers' compensation rate — 20__________________

21. W.C. rate escalated? — 21__________________
1) YES 2) NO

22. If "yes", show dates and amounts of increase(s):

____
____
____

23. Date employee qualified for - or will qualify for - supplemental benefits if disability continues — 23__________________

24. Is/was employee receiving social security benefits as a result of disability related to the workers' compenation injury alleged? — 24__________________
1) YES 2) NO

25. If "yes", give current monthly S.S. rate — 25__________________

26. Are S.S. benefits offsetting or reducing statutory workers' compensation benefits?
1) YES 2) NO

26________________

27. Are supplemental benefits replacing any portion of offset statutory workers' compensation benefits?
1) YES 2) NO

27________________

28. Was claim reported to WCRA?
1) YES 2) NO

28________________

29. If "yes", retention level applicable

29________________

30. Status of claim:
1) OPEN 2) CLOSED

30________________

31. Method of disposition:
1) SETTLED 3) VOLUNTARY
2) TRIED 4) OTHER

31________________

32. If settled or tried, indicate total loss payments prior to settlement/ trial.

32________________

33. If settled or tried, indicate amount of settlement or award by line item below:

33________________

A. Medical Costs — 33A________________
B. Temporary Total Disability — 33B________/wks______
C. Temporary Partial Disability — 33C________/wks______
D. Permanent partial Disability (IC or ERC) — 33D________/wks______
E. Rehabilitation Costs — 33E________________
1) QRC ________________
2) Job Placement ________________
3) Other ________________
F. Permanent Total Disability — 33F________/wks______
G. Dependency Benefits — 33G________________
H. Supplemental Benefits — 33H________________
I. Award — 33I________________
J. Attorney Fees — 33J________________
K. Other — 33K________________
L. TOTAL of A through J — 33L________________

34. If tried, what was the issue(s) determined at the trial?

____
____
____

35. Indicate amounts in #31 paid by:

A. This Insurer — 35A ________
B. Other Insurer(s) — 35B ________
C. Any Other Party — 35C ________

36. Breakdown of allocated loss adjustment expense:

A. Claim investigation — 36A ________
B. House counsel — 36B ________
C. Outside counsel — 36C ________
D. Misc. Defense Costs — 36D ________
E. Other — 36E ________
F. TOTAL EXPENSES — 36F ________

37. Reserves (open Claims only):

A. Beginning loss reserve — 37A ________
B. Present Loss Reserve (including payments) — 37B ________
C. Present LAE reserve — 37C ________
D. Present Settlement Demand if any — 37D ________

38. Current issues - indicate all that are involved (open claims only) — 38 ________

1) Primary Liability
2) Compensation Rate
3) Medical Benefits
4) Temporary Total Disability
5) Temporary Partial Disability
6) Permanent Total
7) Dependency
8) Supplemental Benefits
9) Other

39(A) Based on the information in the file, did the use of a QRC have a positive impact on the outcome?

____
____
____

39(B) Comments on QRC:

____
____
____
____
____
____

40. Additional comments and/or observations:

____

____

____

____

____

benefits, but excludes medical benefits. The Special Compensation Fund assessment is based on this amount.

Question eight tracks the accuracy of the reserving practices of the insurer for both the indemnity position of the claim and the medical expense portion. Question nine identifies whether the employee was compensated for the waiting period. This question allows a cost comparision between Minnesota (where the waiting period is compensated after ten days) and Wisconsin (where it is compensated after seven days.)

Question ten gives the total number of weeks of lost time compensated by the insurer, including temporary total, temporary partial, permanent partial (economic recovery compensation (ERC) benefits), and permanent total benefits.

Questions 11 and 12 compare the first date of lost time and the date notice of the claim was received by the insurer to determine the average time lag for reporting claims.

Question 13 identifies the marital status of the injured worker to help establish, in conjunction with questions relating to age and sex, whether the person is a head of household.

Number 14 records the date when maximum medical improvement (MMI) was reached. This data is significant because it triggers the termination of some types of benefits.

Question 15 of the survey gives a short description of the type of injury. Question 16 identifies the status of the injured employee as full-time or part-time and also whether the employer is either temporary or seasonal. Question seventeen describes the type of business the employer was engaged in generally as well the specific job of the injured employee.

Question 18 gives the first date lost wage benefits were paid. Question 19 records the injured employee's actual gross weekly wage at the time of the injury which in turn determines the employee's weekly benefit rate in question 20. The fact that some injured employees in Minnesota receive non-taxable workers' compensation benefits equal to their gross wage is a particularly controversial aspect of the system.

Minnesota has an automatic cost of living adjustment (escalator) on the anniversary of the employee's injury for as long as benefits are paid. Question 21 establishes whether the compensation rate has been escalated and, question 22 records the time and amount of each increase.

Question 23 identifies those Minnesota files where the injured employee has qualified or may in the future qualify for supplementary benefits. Question 24-26 relate to the social security benefit offset which exists in both Minnesota and Wisconsin and has the effect of reducing the cost to the insurer. Question 27 refers to Minnestoa files only where injured workers, whose workers' compensation benefits are offset by social security benefits, may have the offset amount replaced by supplemental benefits.

