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Director

To: Missouri Workers' Compensation Insurance Carriers

Bulletin 92-11

From: Lewis E. Melahn, Director of Insurance

Date: December 4, 1992

Re: Deductible Plans for Workers' Compensation Policies

Section 287.310 of the Revised Statutes of Missouri was amended by House Bill 975 during the 1992 session of the Missouri General Assembly. The amended section authorizes insurance companies issuing workers' compensation policies to offer deductible plans as part of their policies. The precise language of the section is attached, with the new language which has been added underlined.

The Department has decided to begin the process of approving such deductible plans. The following guidelines should be followed by those insurance companies seeking approval.

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- The decision to offer a deductible plan for a workers' compensation policy is at the option of the insurance company. The amended section 287.310, RSMo provides that a workers' compensation insurer *may offer* a deductible option. Insurance companies are clearly *not* required to offer such programs.
- As is the case in other states where deductible plans are authorized, the insurance company retains the ultimate responsibility for the payment of compensable claims.
- The amended section 287.310, RSMo does not not specify the size of the deductible which may be offered to an employer. In those other states which authorized deductible plans, "large" or "small" deductibles are typically specified. "Large" deductible plans are generally considered to be those which require the insured employer to reimburse the insurer for claims under \$100,000. Such plans usually allow the insurance company and the insured employer to negotiate both the size of the deductible and the size of the premium credit between themselves.

Where "small" deductible plans are authorized or required, states or the NCCI typically set forth a table which lists a number of deductible amounts (\$1, 000, \$5,000, \$10, 000, etc.) as well as the size of the premium credits which shall be applied for each of these amounts. In many cases, the size of the credit is determined by the "hazard group" the insured's business is classified under. Employers in hazard group "I" receive larger credits than employers in hazard group "IV" for a given deductible.

Because the amended provisions of section 287.310, RSMo do not specify any specific size for the deductibles to be offered, insurance companies are free to exercise their judgment on this issue. Regardless of the size of the deductible offered, "appropriate premium reductions" will be required by the Department in accordance with the terms of section 287.310, RSMo. The Department feels the practice of allowing insurance companies and their insureds to negotiate the size of the

deductible for large deductible plans is generally acceptable. Therefore, for those risks with a standard premium of \$500,000 or more, a deductible amount of \$100,000 or more will generally be approved, with the caveat that the deductible not exceed 40% of standard premium. Many companies have previously requested the approval by the Missouri Department of various large deductible plans. These companies should refile these plans in conformity with this Bulletin. Any insurer which feels its current filing meets the requirements of this section should contact the Department's Property and Casualty section by telephone.

Small deductible plans will also be considered by the Department. The NCCI has indicated it plans to file a generic small deductible plan with the Department in the near future. The Department anticipates using this plan as its basis of approval of small deductible plans. Until the NCCI files - and the Department approves - such a plan, any insurer seeking the approval of a small deductible plan will need to file actuarial data supporting their plan. Other states which have approved the insurer's small deductible plan should be specified. Differentiation of the size of premium credits based on hazard groups is encouraged.

- In the other states which have authorized the use of deductible plans, the state statutes typically indicate whether the plans shall be "gross" or "net" plans. Under a "gross" plan, all losses incurred by an employer are considered in calculating the employer's experience modification factor, including those ultimately paid by the employer because they fall within the amount of the policy's deductible. Under a "net" plan, only those losses which the insurance company must ultimately pay are used in calculating the "mod".

Section 287.310, RSMo is apparently unique in that it allows an insurer to use either type of plan. As such, the Department will ultimately be approving the use of both types of plans. For purposes of data collection and ratemaking, insurers will need to indicate which type of plan is being used on a particular risk in their reports to the NCCI. Insurers should consult the NCCI for the proper codes to be used; as of the date of this Bulletin, these codes were still being determined by the NCCI.

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It should be noted that concern has been voiced regarding these two reporting methods. The NCCI is concerned that the use of net plans will reduce the data available for ratemaking. In order to compensate for the effect of net plans, the NCCI is currently developing a modification to the experience rating formula, known as the Deductible Experience Rating Formula or "DERF" program. This program has not yet been filed with the Department. In its recent audit of the NCCI, the NAIC recognized that such an adjustment is needed in order to avoid inequity in rating risks.

Another concern which has been raised is the negative reaction which is anticipated from employers who opt for a gross reportable plan and who incur a very large number of small losses within the deductible amount. Under such a plan, the insured may receive a "debit mod" even though the employer's carrier has paid none of the losses itself. This scenario should be explained to the insured at the outset. Employers should be sophisticated enough to weigh the potential benefits and detriments of the use of such a plan for themselves. Employers should also realize that the use of any type of deductible plan will require increased diligence by the employer in the area loss control (e.g. safety programs, medical management, etc.).

- Initially, the deductible shall apply to indemnity and medical benefits. It shall apply, in the case of accidents, to all bodily injury by accident, and, in the case of disease, to each employee for bodily injury due to disease. Proper reporting codes, as required by the NCCI, shall be used. In the future, alternative coverage, say, limited to medical losses, or including allocated loss adjustment expenses, will be considered.

- An annual aggregate limit on the amount to be reimbursed by the employer due to claims arising in any one policy period may be offered by the insurer.

- Payments by the employer under the deductible should be to the insurer or its agent.

- The amount and type of financial security arrangements to assure the employer's payment of his deductible amounts will be left to the judgment of the carrier and negotiations between the carrier and the employer. For purpose of financial statements, however, in order for an insurer to treat as an asset (or reduction to liabilities) receivables owed to it by employers on claims which fall within given deductible amounts, the insurer should require collateral of the same type and quality required by state statute and the NAIC in connection with credit for unauthorized reinsurance. Such collateral shall secure current and ultimate projected claim payments.
- Policy provisions or endorsement provisions regarding deductible plans should generally track the language used in section 287.310, RSMo. Any unique cancellation provisions relating to the deductible plan should be clearly set forth in the deductible provisions. Insurers shall not be allowed to cancel the deductible portion of the plan *ex parte*.
- Any provisions designed to settle the long-term payment obligations of an employer under the deductible plan for a loss should recognize the time value of money.
- Taxes and Second Injury Fund assessments shall be calculated on a gross basis as if the deductible plan were not being used. This is required under subsection 9 of the amended section 287.310, RSMo, in order to avoid any shortfall in revenue for the operation of the Division of Workers' Compensation.
- Assessments for purposes of satisfying an insurance company's "pool burden" shall be determined by the pool's administrators, not the Department of Insurance.
- Filings of forms shall be made to the Property and Casualty Section of the Missouri Department of Insurance, under the same conditions as with other forms, including the use of TD-2 forms and filing fees. Those insurers seeking approval prior to January 1, 1993 should clearly label any filing envelopes and documents as relating to "W/C Deductible Plans".

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