

# MAINE STATE LEGISLATURE

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STATE OF MAINE  
114TH LEGISLATURE  
SECOND REGULAR SESSION

*Final Report  
of the  
Subcommittee on the*

**FEASIBILITY OF CREATING  
A STATE WORKERS' COMPENSATION FUND**  
*to the  
Joint Standing Committee on Banking and Insurance*

*December 1989*

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## PREFACE TO THE COMMITTEE REPORT

This study was conducted by a subcommittee of the Joint Standing Committee on Banking and Insurance. Committee chairs, Senator Raynold Theriault and Representative Charlene Rydell, served as chairs of the subcommittee. Other subcommittee members included Senator Donald Collins, Representative Ruth Joseph and Representative Anne Rand. Gilbert Brewer, legislative analyst, served as staff for the study.

The subcommittee would like to thank all those persons and organizations who provided invaluable assistance to the completion of this study, including the Bureau of Insurance, the Maine Chamber of Commerce and Industry, the National Federation of Independent Businesses, the Independent Insurance Agents' Association and the many Maine employers who contributed to the study. We would particularly like to thank Mr. Merle Parsley and Mr. George Bambauer from the Idaho State Fund, and Mr. Richard Young of the Oklahoma State Fund, for taking the time to share their experiences with the subcommittee.



## EXECUTIVE SUMMARY

### I. Unanimous Findings and Recommendations

The subcommittee of the Banking and Insurance Committee that conducted this study unanimously make the following findings and recommendations:

1. The eligibility criteria for application of the premium surcharge penalty in the workers' compensation insurance accident prevention account are too broad. Many employers who have active workplace safety programs are inappropriately falling subject to the premium surcharge penalty. This tends to occur most frequently to small employers who are paying relatively small premiums. To minimize the possibility of the premium surcharge penalty being applied to these employers, the threshold requirements for application of the premium surcharge penalty should be amended to minimize the effect of single, disproportionately large claims against the employer.

2. The eligibility criteria for application of the mandatory deductible requirement for workers' compensation insurance policies are also too broad. The threshold premium level of \$12,000 has not been adjusted since its enactment in 1987, and now permits the application of mandatory deductibles to smaller employers than was originally intended. The premium threshold for application of mandatory deductibles should be increased to \$20,000 and, in the future, be automatically adjusted to account for changes in rates and payroll. Further, mandatory deductibles are being required for employers whose loss ratios are high enough to place them in the accident prevention account even though those employers have active safety programs. The statute should be amended to minimize the possibility of such employers becoming subject to the mandatory deductible requirement.

3. The statutory provisions of "Fresh Start" require clarification regarding the application of premium credits or surcharges to employers who were insured in 1987 but who have since become self-insured. The subcommittee recommends that any employer who was part of the insurance market in the policy year for which a surcharge or refund is ordered, but who have since become self-insured, should pay or receive their proportionate part of the deficit or surplus.

4. Many employers are receiving inadequate notice of workers' compensation insurance premium increases. The lack of adequate notice can create severe cash flow problems for small businesses. Insurers should be required to provide their insured employers with at least 30 days' notice of any increase in premium.

## II. Majority Findings and Recommendations

The study subcommittee divided over whether to recommend the creation of a state workers' compensation insurance fund. The majority of the subcommittee makes the following findings and recommendations.

1. Small businesses are suffering disproportionately from the current workers' compensation insurance market in Maine and this situation is unlikely to change substantially. A competitive state fund would better meet the needs of small businesses in Maine by providing better services to small businesses and by providing workers' compensation insurance at lower cost to these employers.

2. Almost all employers in Maine are currently unable to obtain workers' compensation insurance in the voluntary market. A competitive state fund would help restore a competitive workers' compensation insurance market in Maine and enable more businesses to purchase insurance in the voluntary market. Additionally, a state fund would ensure the availability of workers' compensation coverage to all Maine employers.

3. A state fund would provide a benchmark against which the performance of private carriers and the validity of rate requests could be measured.