In Minnesota, all workers' compensation reinsurance is written through the Workers' Compensation Reinsurance Association (WCRA). Insurer's select either a higher or lower retention limit which applies to individual claims. Generally, when a claim approaches the amount of the retention limit or if it is believed to have the potential to reach the retention limit, it will be reported to the WCRA by the insurer. Question 28 identifies whether the claim has been reported to the WCRA. Question 29 states the applicable retention limit of the insurer.

Question 30 simply identifies whether the claim is open or closed and the following question establishes the method of disposition in order to compare the cost of a settled as opposed to a tried claim.

Question 33 itemizes the various categories of benefits and expenses. Examiners recorded the dollar amount spent in each category, as well as the number of weeks the benefit was paid where applicable.

Question 34 applies to tried claims only and specifies which issue(s) were considered at the trial. Question 35 separates any part of the claim which may have been subrogated and question 36 lists the loss adjustment expenses, that is, those expenses associated with investigating and settling/trying a claim.

The next two questions apply to open claims only. Question thirty-seven records current loss and loss expense reserve information. Question 38 identifies unresolved issues on open claims.

Question 39 addresses, in a subjective question, the issue of mandatory rehabilitation. Rehabilitation became mandatory with the 1983 Act in Minnesota. It is not mandatory in Wisconsin. This question gives the examiner's evaluation of the effect of the qualified rehabilitation consultant (QRC) on the case. Examiners referred to correspondence in the file regarding the QRC from the insurer as well as the injured workers progress reports filed by the QRC with the insurer, internal memos, notes from telephone conversations, etc.

Finally, question 40 leaves space for any additional comments the examiner may have on the claim in general.

V. MINNESOTA VERSUS WISCONSIN: A Comparative Study

A. MINIMUM AND MAXIMUM COMPENSATION RATES

Wage loss benefits are subject to the same maximum in Minnesota and Wisconsin, that is, two-thirds of the injured worker's gross weekly wage up to 100 percent of the state average weekly wage (SAWW). Minnesota does, however, have a higher minimum than Wisconsin. Wisconsin has a "flat" minimum benefit level of $20 per week. In Minnesota, if you earn between 20 percent and 50 percent of the SAWW, you receive 100 percent of your gross wage. If you earn between 50 percent and 75 percent of the SAWW, you receive 50 percent of the SAWW. No one is compensated less than 20 percent of the SAWW.

The average weekly compensation rate for all surveyed claims (open and closed) was $242 in Minnesota and $227 in Wisconsin, a difference of $15 or 6.6 percent. However, the difference in average compensation rate is, in fact, explained by the difference in the SAWW between the two states. Minnesota has a higher standard of living which reflects in an average wage that, for the period of the study, is seven percent to eight percent higher than Wisconsin. For instance, in 1989, the average wage in Minnesota was $391 per week and, in Wisconsin it was $363 per week.

The Minnesota minimum benefit structure has frequently been criticized for encouraging disabled workers to remain at home. The argument is that low income workers, who receive up to 100 percent of gross pay, receive a higher income being disabled than they do working or being employed. Thus, there is no incentive to return to work. The data, however, does not appear to support this argument. Those individuals whose gross wage was equal to or less than their workers' compensation rate returned to work 3.8 weeks sooner on average than employees who received only two-thirds of their gross wage in benefits.

Further, few Minnesota claimants are affected by the minimum benefit rate. Only two percent of Minnesota claimants (123) had a gross weekly wage less than 20 percent of the SAWW, while only four percent of all Minnesota claimants fell in the wage category between 20 and 50 percent of the SAWW, where they receive 100 percent of their gross wage.

The data does note a differing composition with regard to the age and sex of claimants who earn less than 50 percent of the SAWW. As illustrated in Tables III-C and III-D, young people and females comprise a greater portion of those claimants who are affected by the minimum benefits in Minnesota.

TABLE III-C

AGE OF CLAIMANTS WHO RECEIVE MINIMUM BENEFIT LEVELS

	Under 18	18-25	26-35	36-50	51-65	Over 65
Claimant whose gross wage is less than or equal to compensation rate	12%	47%	16%	16%	7%	2%
Claimants whose gross wage is greater than compensation rate	.4%	22%	36%	27%	14%	.2%

TABLE III-D

SEX OF CLAIMANTS WHO RECEIVE MINIMUM BENEFITS LEVELS

	MALE	FEMALE
Claimants whose gross wage is less than or equal to compensation rate	50%	50%
Claimants whose gross wage is greater than compensation rate	77%	23%

While the minimum benefit structure in Minnesota has been a primary source of controversy in the debate over workers' compensation reform in Minnesota, it is apparent from the data that it does not represent a significant expense to the system. If the insurer in this study, for example, only had to pay two-thirds of the gross wage for all claimants, the company would have saved a total of only $124,740 on the claims reviewed.

