

## EXECUTIVE SUMMARY

California's workers' compensation system has grown rapidly in recent years. Direct written premiums have increased from \$2.9 billion in 1982 to \$5.3 billion in 1986, an increase of 83 percent. As a result, California's workers' compensation system is the largest system of its kind in the United States.

While the amount of written premiums have been rising, the weekly benefit rates paid to injured workers in California is among the lowest of the urban industrialized states in the country. At the same time, the operational cost of the workers' compensation system has rapidly increased. Total losses incurred by insurance carriers for benefit payments increased from \$1.2 billion in 1980 to \$2.3 billion in 1984, an increase of approximately 92 percent. However, the number of injuries reported per 1,000 workers decreased from 39.17 in 1979 to 35.89 in 1986, a decrease of 8.4 percent. The increased costs of the system are therefore attributable to an increase in the average cost of claims as well as an increase in the number of persons in the workforce, not to an increase in the rate of claims filed.

Due to the recent growth in the State's workers' compensation system and its escalating costs, the Little Hoover Commission initiated a study to determine what measures could be taken to improve the system's administration and operation.

The Commission found that the cost of operating California's workers' compensation system is among the highest in the country. Although comparisons between states are difficult to make, several recent studies indicate that California's premium rates for coverage in certain categories are among the highest in the country and have been increasing at a relatively faster rate than those of other states. The number of claims filed, number of claims litigated, and administrative costs of operating the system have all increased in recent years, and have been passed on to employers as increased premiums. The increasing costs have had a negative impact on the perception of California's business climate.

The Commission also determined that the State of California and private insurers are not actively encouraging the investigation and prosecution of cases of fraud and abuse in the workers' compensation system. Private insurers have referred only 160 cases of suspected fraud and abuse in the workers' compensation system to the Department of Insurance's Fraud Bureau during the last eight years. Only 17 of the 160 cases, or approximately 11 percent, have been opened for investigation by the Department, and only one of these cases has been prosecuted.

The Commission also found that delays in the workers' compensation system have slowed benefit payments to injured workers and increased the administrative costs of the system. In the first half of calendar year 1987, the average injured worker had to wait 32.5 days for the first benefit payment. This is more than twice the 14 days required by regulation. In addition, litigation costs have increased 304 percent in

the period from 1977 through 1986, and forensic medical costs have increased 224 percent during the same period. Moreover, in 1986, it cost 52 cents in direct overhead to deliver one dollar in benefits, compared to 32 cents ten years earlier.

The Commission determined that some employers also attempt to abuse the workers' compensation system by either misreporting wages or inappropriately classifying their employees to gain lower premium rates. This forces other employers to carry a heavier burden of losses through increased rates. While the extent of such inaccurate reporting is not known, no central organization is focussing significant attention on locating and penalizing such employers who do not accurately report wages or inappropriately classify employees.

The study also showed that the escalating use of employer liability insurance has significantly raised the costs of employers and carriers. Workers' compensation policies provide both coverage for work-related injuries and employer liability, the latter to cover any potential liability not anticipated in the basic policy. Prior to 1979, claims made under the employer's liability portion of a workers' compensation policy were extremely rare. Since then, there has been a dramatic increase in the number of civil suits filed by employees under the employer's liability policy sections. This has raised costs for employers and carriers and has caused some carriers to modify or limit employer liability coverage.

The Commission's study further revealed that claims for mental stress injuries increased by 531 percent from 1980 to 1986. Such claims, because of their subjective and controversial nature, result in more frequent litigation which drives up administrative costs, increases hearing backlogs, and further delays payments to injured workers.

Finally, the Commission determined that the effectiveness of California's vocational rehabilitation programs has not yet been fully evaluated, but that opportunities currently exist to better control costs in such programs. Vocational rehabilitation benefits are a rapidly growing part of the workers' compensation benefit structure, accounting for approximately 15 percent of all benefit costs in 1986. This is a significant increase from the two percent of all benefit costs in 1976, the first year vocational rehabilitation benefits were available by law. Although systems in other states may differ from California's, measures used elsewhere to track and control costs may be applicable in California.

The Commission's report presents 13 recommendations for improving various aspects of California's workers' compensation system. These actions include:

1. The Department of Insurance Fraud Bureau should establish written criteria for opening and closing workers' compensation fraud and abuse cases. In addition, the Department should encourage carriers to report potential fraud and abuse and should actively prosecute such cases or cause them to be prosecuted.

2. The Governor's Multi-Agency Task Force on the Underground Economy should specifically establish a method to identify employers who intentionally fail to report wages to misclassify employees in order to reduce workers' compensation premiums.
3. The Insurance Commissioner and the Workers' Compensation Insurance Rating Bureau should establish a policy and method to identify employers who change business or corporate identities to avoid being properly rated based upon prior claims experience.
4. The current allowable vocational rehabilitation services should be modified by the Legislature based upon the evaluation of results of the study currently being performed by the Division of Industrial Accidents in corporation with the California Workers' Compensation Institute and other studies of the long-term effectiveness and control of vocational rehabilitation programs. Specifically, there should be uniform standards for vocational rehabilitation programs.
5. The Governor and the Legislature should provide the Division of Industrial Accidents with the authority to identify insurance carriers for audits based on poor performance, including untimely payment of benefits, and to specify the necessary audit procedures. The Department of Insurance should be required to report to the Division of Industrial Accidents the results of those audits.
6. The Department of Insurance should require the Workers' Compensation Insurance Rating Bureau to collection information on the carrier's employer liability policy sections and to recommend a standardization of policies. The Department of Insurance should use this information to establish industry standards and actuarially determine if a premium is needed for this section and its specific coverages. In addition, the information on each carrier's policies should be provided to the public.
7. The Department of Industrial Relations should consider the use of professional court administrators to assess and manage the ongoing administrative systems and calendars of the Workers' Compensation Appeals Board Offices.
8. As an interim measure, the Department of Industrial Relations should consider assigning Motions and Settlements Judges to review only Compromise and Release agreements as a method of expediting the adjudication process.
9. The Governor and the Legislature should enact legislation to require a single and final "agreed upon third party" medical report when the results of two previous reports do not provide agreement on the nature or extent of injury to the worker.

10. The Governor and the Legislature should enact legislation to repeal the "power press" exception to general workers' compensation coverage.
11. The Department of Industrial Relations should examine the impact of recently implemented regulatory examination protocols on the evaluation of claims for psychological and stress-related injuries. If the results of this review indicate that minimum standardized examination procedures are of value in assessing injury, the Department should work to establish examination protocols for other injuries not covered by current protocols.
12. The Governor and the Legislature should consider adopting legislation to clarify and strengthen the Insurance Commissioner's and Director of Industrial Relations' powers to assess penalties upon carriers and self-insured employers for delaying payment to the injured employee as an incentive to reduce litigation.
13. The Governor and the Legislature should consider requiring employers to provide the employee with a thorough description of the full spectrum of benefits available through the workers' compensation insurance program when an employee is hired.