4. Although there currently exists no broad-based support among the business community for the creation of a state workers' compensation insurance fund, support will grow when employers learn more about how a state fund operates and what it can do to help them. The business communities in states that have state funds generally support the continued operation of those state funds.

5. The majority recommends that the State enact legislation establishing a competitive state workers' compensation insurance fund, to take effect upon funding being provided to implement the legislation. To ensure that the state fund has the necessary degree of independence, the state fund should be structured as an independent mutual insurance company. To the maximum extent possible, the state fund will be treated the same as any other insurance carrier. The state fund would be subject to regulation and be required to participate in the assigned-risk pool and pay premium and other taxes just as a private carrier. Where investments of equal value exist, the state fund will give preference to an investment that will benefit the people of Maine. This requirement will ensure that while the financial integrity of the state fund remains the paramount investment guide, to the maximum extent possible, the money of Maine businesses will stay in the state to improve the quality of life for Maine people.

To provide initial funding for the state fund, the State should authorize a bond issue or provide a General Fund appropriation in the amount of \$10,000,000. This money should be provided to the state fund in the form of a loan, to be paid back to the State as the state fund operates.

6. The majority supports the passage of a constitutional amendment to prevent the use of money held by the state fund for any purpose other than the legitimate expenditures of the state fund.

7. The majority recommends that the State, as an employer, insure for workers' compensation with the state fund. This requirement provides a guaranteed base upon which the state fund can establish its operations and ensures that the State will receive professional claims management and loss control services, as well as providing a more stable budgetary base for workers' compensation expenditures.

### **III. Minority Findings and Recommendations**

The minority report of the study subcommittee makes the following findings and recommendations.

1. The necessary support for the creation of a state fund does not exist. The business community in Maine is, at best, ambivalent toward the creation of a state fund. The proposed state fund will not be successful without the support of the business community.

2. The effectiveness of state funds varies widely among states that have enacted competitive state funds. Several state funds have experienced severe financial difficulties and would be forced into bankruptcy if they were private companies. There are very few areas in which government entities have been successful in competing with private companies who are subject to market forces requiring them to operate as efficiently as possible. It is simply impossible to legislate the economic success of the proposed state fund.

3. If, as has happened in other states, the proposed state fund begins to lose money, it will create tremendous pressure upon the Legislature to bail out the faltering state fund. In such a situation, it should not be the responsibility of the taxpayer to subsidize an inefficient government insurer.

4. Now is not the time to enact major new programs requiring large expenditures when State revenues appear to be in short supply, particularly when the efficacy of the proposed state fund is itself in doubt.

5. The proposed state fund may be subject to political pressure. State funds in other states have experienced severe problems when political influences, rather than wise management, begins to dictate the state fund's policies.

6. It is too soon to recommend that the State undertake such a major project as the creation of a state fund. The current trends in the workers' compensation insurance market are very encouraging and indicate that the market is returning to a "normal" status. We must provide sufficient time for the major workers' compensation reforms enacted in 1987 to take effect. When the early signals are so promising, it would be premature and potentially harmful for the State to create a state workers' compensation insurance fund at this time.

## INTRODUCTION

Maine, like every other state in the United States, has established a workers' compensation system to provide benefits to employees who are injured in the course of their employment. With very limited exceptions, the system is mandatory upon all Maine employers. These employers must provide an assurance that the benefits provided under law will be paid. They can accomplish this by receiving approval from the Bureau of Insurance to self-insure as an individual entity, by joining an approved group self-insurance plan or by purchasing workers' compensation insurance from a private insurance carrier.<sup>1</sup> In this respect, Maine is similar to most other states which provide these same three options to an employer.<sup>2</sup>

In 13 states, however, a fourth option exists; this option is a competitive state fund. These states include Arizona, California, Colorado, Idaho, Maryland, Michigan, Minnesota, Montana, New York, Oklahoma, Oregon, Pennsylvania and Utah.<sup>3</sup> In addition, the State of Hawaii has enacted statutory authorization to create a state fund but has not yet provided funding to implement the legislation.<sup>4</sup> These states have chosen to create an agency which offers workers' compensation insurance to employers in the state in competition with insurance offered by commercial insurers.