B. TEMPORARY TOTAL DISABILITY (TTD):

Both Minnesota and Wisconsin limit the eligibility period for TTD benefits by a similar concept which is known in Wisconsin as the "healing period" and in Minnesota as the point of "maximum medical improvement." In both states, TTD benefits are

terminated once that point is reached - or shortly thereafter (90 days after MMI in Minnesota). In Wisconsin, however, if the injured worker enters a state-run vocational rehabilitation program once the healing period ends, he or she may be eligible for up to 40 more weeks of TTD benefits.

As a result of this extended eligibility period in Wisconsin, temporary total disability payments are, on average $1,119 higher per claimant in Wisconsin compared to Minnesota and are paid for ten weeks longer.

TABLE III-E
Temporary Total Disability Comparison

	Minnesota	Wisconsin	Percentage Difference
Average TTD period (weeks)	11.0	20.7	92%
Average Total TTD payment	$2,851	$4,570	60%

It should be noted that the two states have a virtually identical percentage of indemnity claims that include TTD benefits; 92 percent in Wisconsin and 93 percent in Minnesota.

Wisconsin also has higher TTD payments due to the fact that the three day waiting period is compensated after seven days of lost time in Wisconsin while Minnesota workers must miss ten days of work before the waiting period is compensated. Eighty-nine percent of Wisconsin claimants receive benefits for the first three days of lost time compared to 65 percent of the claimants in Minnesota.

Using the 1989 SAWW, the cost of compensating the waiting period in Wisconsin is $136 per claimant. In other words, Wisconsin spends $3264 more per 100 indemnity claims than Minnesota because of the seven day retroactive provision.

C. DEATH BENEFITS

Wisconsin's death benefit provisions are considerably more limited than Minnesota's. In Wisconsin, a surviving spouse's benefits are limited to four times the deceased employee's average annual earnings or 300 weeks of benefits (5.8 years). Once this "primary death benefit" is exhausted, each

dependent child under the age of 18 continues to receive 10 percent of the surviving spouse's benefits until reaching the age of 18.

In Minnesota, a surviving spouse with no dependents receives 50 percent of the deceased worker's weekly wage, subject to 100 percent of SAWW maximum, for ten years. A surviving spouse with one dependent receives 60 percent of the deceased spouse's weekly wage and a spouse with two dependents receives 66 2/3 percent of the wage until he or she no longer has any dependents. When a surviving spouse no longer has any dependent children, he or she will then receive ten years of benefits as described above.

Clearly, the Minnesota death benefit is more comprehensive and expensive. However, death claims are rare. Only four of the Minnesota claims (.1%) included payment of dependency benefits. Wisconsin had ten death claims (.4%) that included dependency benefits. Table III-F and III-G list the dependency claims for each state.

TABLE III-F: Minnesota Dependency Claims

JOB TYPE	AGE CATEGORY	PAYMENT TO DATE	STATUS
Construction	36-50	$273,381	Open
Loader Operator	26-35	95,708	Open
Heavy Equipment Operator	36-50	106,961	Open
Electrician	36-50	130,610	Closed
TOTAL PAID		$606,660	
Average per claim		$151,665	

TABLE III-G: Wisconsin Dependency Claims

JOB TYPE	AGE CATEGORY	PAYMENT TO DATE	STATUS
Clergy	51-65	$ 30,720	Closed
Packer Loader	26-35	44,000	Open
Truck Driver	26-35	52,857	Closed
Police Officer	26-35	50,076	Open
Police Officer	51-65	84,761	Open
Production Worker	18-25	98,700	Open
Truck Driver	51-65	98,300	Closed
Laborer	18-25	40,980	Open
Sheet Metal Worker	36-50	66,095	Open
Laborer	36-50	68,159	Open
TOTAL PAID		$635,648	
Average Paid per Claim		$ 63,565	

Although the Minnesota average dependency payment is more than double that of Wisconsin, the total paid is greater in Wisconsin due to the higher frequency of dependency claims in that state. There was one dependency claim for every 216 indemnity claims in the Wisconsin sample compared to one dependency claim for every 1,475 indemnity claims in Minnesota.

D. PERMANENT PARTIAL DISABILITY

The permanent partial disability (PPD) benefit is perhaps the most complex of the various types of compensation paid to injured workers. These benefits are paid when an employee is injured and has a permanent impairment. The Minnesota and Wisconsin systems vary considerably in their method of paying these benefits. As discussed earlier, PPD benefits in Minnesota were changed significantly by the 1983 Legislature and the two-tiered benefit system was put into effect.

Both states make PPD payments based on schedules. The schedules, however, differ in the types of injuries included and the amount of compensation paid. Further, Wisconsin does not have a "two-tiered system" like

Minnesota's, where injured employees who return to work receive a lump sum PPD payment. Instead, all Wisconsin permanency benefits are payable on a weekly basis at a fixed rate that is set annually. The rate as of January 1, 1989 is $125 per week and benefits are payable for a maximum of 1,000 weeks.

