



**Written Testimony of Secretary Michael Vovakes
Department of Labor & Industry**

before the House Veterans Affairs and Emergency Preparedness Committee

Harrisburg, Pennsylvania

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Good morning Chairman Barrar, Chairman Sainato, committee members and committee staff. I appreciate the opportunity to testify today before the House Veterans Affairs and Emergency Preparedness Committee on House Bill 2522. My name is Michael Vovakes and I am the Deputy Secretary for Compensation and Insurance in the Department of Labor and Industry.

House Bill 2522 has been introduced by Representative Farry in an effort to address the costs of workers' compensation coverage for volunteer fire companies. The department appreciates his desire to reduce costs for these important services, and has engaged in conversations on this topic with both the Representative and his staff. We appreciate their willingness to receive feedback and are glad to continue this conversation before the committee today.

As currently written, HB 2522 would amend the Pennsylvania Workers' Compensation Act (Act) to require that the Department of Labor and Industry (L&I) promulgate regulations that establish a process for groups of political subdivisions to create group self-insurance funds to insure volunteer fire companies. The bill also would require that these group self-insurance funds be funded by excess reserves from the existing workers' compensation policies that cover the volunteer fire companies joining the group. The bill would authorize L&I to waive or modify the current statutory requirements for group self-insurance funds to create additional options for affordable workers' compensation coverage as to volunteer fire companies only, and allow a regulation requiring that a volunteer fire company group self-insurance fund accept responsibility for the administration of pre-existing workers' compensation claims of the group fund members. The bill additionally places reporting requirements on L&I regarding enrollees and fund surplus/deficiency as well as advance notice of proposed changes in group "premium" rates.

By way of background, "self-insurance pooling" was added to the Act in Article XVIII by Act 44 of 1993, enabling employers to join together and operate as a group "self-insurer" under the strict regulations included in the Article XVIII provisions. L&I has promulgated regulations

regarding the procedures for group self-insurance, which are found at 34 Pa. Code §§ 125.131-156.

Group self-insurance in Pennsylvania is the result of a group of five or more employers pooling their resources for the purposes of satisfying the workers' compensation liability of each member of the group. The employers must be "homogenous" in that they all must have been assigned to the same classification series for at least one year or be engaged in the same or similar types of business, including political subdivisions and entities created thereby pursuant to law. Each fund member must execute a trust agreement making it jointly and independently liable for the payment of each and every other member's workers' compensation obligations.

A prospective group self-insurance fund must file an application with L&I no later than 90 days prior to the requested effective date of the group fund. The application must include, among other things, the trust agreement, information on the aggregate workers' compensation losses of the prospective members and excess insurance proposals. If L&I determines that the application complies with the Act and regulation requirements and that the applicant has demonstrated with reasonable certainty that it will meet all liabilities incurred under the Act by its members, L&I may approve the application. There are currently 18 approved group self-insurance funds in the Commonwealth.

Pursuant to Section 806 of the Act, group fund members pay annual assessments into the group fund in a frequency determined by the group's by-laws, as well as an initial assessment which is paid before the inception of the fund. Each member's assessment to the fund must equal the member's annual payroll, multiplied by the applicable rates utilized by the State Workers' Insurance Fund (SWIF), and subtracting the premium discount specified in Schedule Y as approved by the commissioner. It is the fund's responsibility to request classifications for its participants which are to be used in making assessments. The group fund may levy supplemental assessments on its members in the event the fund's assets are insufficient to discharge its liabilities or maintain appropriate reserves.

In the event that a group fund defaults on its liabilities or is deemed insolvent, L&I is authorized to proceed against the fund as it would against a defaulted individual self-insurer, with liability for the group fund's claims potentially being borne by the Self-Insurance Guaranty Fund.

Currently in Pennsylvania, some municipalities participate in group self-insurance funds, and some have obtained workers' compensation insurance through commercial insurers via the voluntary market. Most municipalities, however, estimated at around 75%, have chosen to insure their workers' compensation liability through SWIF.

SWIF is a statutorily-created insurance company designed to ensure that every Pennsylvania employer can obtain workers compensation insurance for its employees, no matter how high the risk. There are additional challenging factors involved with insuring firefighters. Those policies must cover compensable losses occurring not only within the traditional 3-year statute of limitations for traumatic injuries, but also those compensable losses encompassed within the extended 600-week statute of limitations associated with Act 46 cancer claims. Furthermore, in the case of volunteer firefighters, who receive no salary for their service, they are entitled to receive wage loss benefits based upon the statewide average weekly wage, which is \$1,025.00 for 2018. SWIF presently has 1,057 policies in force insuring 1,657 fire companies. It has collected approximately \$25 million in premiums, and has experienced 474 claims/losses associated with those policies. The premium is calculated by population served by the fire company based upon US Census information, which is the methodology chosen by the Pennsylvania Compensation Rating Bureau (PCRB) and approved by the Insurance Department, with the addition of the approved loss cost multiplier for SWIF. As the "insurer of last resort," SWIF cannot turn away any employer, no matter how dangerous the occupation, resulting in a generally higher loss cost multiplier than that which is typically utilized in the commercial market. Based upon its acceptance of the premium and issuance of the policies, SWIF is obliged to maintain loss reserves based on the actuarial studies/industry standards to cover ongoing work-injury related losses for all of its policyholders and the potentially substantial future liabilities arising from compensable work-related injuries covered by all of its policies. Based on its liabilities, SWIF is currently operating at a deficit of \$389 million. However, in an effort to ease the burden of premiums for municipalities, SWIF worked with the PCRB and the Insurance Department to allow municipalities that had multiple volunteer fire companies to purchase joint coverage. This allowed multiple companies in a single municipality to be insured on one policy, thus lowering overall cost.