The issue of whether Maine should establish a competitive state insurance fund for workers' compensation is not new. At least as early as 1975, legislation had been submitted to create a state insurance fund for workers' compensation.<sup>5</sup> Similar legislation, to establish either a competitive or monopolistic state fund, has been submitted in virtually every biennium of the Legislature since then, the latest being the submission of L.D. 1320, "An Act to Create a State Fund to Provide Workers' Compensation Insurance Coverage to Employers," in the First Regular Session of the 114th Legislature.<sup>6</sup>

Interest in the creation of a state fund gained renewed impetus in the aftermath of the workers' compensation insurance "crisis" that occurred in 1987. At that time, the State was faced with the impending withdrawal from the Maine market of virtually every workers' compensation insurance carrier. The asserted reason for the withdrawal was the perceived rate inadequacy in Maine. In response to this "crisis," the State substantially reformed both the benefit provisions of its workers' compensation law and the rate-setting provisions of its insurance law related to workers' compensation insurance. The reforms were successful in convincing a sufficient number of commercial insurers to remain in the Maine market to ensure the continued availability of workers' compensation insurance to Maine employers.

Although the immediate crisis had been resolved, questions continued to remain over whether a workers' compensation state insurance fund would stabilize the insurance market or reduce the cost of workers' compensation insurance in Maine. In response to the submission of L.D. 1320, the Joint Standing Committee on Banking and Insurance agreed to request authorization to study the feasibility of creating a competitive state workers' compensation insurance fund in Maine. The Legislative Council approved the committee's request for a study and a subcommittee of the Banking and Insurance Committee was appointed to conduct the study. The subcommittee proceeded to meet five times over the course of the summer and fall of 1989 to complete the study, of which this report and the accompanying legislation is the result.

The report is structured as follows. Section I provides a brief summary of the evidence and testimony received and considered by the subcommittee during the study. Section II contains those recommendations of the subcommittee, unanimously supported, that suggest revisions to the existing workers' compensation insurance law. Section III sets forth the recommendation of a majority of the subcommittee that a competitive state fund be created, along with the majority's findings supporting that result. Section IV contains the minority recommendation rejecting the proposed creation of a state fund and likewise includes the minority's findings supporting its recommendation.

## **I. SUMMARY OF EVIDENCE AND TESTIMONY RECEIVED BY THE SUBCOMMITTEE**

The subcommittee met five times over the course of the summer and fall in conducting this study. The first four meetings were devoted to receiving testimony regarding the proposed creation of a competitive state fund and the current state of the workers' compensation insurance market in Maine. In addition to this testimony, the subcommittee staff and several interested parties provided the subcommittee with voluminous written information related to the proposed state fund. The fifth and final meeting was devoted to subcommittee deliberations.

The first meeting of the subcommittee was held on August 17, 1989. Although held primarily for organizational purposes, the subcommittee also heard testimony from Merle Parsley, Manager of the Idaho State Fund, and George Bambauer, the Idaho State Fund's chief underwriter. The Idaho State Fund was selected due to the similarities that Idaho has with the State of Maine, such as population, geographic dispersion and industry mix. Mr. Parsley and Mr. Bambauer provided the subcommittee with a general history of state funds and a spirited exposition on the details of the Idaho State Fund's operations.