In Minnesota, the vast majority of the PPD payments are lump sum Impairment Compensation (IC) payments rather than economic recovery compensation (ERC) payments, which are spread over a number of weeks but are higher payments in total. Fifty-two Minnesota PPD claims (5%) were ERC claims while 95 percent were IC claims. The average ERC payment was $9,882 (with only 17% of the ERC claims closed) while the average IC payment was $5,976.

Wisconsin PPD payment frequency is more than double that of Minnesota. On average, 39.5 percent of all Wisconsin indemnity (wage loss) claims include PPD benefits compared to 16.3 percent in Minnesota. This difference in frequency between the two states is likely due to the difference in injury schedules used. The Wisconsin schedule accomodates more injuries than the Minnesota schedule because it provides for compensation of unscheduled injuries which the Minnesota system does not.

The average PPD payment is slightly higher overall in Minnesota than in Wisconsin. Table III-H below shows the average PPD payment by state for closed PPD claims, open claims and all claims.

TABLE III-H: Average PPD Payments

	ALL CLAIMS		CLOSED CLAIMS		OPEN CLAIMS	
	NUMBER OF CLAIMS	AVERAGE PAYMENT	NUMBER OF CLAIMS	AVERAGE PAYMENT	NUMBER OF CLAIMS	AVERAGE PAYMENT
Minnesota	1,019	$6,195	652	$5,075	367	$8,186
Wisconsin	964	5,919	781	4,978	183	9,933

It should be noted that the average PPD payment in Minnesota dropped 30 percent following the 1983 law change as shown in Table III-I below. Because of the significance of the 1983 change, when average PPD payments from 1984-1986 are compared, Wisconsin actually has the higher average (see Table III-J).

TABLE III-I: Average PPD Payments in Minnesota (1982-1986)

LOSS YEAR	ALL FILES	CLOSED	OPEN
1982	8,220	6,075	14,256
1983	7,393	6,326	10,282
1984	5,172	4,546	9,508
1985	5,870	4,625	7,251
1986	5,265	3,927	6,555

TABLE III-J: Average PPD Payments - All Claims Minnesota vs. Wisconsin (1984-1986)

LOSS YEAR	MINNESOTA	WISCONSIN
1984	$5,172	$6,496
1985	5,870	6,353
1986	5,265	5,983

E. TEMPORARY PARTIAL DISABILITY

Temporary partial disability benefits are paid to an injured worker who returns to work but does not receive the same wage as he or she earned prior to being injured. Both states pay two-thirds of the difference between the pre- and post-injury wage in TPD benefits.

In Wisconsin, however, temporary partial disability (TPD) benefits are payable only through the healing period while Minnesota currently has no limitation on the length of time an injured worker who is actually working can continue to receive such benefits.

The extended eligibility in Minnesota is reflected in the higher averages shown in Table III-K, particularly with the claims that remain open. The average TPD payment for all files that include TPD benefits was 23 percent higher in Minnesota than Wisconsin.

TABLE III-K: Temporary Partial Disability Comparison
Minnesota vs. Wisconsin

	ALL FILES		CLOSED		OPEN	
	AVERAGE WEEKS	AVERAGE PAYMENT	AVERAGE WEEKS	AVERAGE PAYMENT	AVERAGE WEEKS	AVERAGE PAYMENT
MN	15.3	$2,411	6.3	$ 822	39.2	$6,244
WI	14.2	1,862	11.9	1,243	21.2	3,615

A similar percentage of indemnity claims included TPD payments in Minnesota (20%) and Wisconsin (16%).

F. COST OF LIVING ADJUSTMENTS

Minnesota's system includes provisions for cost of living adjustments (COLA's) to compensation rates when an individual is disabled for more than one year. The adjustment, which is pegged to the state's inflation rate, is calculated annually and may not exceed six percent. Wisconsin does not use COLA's.

Table III-L below shows the percent of Minnesota indemnity claimants who were affected by the COLA provision.

TABLE III-L: Percent of Minnesota Indemnity Claimants Receiving COLA's

LOSS YEAR	PERCENTAGE OF CLAIMANTS WHO RECEIVED AT LEAST 1 COLA	RECEIVED AT LEAST 2 COLA's	RECEIVED 3 OR MORE COLA'S
1982	10.0%	7.3%	5.8%
1983	12.1	9.5	6.7
1984	9.3	6.4	3.8
1985	10.2	6.0	4.0
1986	10.6	6.8	---

The COLA may affect several different types of benefits including temporary total, temporary partial, permanent total, and death benefits. As a result, calculating the actual cost of the COLA is problematic. However, using a "worst case scenario", the <u>maximum</u> cost of the COLA may be derived as follows:

The most expensive application of the COLA would be to an injured worker receiving compensation at the temporary total rate for 52 weeks per year.

