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Maryland General Assembly
2015 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 465

(Senator Klausmeier, *et al.*)

Finance

Economic Matters

Chesapeake Employers' Insurance Company

This bill subjects the Chesapeake Employers' Insurance Company (Chesapeake) to Title 11 of the Insurance Article, which requires workers' compensation insurers in the State to join a rating organization. The rating organization must (1) make annual reports to specified committees of the General Assembly concerning the status of Chesapeake joining the rating organization and (2) create a classification code for governmental occupations that are not already included in police, firefighter, and clerical classifications. The bill authorizes Chesapeake to own a subsidiary under specified conditions and alters the selection process for Chesapeake board members. The bill also requires the Insurance Commissioner to review the State's self-insured workers' compensation program for State employees at least once every five years and submit a report of its findings to the State Treasurer.

Provisions related to the annual report remain in effect for eight years and terminate September 30, 2023. Provisions related to the classification code requirement for the rating organization take effect January 1, 2022. Provisions related to Chesapeake being subject to Title 11 of the Insurance Article take effect January 1, 2023.

Fiscal Summary

State Effect: The bill does not materially affect State operations or finances. The Maryland Insurance Administration (MIA) can handle the bill's review and reporting requirements with existing resources.

Chesapeake Employers' Insurance Company Effect: Expenditures increase approximately \$1 million per year starting in 2023 due to affiliation with an insurance rating organization. Revenues increase approximately \$1 million per year starting in 2023 due to Chesapeake being able to directly offer insurance coverage in other states.

Expenditures related to the review of the State's self-insured workers' compensation program for State employees are expected to be minimal and can be absorbed by Chesapeake with existing resources. Thus, there is no net material effect on Chesapeake finances.

Local Effect: The bill does not materially affect local governmental operations or finances as Chesapeake-insured local government entities continue to have a single classification code for specified governmental operations.

Small Business Effect: Potential minimal.

Analysis

Bill Summary:

Subsidiary Authorization: The following provisions take effect October 1, 2015. As a condition of being an authorized insurer in the State, Chesapeake must be the workers' compensation insurer of last resort. Furthermore, Chesapeake may establish, own, or control a subsidiary for any lawful purpose if the subsidiary (1) is, or after acquisition will be, wholly owned by Chesapeake; (2) engages in a business activity that is ancillary to the workers' compensation insurance business; and (3) is operated for the purposes of benefiting Chesapeake.

Chesapeake Board Structure: The following provisions take effect October 1, 2015. Two of the board's nine members must be appointed by the Governor. The other seven members must be selected by policyholders under the procedures required by the board's bylaws. The Governor may only remove a member of the board for incompetence or misconduct if that member was appointed by the Governor; however, the policyholders may remove a member appointed by the policyholders at any time, with or without cause, by majority vote. Furthermore, the Insurance Commissioner may remove a member appointed by the policyholders for misconduct, incompetence, or malfeasance after notice and opportunity for a hearing. Members are no longer required to take the oath required by the Maryland Constitution. The bill specifies the appointment dates and term limits of board members through 2029.

Chesapeake Membership in a Rating Organization: The following provision takes effect October 1, 2015, and terminates September 30, 2023. On or before October 1, 2016, and each following year through October 1, 2022, the rating organization, in consultation with Chesapeake, must submit a report to the Senate Finance Committee and the House Economic Matters Committee on the progress that Chesapeake has made in preparing to become a member of the rating organization.

The following provision takes effect January 1, 2022. The rating organization must create and maintain an exception in its occupation classification system to allow any authorized insurer in the State to use a single classification code for governmental occupations that are not already included in police, firefighter, and clerical classifications. The bill also expresses legislative intent that this exception be in place on or before January 1, 2022.

Chesapeake Ratemaking Requirements: The following provisions take effect January 1, 2023. Chesapeake is no longer exempt from Title 11 of the Insurance Article, which regulates insurance rates and ratemaking procedures. As such, Chesapeake must join the rating organization chosen by the Insurance Commissioner and follow all reporting and ratemaking requirements in the same manner as all other workers' compensation insurers in the State.

Current Law: Chapter 570 of 2012 converted the Injured Workers' Insurance Fund (IWIF) into a private, nonprofit, and nonstock workers' compensation insurer as of October 1, 2013. This new organization is the Chesapeake Employers' Insurance Company. Chesapeake may not be considered to be a department, unit, agency, or instrumentality of the State for any purpose. The functions, powers, duties, assets, real and personal property, accounts, liabilities, contracts, and obligations of IWIF transferred to Chesapeake. Chesapeake is required to serve as the workers' compensation insurer of last resort in the State and administers the State's self-insured workers' compensation program for State employees.

Unless specifically exempted, Chesapeake is subject to the same provisions of law as other insurers that are authorized to sell workers' compensation insurance in the State, and it possesses the same powers, privileges, and immunities. Chesapeake is authorized, examined, and regulated by the Insurance Commissioner in the same manner as other property and casualty insurers in the State.

Chesapeake's board is responsible for managing its business and affairs as a private, nonprofit corporation in accordance with State law. The board consists of nine members who are appointed by the Governor with the advice and consent of the Senate. Chapter 172 of 2014 requires that Chesapeake's board, to the extent practical, reflect the geographic and demographic diversity of the State. Furthermore, Chapter 172 specifies minimum qualifications for certain members of the board. Members must be a resident of the State, and before taking office, each member must take the oath of office required by the Maryland Constitution. The term of a member is five years, and the terms are staggered. At the end of a term, a member continues to serve until a successor is appointed and qualifies. A member may not serve for more than two full terms or a total of 10 years. The Governor may remove a member for incompetence or misconduct.