The second subcommittee meeting was held on September 11, 1989. At this meeting, the subcommittee heard comments from Joel Russ of the Maine Chamber of Commerce & Industry, and David Clough of the National Federation of Independent Businesses (NFIB). Both of these speakers testified regarding their organizations' positions on the creation of a state fund. Joel Russ's comments were directed primarily at the need to determine whether the private insurance industry was adequately serving Maine employers. He stated that although the Chamber had not taken a definitive position on the establishment of a state fund, it could support such action if it was satisfactorily shown that the private sector was unable to meet the workers' compensation insurance needs of Maine employers. David Clough focused on the peculiar needs of small businesses in Maine, noting that the current workers' compensation insurance market had forced almost all small businesses into the residual market. The NFIB, as an organization, was also ambivalent about the creation of a state fund. David Clough noted that NFIB members in Maine were evenly divided on the issue. Both organizations offered to assist the subcommittee in its efforts to develop data regarding the state fund study. In addition, the subcommittee reviewed the preliminary results of a questionnaire mailed to private carriers, insurance agents and employers throughout the state.

The third subcommittee meeting was held on October 5, 1989. The subcommittee heard from Gary Robb, an executive with Industrial Indemnity Co. in Idaho. Mr. Robb testified concerning the insurance industry's view of writing workers' compensation coverage in a state with a state fund. Mr. Richard Young, Commissioner of the Oklahoma State Fund also spoke with the subcommittee at this meeting. His testimony concerned the Oklahoma State Fund's operations generally, and was particularly directed to the fund's recent involvement in defeating an industry-requested rate increase in Oklahoma. Peter Burton, Northeast Regional Director of the National Council of Compensation Insurers (NCCI), appeared before the subcommittee to discuss NCCI's viewpoint on state funds and the current Maine workers' compensation market. Members and staff of the former "Menario Commission" were also present at this meeting to discuss their reasons for recommending the creation of a state fund in 1984. The "Menario Commission" was established upon the order of then-Governor Joseph Brennan, to investigate the costs of providing workers' compensation insurance in Maine. The commission was composed of a business representative, Alan Timm, a representative of labor, Floyd Harding, Esq., and a public representative, John Menario, who chaired the commission. The commission engaged the Tillinghast actuarial firm to assist them in their work, which resulted in a lengthy report. Joel Russ also returned to update the subcommittee on the response to a mailing performed by the Chamber of Commerce on the subject of the current workers' compensation insurance market and the proposed state fund. Steve Hoxsie, from Thomas Moser Cabinetmakers, Inc., spoke with the subcommittee concerning his employer's recent difficulties with the Accident Prevention Account. Finally, the subcommittee heard from their staffperson regarding information that the subcommittee had earlier requested.

The fourth subcommittee meeting was held on October 26, 1989. At this meeting, the subcommittee heard from over a dozen employers selected because of their interest in the current workers' compensation insurance market.

The fifth and final subcommittee meeting was held on November 20, 1989, to conduct deliberations and make final recommendations.

## II. UNANIMOUS RECOMMENDATIONS

The subcommittee unanimously makes the following findings, and recommends the following amendments be made to the existing workers' compensation insurance law. The suggested legislation to implement these amendments appears as Appendix I to this report.

### A. Accident prevention account premium surcharge

**Finding:** The eligibility criteria for application of the premium surcharge penalty in the accident prevention account are too broad.

The purpose of the accident prevention account is to separate those employers in the residual market who have poor safety practices from those employers who have good safety programs, but were unable to purchase workers' compensation insurance in the voluntary market due to their small size or other factors unrelated to their loss experience. Employers in the accident prevention account are potentially subject to a system of financial penalties that are intended to provide a financial incentive for those employers to improve their experience by attempting to minimize the risk of workplace injuries and thereby provide a safe workplace for their employees.

The subcommittee heard repeated testimony that employers who were very safety-conscious were being placed in the accident prevention account and being subjected to the surcharge penalties applicable to certain employers under existing law. The subcommittee finds that the criteria originally established to determine eligibility for premium surcharge penalties do not accurately describe the type of employer that should be subject to the surcharge penalties. The primary problem appears to involve employers whose loss ratios are distorted due to the effect of one serious injury.