Assuming that all the claimants in the study who received COLA's were receiving benefits at the TTD rate, the cost to the insurer for the first year COLA was .8 percent of the total amount (medical and indemnity benefits) paid to Minnesota claimants. The cost of providing the second year COLA is .4 percent of the total benefits paid and the cost of the third year was .6 percent.

The above figures are undoubtedly high for the following reasons:

1. The calculations assume that each employee who received a COLA in a given year continued to receive benefits for a full year thereafter (52 weeks of benefits). Clearly a portion of these claims would close sometime during that year.

2. The calculations also assume that all those who received a COLA were receiving benefits at the TTD rate. In reality, some of the claims would involve lesser payments such as death benefits, or temporary partial benefits.

G. PERMANENT TOTAL DISABILITY

When an employee is permanently injured to the extent that he or she can never return to the work force, permanent total disability (PTD) will be paid for the rest of his or her life. There were two (.04% of all claims) permanent total disability claims in Wisconsin and 17 (.03% of all claims) in Minnesota for the period of the study. Both of the Wisconsin claims have been closed while all but one of the Minnesota claims remain open. Table III-M below shows the PTD payments and reserves for each state.

TABLE III-M: Permanent Total Disability Claims

	MINNESOTA		WISCONSIN	
LOSS YEAR	NUMBER OF CLAIMS	TOTAL PTD PAID	NUMBER OF CLAIMS	TOTAL PTD PAID
1982	7	$452,719	---	---
1983	2	97,842	---	---
1984	7	151,258	1	$40,000
1985	1	20,149	1	26,000
TOTALS	17	$721,968	2	$66,000

Minnesota Average PTD Payment=$42,469
Wisconsin Average PTD Payment= $33,000

It should be noted that Wausau's files indicate outstanding case reserves on Minnesota PTD claims of $4,578,465. However, a case-by-case review of these claims indicates that over half of the reserves exceed the insurer's retention limit with the Workers' Compensation Reinsurance Association (WCRA). Those claims which are reserved at amounts above the point where reinsurance will begin paying have the effect of inflating the loss or potential loss which would actually be paid by the insurer. The total PTD reserve in excess of the retention limit is $1,590,773, a reduction of 35 percent on Wausau's actual exposure on those claims.

H. AWARDS

When making final settlements on claims, both Minnesota and Wisconsin will make an "award" to the claimant either in the form of a lump sum payment or, in Wisconsin, more frequently in the form of an annuity. When an award is made, it is generally not specified whether it is attributable to a certain type of benefit such as temporary partial or permanent partial, etc.

Ten percent of the Wisconsin claims included an award compared to seven percent of the Minnesota claims. However, the average award in Minnesota was considerably higher than in Wisconsin, $22,012 compared to $9,065. Frequently the medical portion of a claim would remain open even after a final settlement was reached on the indemnity portion of the claim. Accordingly, both the open and closed claims were included in the table below.

TABLE III-N: Award Payments 1982-87

	MINNESOTA			WISCONSIN		
LOSS YEAR	TOTAL AWARD PAID	NUMBER OF CLAIMS	AVERAGE AWARD	TOTAL AWARD PAID	NUMBER OF CLAIMS	AVERAGE AWARD
1982	$1,471,494	64	$23,398	---	--	---
1983	2,432,859	80	30,411	---	--	---
1984	2,016,887	115	17,538	$1,166,629	94	$12,411
1985	1,536,610	87	17,662	536,831	71	7,561
1986	1,408,805	54	26,088	314,261	50	6,285
1987	88,305	8	11,038	77,447	18	4,302
TOTAL	$8,980,960	408	$22,012	$2,095,168	233	$9,065

I. REHABILITATION

The Minnesota law contains a mandatory rehabilitation provision requiring employers to provide the services of a qualified rehabilitation consultant (QRC) to any employee whose lost time exceeds 60 days (30 days in the case of back injuries). There is no mandatory rehabilitation division in Wisconsin law.

Table III-O below contains a summary of QRC costs in Minnesota.

TABLE III-O: Qualified Rehabilitation Consultant Costs
Minnesota Claims

LOSS YEAR	PERCENT OF CLAIMS USING QRC	AVERAGE QRC PAYMENT CLOSED CLAIMS		AVERAGE QRC PAYMENT TO DATE OPEN CLAIMS	
1982	10.9%	55	$2,414	44	$8,893
1983	12.7	79	2,308	57	7,900
1984	11.8	79	2,593	76	6,223
1985	15.1	79	2,517	83	5,479
1986	13.2	44	2,002	70	5,546
OVERALL AVERAGE	12.7%	343	$2,374	332	$6,519

The average QRC payment was $4,374, a figure that is 53 percent higher than the temporary total payment made to the average Minnesota claimant.

In addition, Department examiners made subjective comments regarding their impressions of the impact, positive or negative, of the QRC on the outcome of the claim. Examiners found little evidence to indicate QRCs improve the disabled worker's opportunity to return to work or that the QRC's assistance was welcomed by the disabled worker or the insurer.

J. MEDICAL COSTS

A significant portion of the cost of a workers' compensation claim is the cost of medical care.