Each workers' compensation insurer in the State, except Chesapeake, is required to be a member of a workers' compensation rating organization and adhere to the policy and rate forms filed by the rating organization. Currently, each workers' compensation insurer in the State is required to be a member of the National Council on Compensation Insurance (NCCI). Chesapeake is not subject to Title 11 of the Insurance Article, which regulates insurance rates and ratemaking procedures and requires membership with a rating organization. Instead, the board must adopt a schedule of premium rates following sound actuarial practices and ensure that the rates are not excessive, inadequate, or unfairly discriminatory. The board must determine the schedule of premium rates by classifying all policyholders by the hazard level of their occupation and setting a premium based on the level of hazard, as well as incentives to prevent employee injuries. The board must use the rating system that, in its opinion, (1) most accurately measures the hazard levels based on the number of injuries that occur for that occupation; (2) encourages the prevention of injuries; and (3) ensures the solvency of Chesapeake from year to year. The Insurance Commissioner must review these rates to determine whether Chesapeake's ratemaking practices result in actuarially sound rates.

Background:

Chesapeake's Affiliation with NCCI: In addition to converting IWIF into Chesapeake, Chapter 570 of 2012 also required the Insurance Commissioner to consult with IWIF/Chesapeake and the State's designated workers' compensation rating organization, NCCI, to determine whether Chesapeake should be required to use the same ratemaking practices as all other workers' compensation insurers in Maryland by becoming a member of NCCI. On October 1, 2012, MIA recommended in a follow-up report that Chesapeake become subject to Title 11 of the Insurance Article by "becoming a fully affiliated member of the rating organization and adhering to the rating organization's policy forms, uniform classification system and uniform experience rating plan."

At that time, IWIF/Chesapeake found two potential disadvantages to its affiliation with NCCI: (1) costs of affiliation; and (2) time required to make administrative changes to record and report data in the manner that NCCI requires. NCCI estimated the total cost of affiliation at that time would be \$592,000. IWIF/Chesapeake believed the affiliation would only benefit other insurers at Chesapeake's expense. MIA believed that benefits related to uniformity in ratemaking, a level competitive playing field among all insurers, and ratemaking transparencies would outweigh these costs.

Chesapeake believes that if it should be required to pay the costs associated with affiliation in NCCI then it should also be allowed to write compensation policies in other states, in the same manner as all other compensation insurers in the State, to offset the additional costs. The bill subjects Chesapeake to Title 11 of the Insurance Article by removing specified exemptions, and it requires Chesapeake to become an affiliated member with a

rating organization, currently NCCI, just like all other compensation insurers in the State. To allow Chesapeake to write insurance coverage in other states, it is necessary to authorize it to create a subsidiary and to change the board's selection process and make-up. Chesapeake reports that most other states have "government control statutes" that prohibit government-controlled insurers from being authorized in their state. Because the governing board is appointed entirely by the Governor, Chesapeake is considered a government-controlled insurer. Additionally, as the workers' compensation insurer of last resort, Chesapeake is only authorized to write workers' compensation policies in Maryland and needs a subsidiary in order to sell insurance in other states. Chesapeake advises that this subsidiary structure is being successfully utilized by the Maine State Fund, the insurer of last resort in that state.

Chesapeake also advises that the phase-in process for full NCCI affiliation, MIA rate approval, and the new board structure that is established by the bill is critical in order to avoid disruption to policyholders and to ensure an orderly transition to NCCI affiliation.

Classification Codes for Local and Municipal Government Employees: Employees covered under workers' compensation law are categorized under classification codes by insurers to determine the rate charged to the insured to insure the employee. For example, insuring an employee under the firefighter classification code is more costly than insuring an employee under a clerical classification code because firefighters have a far greater risk of being injured at work when compared to a clerical worker. IWIF and now Chesapeake have always insured local governments and allowed all local government employees, with the exclusion of firefighters and police officers due to their higher-than-average risk and clerical workers due to their lower-than-average risk, to be categorized under a single municipal worker classification code. Chesapeake reports that this is beneficial because, in small towns, cities, and municipal governments, individual employees may perform many duties and would be administratively costly and difficult to classify. Chesapeake also advises that the bill's requirement that the rating organization it joins also adopt a similar exception has already been negotiated with and accepted by NCCI.

Chesapeake Employers' Insurance Company Effect: Chesapeake estimates that, after the phase-in, costs of affiliation with NCCI will exceed \$1 million per year due to additional costs paid directly to NCCI for membership and additional personnel costs for additional staff (actuarial, underwriting, programming, and financial) needed to comply with loss data and other reporting requirements necessary for affiliation. In 2013 dollars, Chesapeake and NCCI estimate about \$365,000 in additional costs paid directly to NCCI, and Chesapeake estimates approximately \$460,000 in additional personnel costs. Chesapeake reports that, unless these costs are offset by allowing it to write insurance coverage in other states, it would need to pass these costs on to policyholders.

Chesapeake reports that it insures about 500 Maryland-based businesses that have operations in neighboring states. Chesapeake cannot currently offer coverage to the portion

of these businesses that do not operate in Maryland. To accommodate these policyholders, Chesapeake has a contractual arrangement with a standard carrier that writes coverage in other states. Chesapeake estimates that, if it is allowed to directly provide coverage to each portion of these businesses, it will no longer have to pay the standard carrier, resulting in increased revenues of \$1 million per year and completely offsetting the costs of affiliation with NCCI.

Additional Information

Prior Introductions: Similar legislation as introduced (SB 479 and HB 341 of 2014) was amended to modify Chesapeake's board structure and enacted as Chapter 172 of 2014.

Cross File: HB 468 (Delegates Jameson and Davis) – Economic Matters.

Information Source(s): Department of Budget and Management, Maryland Insurance Administration, Chesapeake Employers' Insurance Company, National Council on Compensation Insurance, Department of Legislative Services

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