To be eligible for inclusion in the accident prevention account, an employer must have a loss ratio greater than 1.0 and at least two lost time claims in the reporting period.<sup>7</sup> A loss ratio greater than 1.0 means that an employer has incurred more losses over the 3-year reporting period than he paid in premiums during that same time. If a small employer experiences a large claim, the effects of that loss alone may well cause that employer's loss ratio to exceed the designated 1.0 threshold level. If that employer experiences even a single additional lost time claim within the 3-year reporting period, the employer automatically becomes eligible for inclusion in the accident prevention account. This is true even if the second claim is minor and the large claim was the result of an anomalous "freak" accident. This situation unfairly characterizes even very safety-conscious employers as "bad" employers who don't care about safety on the job, and subjects them to potential premium surcharges, primarily on the basis of one large claim.

**Recommendation:** the threshold requirements for application of the premium surcharge penalty should be amended to minimize the effect of single, disproportionately large claims.

The subcommittee unanimously recommends that the threshold requirements for application of the premium surcharge penalty be amended to minimize the effects of a single, disproportionately large claim. To accomplish this end, we recommend the use of a new "threshold loss ratio" requirement. The "threshold loss ratio" would be calculated by dividing an employer's actual incurred losses over the 3-year reporting period by the premium charged to that employer during the same period, except that if any single claim in the 3-year reporting period exceeds the premium paid by that employer in the year that the loss occurred, that loss will be limited to the employer's premium amount for the year in which the claim was initiated. This formula will limit the effects of a single large claim, preventing employers whose high loss ratio is due primarily to a single expensive claim from falling subject to the premium surcharge penalty. Additionally, it will perform this function most efficiently for small businesses that do not incur large numbers of claims, the very type of business that the subcommittee finds most likely to fall victim to the flaw in the current threshold requirements. The "threshold loss ratio" should help prevent most of those employers who do take an active role in providing a safe workplace from becoming subject to the premium surcharge penalty.

While the "threshold loss ratio" requirement will help to screen out some safety-conscious employers, there will continue to be some good employers who remain eligible for the premium surcharge penalty. This is the result of using a financial measure (loss ratios) as a substitute for an individualized determination regarding the safety practices of employers. While the loss ratio concept provides a fair estimation of an employer's safety record (especially as modified through the use of a "threshold loss ratio"), it will never perfectly separate those employers with poor safety practices from the safety-conscious employers. The subcommittee considered the possibility of allowing employers in the accident prevention account to file an appeal with the Bureau of Insurance in which the employer could attempt to demonstrate the adequacy of his workplace safety program. This approach, however, suffers from many practical implementation problems. Although we do not recommend any action be taken in this area now, it is a subject that may deserve further consideration in the future.

## **B. Mandatory deductibles**

**Finding:** The eligibility criteria for application of the mandatory deductible requirement are too broad.

As part of the 1987 workers' compensation reforms, the workers' compensation insurance law was amended to require the application of an automatic deductible to any employer in the accident prevention account whose annual premium exceeded \$12,000 and was not subject to retrospective rating.<sup>8</sup> The purpose of this requirement is to provide an additional direct financial incentive to employers with poor experience to increase safety in their workplaces. The \$12,000 premium level threshold was adopted to prevent an undue financial burden upon small businesses.

Since 1987, the state has experienced rate increases totalling, on average, more than 53% over the 1987 rate levels.<sup>9</sup> In addition, employee wages have risen approximately 9.4% over this same time.<sup>10</sup> Since workers' compensation insurance premiums are set on the basis of an employer's total payroll, the average small employer that paid a \$12,000 premium in 1987, would be paying approximately \$20,100 today. The failure to amend the \$12,000 premium level threshold to reflect these increases has resulted in more small businesses becoming potentially subject to severe financial penalties. The purpose of these penalties is to encourage greater safety in the workplace, not to shut down the workplace entirely because the employer cannot meet the financial burden imposed under the law.

**Recommendation:** The premium threshold for application of mandatory deductibles should be increased to \$20,000 and, in the future, be automatically adjusted to account for changes in rates and payroll. Further, a threshold loss ratio of 1.0 or greater should also be applied as a prerequisite to application of the mandatory deductible.