Table III-P shows the cost of the medical portion of the claims reviewed in Minnesota and Wisconsin for loss years 1984 to 1987.

TABLE III-P
Medical Cost Comparison

MINNESOTA

LOSS YEAR	TOTAL MEDICAL PAID	AVERAGE PAYMENT	PERCENT OF TOTAL PAID TO CLAIMANT
1984	3,601 370	2,779	33
1985	2,932,234	2,803	33
1986	2,381,563	2,890	22
1987	667,685	959	43
TOTAL/ AVERAGE	$9,582,852	$2,481	32%

WISCONSIN

LOSS YEAR	TOTAL MEDICAL PAID	AVERAGE PAYMENT	PERCENT OF TOTAL PAID TO CLAIMANT
1984	$3,136,587	$5,011	34%
1985	3,092,492	5,037	35
1986	2,889,096	5,159	36
1987	1,342,984	3,751	44
TOTAL/ AVERAGE	$10,461,159	$4,951	36%

The average medical cost per claim in Wisconsin is nearly double that of Minnesota, 94 percent higher. Medical costs also represent a higher percentage of the overall claim payment in Wisconsin than in Minnesota. Taking medical cost as a percent of total claim payment for the same period in both states, the difference is four percent -- 32 percent in Minnesota and 36 percent in Wisconsin.

K. SPECIAL COMPENSATION FUND COST

The Minnesota Special Compensation Fund exists to finance four parts of the workers' comepnsation system in this state:

1. It pays supplementary benefits to long term totally disabled workers whose benefits would otherwise be less than 65 percent of the SAWW;

2. It reimburses insurers for benefits paid to injured workers when the disability was caused

by or is substantially greater because of a pre-existing physical impairment (Second Injury Fund);

3. It pays benefits to employees whose employers were either bankrupt self-insurers or were uninsured; and

4. It pays the administrative costs of the Department of Labor and Industry, the Office of Administrative Hearings, and the Workers' Compensation Court of Appeals.

It is not the purpose of this study to analyze the cost or merit of the various individual components of the Special Compensation Fund, rather, it is to measure the cost of the Fund to the insurer. This is a fairly simple cost to evaluate because it is paid in the form of an assessment on paid indemnity benefits. Each insurer and self-insurer in the state pays the Special Compensation Fund assessment.

The assessment rate changed considerably over the period of the study as illustrated in Table III-Q below.

TABLE III-Q. Minnesota Special Compensation Fund Assessment Rates 1982-87

TIME PERIOD	ASSESSMENT RATE (PERCENT OF PAID INDEMNITY BENEFITS)
1/1/82 to 12/31/82	15%
1/1/83 to 12/31/83	17
1/1/84 to 6/30/84	20
7/1/84 to 6/30/87	25
7/1/87 to Present	31

The study data is organized according to the year the loss occurred and not the year benefits were paid. Because the Special Compensation Fund assessment rate is based on the year the benefits were paid, an exact calculation of the cost of the assessment is problematic. However, by once again employing a "worst case scenario", the maximum expense may be calculated as follows:

The majority of the indemnity benefits in the study were likely paid during the 1984-87 period when the assessment rate was set at 25 percent. Accordingly, although a significant portion of indemnity benefits were likely assessed at the lower, pre-1984 rates which ranged from 15-20 percent, the 25 percent rate will be used to calculate a maximum Special Compensation Fund cost for the period of the study.

Total Minnesota Indemnity Benefits Paid	$35,594,659
X Maximum Assessment Rate	x .25
= Special Compensation Fund Cost	$ 8,898,664

This cost of $8,898,664 was included in calculating the Minnesota average claim payments found in the cost summary section of this report.

L. SUMMARY OF CLAIM COST

Tables III-R and III-S on the following page summarize the aggregate claim costs for each state.

The data indicate that the Wisconsin system is six percent more expensive than the Minnesota system.

The average claim payment -- including medical and indemnity -- was $13,192 per claimant in Wisconsin and $9,882 per claimant in Minnesota. (Minnesota figure includes Special Compensation Fund assessment.)

The average paid allocated claim expense was $697 per claim in Wisconsin and $970 per claim in Minnesota.

The average indemnity payment was $7,450 in Minnesota (including Special Compensation Fund assessment) and $8,348 in Wisconsin.

The average open indemnity reserve was $60,069 in Minnesota and $25,812 in Wisconsin. However, after the loss reserves in excess of the WCRA retention limit are subtracted, the Minnesota average reserve becomes $49,573.

The average claim cost -- including medical and indemnity payments, allocated claim expenses, indemnity reserves, and Special Compensation Fund costs -- was $18,015 in Wisconsin and $16,948 in Minnesota. Table III-T below indicates the percentages of each claim dollar which goes toward each benefit in Minnesota and Wisconsin.