Based upon all of the foregoing, HB 2522 as drafted raises some questions and issues that may need further review and clarification. Nonetheless, it is the department's understanding that this legislation has been introduced as a conceptual starting point. The bill may not be workable in its current form, but further discussion is certainly warranted.

First, it should be noted that existing language in the Act already allows political subdivisions to establish group self-insurance funds to insure the entire liability of the political subdivisions including volunteer fire companies. Some municipalities historically have availed themselves of that option. However, the bill's proposal to waive or modify the statutory requirements for group self-insurance in order to effectuate its purpose to provide affordable insurance coverage raises some concern because most of the group fund financial requirements exist to ensure the payment of claims to injured workers and the solvency of the group fund. The possible waiver

of requirements to achieve affordability must be approached carefully, because it could impact the fund's ability to pay benefits to injured workers and the potential exposure to the Self-Insurance Guaranty Fund, which is funded by assessments paid by all insured employers, individual self-insurers and group funds.

Next, the legislation's proposed transfer of excess reserves associated with current coverage of volunteer fire companies by SWIF or other insurers may require further clarification. Preliminarily, the bill may need to confirm that this transfer is intended simply to supplement the existing funding mechanism for group self-insurance funds currently found in the Act and regulations, rather than replace them. While it may be possible for such transferred amounts to be used by the individual member as part or all of its pre-inception assessment payment into the fund, the language of the bill would need to be modified to make that clear.

Furthermore, the transfer of existing reserves to the group fund, while a potential means of initial funding, also would need further clarification in the bill, including identifying the method by which this calculation would be performed. Reserves are dedicated to ongoing claims, and typically are not liquid assets that can be transferred. Insurers may argue that this can be construed a "taking" of the property of the insurer, so that argument may need to be further examined. The bill may need to address additional issues such as the fact that not all of an insurer's volunteer fire company policies or liabilities may be transferred and that the calculation may not be uniformly or accurately done by each insurer. It also should be determined whether L&I or the Insurance Department would be the appropriate entity to monitor and enforce compliance of this type of calculation and transfer.

Additionally, the bill raises questions about the effect of such a transfer on the existing workers' compensation insurance policy that the political subdivision has with SWIF or another insurer, which may cover more than just the volunteer fire company liability. It is not readily known whether these policies could be voided in whole or part, and input from the Insurance Department may be required.

There also are potential financial and legal impacts to be considered that would result from the bill's allowance for a requirement that group fund members must accept responsibility for the administration of existing claims. Currently, group funds only are liable for obligations incurred after the effective date of the fund, with each fund member being jointly and severally liable for fund liabilities. The retroactive assumption of pre-existing liabilities of individual members, if legally feasible, would substantially increase any necessary funding for the group and raise the likelihood of default or insolvency. This could result in political subdivisions with substantial pre-existing claims not being able to join a group fund solely because of the size of their prior insured liabilities. If this is to be accomplished in the bill, there may need to be further

explanation as to the method by which the pre-existing insured liability would be transferred to the group fund from the liable insurer.

Some of L&I's new reporting requirements which are added in the bill also require clarification. Since L&I does not set "premium" rates for funds, it should be clarified what proposed rate changes are intended to be subject to the 60-day "advance notice of any proposed change in premium rates for the group" reporting requirement to the Governor and the legislature in subsection (e) of the bill. To the extent that this section is referring to the contribution rates that members are assessed by the fund, the Act provides that those rates are set by the group fund, not L&I, and are based on a number of variables, which may include experience and number of covered volunteers. Not all group fund members pay the same rate, and every time a group fund member increases its number of covered volunteers that rate could change, with L&I having no advance knowledge. As such, whether or how advance notice from the Department of these changes could be provided may require further review.

Moreover, because the language of the current bill only addresses the creation of group funds for volunteer fire companies, further consideration may be warranted to determine whether any change also should apply to other related emergency services entities that likewise would require coverage for volunteer personnel under Section 601 of the Act, such as ambulance corps, rescue and lifesaving squads, and hazardous material response teams, for which a political subdivision still may need to obtain workers' compensation insurance coverage.

Finally, it is also possible that the existence of mutual aid and reciprocal agreements between group fund members and non-group fund entities could create additional group fund exposures and liabilities where the "visiting" volunteer emergency response organization is providing services to a non-group member. This issue may need to be examined further to ensure that there is no unintended or substantial impact from these agreements.

To conclude, I would again like to thank this committee for the opportunity to testify today to provide information regarding House Bill 2522.

The Department of Labor & Industry remains committed to working with the General Assembly and all stakeholders on this issue to identify possible areas of improvement in the workers' compensation system in Pennsylvania, including identifying additional options for affordable workers compensation coverage.

Thank you, and I would be glad to answer any questions that you may have.