TABLE III-R: WISCONSIN CLAIM SUMMARY

LOSS YEAR	NUMBER OF CLAIMS	PERCENT CLAIMS CLOSED	PERCENT CLAIMS OPEN	TOTAL PAID TO CLAIMANT	TOTAL ALLOCATED PAID CLAIM EXPENSE	OPEN INDEMNITY RESERVE	TOTAL PAID RESERVE
1984	651	89%	11%	$9,428,484	$592,296	$1,778,142	$11,798,922
1985	632	83	17	8,820,615	440,708	3,660,764	12,922,087
1986	573	78	22	8,017,323	447,123	3,263,865	11,728,311
1987	365	89	11	3,022,962	65,992	460,324	3,548,278
TOTAL	2,221	84%	16%	$29,289,384	$1,546,119	$9,163,095	$39,997,598

TABLE III-S: MINNESOTA CLAIM SUMMARY

LOSS YEAR	NUMBER OF CLAIMS	PERCENT CLAIMS CLOSED	PERCENT CLAIMS OPEN	TOTAL PAID TO CLAIMANT	TOTAL ALLOCATED PAID CLAIM EXPENSE	OPEN INDEMNITY RESERVE	TOTAL PAID RESERVE
1982	906	92%	8%	$ 9,021,820	$1,112,181	$6,369,388	$16,503,389
1983	1,064	89	11	11,210,289	1,336,729	8,847,617	20,394,635
1984	1,338	87	13	10,951,802	1,659,097	8,064,185	20,675,084
1985	1,084	84	16	9,807,041	1,233,650	7,825,692	18,866,383
1986	864	79	21	7,234,410	771,618	5,148,449	13,154,477
1987	726	100	--	1,541,141	22,708	---	1,563,849
TOTAL	5,982	88%	12%	$49,766,503	$6,135,983	$36,255,331	$92,157,817

* Includes case reserves in excess of the WCRA retention limit.
Reserves capped at retention limit = $30,040,962.

TABLE III-T : Breakdown of Claim Dollar According to Benefits Paid to Claimants

BENEFIT	WISCONSIN	MINNESOTA
Medical Expense	35.8%	29.0%
Temporary Total	31.8	32.4
Temporary Partial	2.2	5.9
Permanent Partial	19.5	12.5
Permanent Total	.2	1.0
Dependency	2.1	1.3
Award	7.2	17.9
Other	1.2	---
	100.0%	100.0%

M. CONCLUSION

The field survey concludes that the Wisconsin and Minnesota systems are not significantly different in overall cost. The examiners, however, found that the Wisconsin system resulted in substantially smaller claim files in terms of claimants and paper work. The Wisconsin system seems to have a much quicker resolution of claims.

Wisconsin leaders in the area of workers' compensation state that workers' compensation was not considered a political issue, much less a partisan one. They noted that all workers' compensation issues are reviewed, deliberated and resolutions proposed by an administrative council, and that it is rare for the legislature to reject or modify those proposals.

Some of the cost variance between the two states identified may be attributable to differences in the industrial mix and types of risk insured. However, the risk variance is diminished by the fact that the same insurer, using the same underwriting guidelines, was examined in each state. In addition, the size of the sample enhances the study's credibility to the degree that it is unlikely that the study's findings would be altered significantly using a different sample.

The field survey identified several notable differences between the two systems:

1. Health providers in Minnesota are paid considerably less per claim than in Wisconsin. This is probably due to the concentration of the health care financial intermediary system in Minnesota which has held down medical costs. The administrative fee schedule in Minnesota also would affect the cost, as well

as the Minnesota provisions which allows the employer to select the provider. The injury classifications of all files reviewed in each state are similar.

2. Minnesota mandates that employees be counselled by a Qualified Rehabilitation Counselor (QRC). The rehabilitation costs in Minnesota are very high in proportion to Wisconsin. The files noted evidence of disfavor by workers and insurers with the Minnesota rehabilitation system. QRC costs are approximately four percent of the cost of the system.

3. The death benefits for widows and dependents in Minnesota are more liberal. The infrequency of such claims, however, results in minimal overall cost differential between the two states. (Minnesota has approximately 45 work-related deaths each year.)

4. The Cost Of Living Adjustments (COLAs) in Minnesota are also higher (Wisconsin does not have them.) The frequency of such claims, however, are such that the cost of the overall system is not significant.

5. The total cost of the differential between the two states for the above COLAs and the death benefits is less than 6 percent. The substantial portion of these costs occur in catastrophic cases where reinsurance retention limits are met. In Wisconsin, the cost for $200,000 retention limit reinsurance averages 3 1/2 percent of premium. In Minnesota, the cost for similar (although not exact) coverage is approximately 8 percent of premium. It is believed that the difference in these two costs equals the cost of the dependency benefits and COLAs in Minnesota. Due to differences in the premium structure, the cost differential for reinsurance between the two states is approximately eight percent.

6. The permanent partial benefit (compensation for body disfunction) appears to be more comprehensive in Wisconsin.

7. The Wisconsin system received considerably more praise for its efficiency. The Minnesota system has been criticized by participants as being expensive and time consuming.

8. The cost of the minimum benefit level for temporary total disability is minimal (less than one percent). Nonetheless, the Minnesota minimum benefit level has been the target of advertising campaigns as being representive of a wasteful system where healthy people are rewarded for not returning to work. This benefit level, which is not present in the 49 other states, is a benefit which affects primarily young, low income women.

9. The temporary partial disability benefit is not limited in duration in Minnesota. It is two-thirds of the difference between a worker's pre- and post-injury wage. In Wisconsin, this benefit terminates when the injury has healed even though the worker is still disabled.

   For instance, if a worker in a lumber yard makes $15 per hour and injures his back, and six months thereafter his back reaches maximum medical improvement, he will be assigned a job in the lumbershop as a clerical making $8 per hour since his back is still not fully functional and he cannot lift. In Minnesota the worker is paid two-thirds of the difference until he or she attains the $15 per hour wage. In Wisconsin, the worker's benefit is terminated when the back reaches its full medical improvement at six months.

   This benefit is probably the true fulcrum upon which the workers' compensation debate is conducted. The cost of this additional benefit in Minnesota is under three percent.

10. Supplemental benefits: Minnesota does pay increased benefits to low income workers after they have been disabled for a period of four years. Prior to 1983, this increased benefit was paid if the worker was disabled for a period of two years. It is believed that the 1983 law substantially decreased the number of supplemental claims due to extension of the qualifying period.

    A substantial portion of these benefits, known as supplemental benefits, relate to pre-1984 cases. Wisconsin does not have such a supplemental benefit system.

11. Uninsured benefits: Wisconsin does not have a fund through which uninsured workers file a claim for benefits. Minnesota permits employees of uninsured employers to file a claim against a special compensation fund administered by the Department of Labor and Industry. It is believed the cost of this fund is about one percent of the total system.

12. If one assumes that Wisconsin rates are 36 percent lower than those of Minnesota, the benefit difference between the two states does not explain the gap. Even if one adds all of the benefits which are more expensive in Minnesota, and does not subtract those benefits which are more expensive in Wisconsin, there is still a 16 percent difference between the rates. This differential in rates represents the difference between a tightly regulated state (Wisconsin) and a deregulated one such as Minnesota.

Economic recovery compensation. If an employee is not eligible for an impairment award pursuant to subdivision 3b, then the employee shall receive economic recovery compensation for a permanent partial disability pursuant to this subdivision. The compensation shall be 66-2/3 percent of the weekly wage at the time of injury subject to a maximum equal to the statewide average weekly wage. For permanent partial disability up to the percent of the whole body in the following schedule the compensation shall be paid for the proportion that the loss of function of the disabled part bears to the whole body multiplied by the number of weeks aligned with that percent.

Percent of Disability	Weeks of Compensation
0-25	600
26-30	640
31-35	680
36-40	720
41-45	760
46-50	800
51-55	880
56-60	960
61-65	1040
66-70	1120
71-100	1200

The percentage loss in all cases under this subdivision is determined according to the rules adopted by the commissioner pursuant to section 176.105, subdivision 4. This subdivision applies to an injury which occurs on or after January 1, 1984.

Impairment compensation. An employee who suffers a permanent partial disability due to a personal injury and receives impairment compensation under this section shall receive compensation in an amount as provided by this subdivision. For permanent partial disability due to the percent of the whole body shown in the following schedule the amount shall be equal to the proportion that the loss of function of the disabled part bears to the whole body multiplied by the amount aligned with that percent in the following schedule:

Percent of Disability	Amount
0-25	$ 75,000
26-30	80,000
31-35	85,000
36-40	90,000
41-45	95,000
46-50	100,000
51-55	120,000
56-60	140,000
61-65	160,000
66-70	180,000
71-75	200,000
76-80	240,000
81-85	280,000
86-90	320,000
91-95	360,000
96-100	400,000

APPENDIX B

Written and Earned Premium*
Wausau Insurance Company
1980-1988

CALENDAR YEAR	MINNESOTA NUMBER POLICIES ISSUED	MINNESOTA WRITTEN	MINNESOTA EARNED	WISCONSIN NUMBER POLICIES ISSUED	WISCONSIN WRITTEN	WISCONSIN EARNED
1980	528	$17,265,656	$16,924,494	3,562	$48,164,776	$48,644,091
1981	542	15,249,217	15,090,100	3,559	53,018,814	50,598,444
1982	551	10,265,571	9,843,794	3,528	41,844,148	43,204,784
1983	677	16,792,380	18,283,536	3,505	51,073,610	55,384,275
1984	571	15,992,924	16,640,252	3,493	61,140,662	61,122,857
1985	325	19,737,553	20,106,697	3,019	59,196,404	59,475,262
1986	244	20,734,399	20,665,540	2,879	63,625,334	63,901,124
1987	218	24,337,875	24,033,896	2,551	69,952,406	69,356,538
1988	194	24,698,218	24,012,433	2,373	87,392,942	87,907,820

* Figures do not include assigned risk pool business in either state.