The subcommittee unanimously recommends that the premium threshold for application of mandatory deductibles be increased to \$20,000 and, in the future, be automatically adjusted to account for changes in rates and payroll. Further, a threshold loss ratio of 1.0 or greater should also be applied as a prerequisite to application of the mandatory deductible.

The recommended increase in the premium threshold will merely restore the threshold to the same relative level originally established in 1987. This will prevent very small employers from having to face the potentially disastrous financial burden of having to pay mandatory deductibles under the statute. The subcommittee further recommends that the \$20,000 level be adjusted annually by the Bureau of Insurance to reflect any intervening rate increases (or decreases) and to account for any changes in payroll. We recommend that the payroll adjustment be tied to the annual change in the state

average weekly wage, which is already calculated by the Bureau of Employment Security. These adjustments will prevent further "slippage" of the minimum premium level over time and obviate the need for future amendments by the Legislature.

Finally, the subcommittee recommends that the "threshold loss ratio" established above be applied as a prerequisite for application of the mandatory deductible requirement. This recommendation is made here for the same reasons stated above. The mandatory deductible requirement was established to provide a further financial incentive for an employer to provide a safe workplace. If the employer has been included in the accident prevention account because of a single large claim, it is not necessary to apply the mandatory deductible.

### **C. "Fresh Start"**

**Finding: "Fresh Start" statutory provisions need clarification regarding the application of premium credits or surcharges to employers who were insured in 1987 but who have since become self-insured.**

When the 1987 workers' compensation reforms were enacted, a provision was included to authorize the Superintendent of Insurance to investigate the profitability of policies written in the residual market. If the superintendent finds that an excessive profit was made, he may order a credit to policyholders in the residual market. If a deficit is found, and the Superintendent further finds that the rate of return for the entire workers' compensation insurance market was less than reasonable in that year, he may order a surcharge against all employers, whether insured in the voluntary or residual market. The resulting credit or surcharge is applied to current-year policies in the amount necessary to offset any adverse cash flow resulting from the deficiency; the entire actuarially-determined deficit is not necessarily collected from employers at one time. These provisions have been generally referred to as "Fresh Start."<sup>11</sup>

A question has arisen concerning which employers will be subject to a current-year premium surcharge, if any is ordered by the superintendent. The primary question is whether employers who were part of the commercial insurance market in the policy year on which the surcharge is based, but who have since become approved for self-insurance or have joined an approved group self-insurance plan, will be subject to any surcharge. The statutory language is not clear as to whether these employers are obligated to pay the surcharge or not. There are at least two large employers who have already obtained approval to self-insure and many more employers are attempting to gain approval from the Bureau of Insurance to self-insure independently or as a group.

The subcommittee unanimously finds that it would be manifestly unfair to allow an employer to avoid paying his fair share of any deficit incurred in the policy year for which a current-year surcharge is assessed. The fact that the employer has since become self-insured does not remove the obligation of that employer to "carry his weight" for prior years when the employer was part of the workers' compensation insurance market. "Fresh Start" is intended to ensure that all insured employers share the benefits or burdens of the insurance market in the years for which they contributed to that market.

**Recommendation:** All employers who were part of the insurance market in the policy year for which a surcharge or refund is ordered should pay or receive their proportionate part of the deficit or surplus.

The subcommittee recommends that all employers who were part of the insurance market in the policy year for which a deficit or surplus is found to have existed should pay or receive their proportionate part of the deficit or surplus. Any surcharge or credit to be applied in the current policy year, as calculated by the Superintendent of Insurance, must be fairly shared by all employers who participated in the insurance market during the policy year which created the need for the current-year surcharge or credit.

The subcommittee also considered the possibility of clarifying the criteria by which the Superintendent of Insurance is to determine the amount of any deficit collectable by insurers if he finds that insurers have not made a good-faith effort to maximize the number of risks in the voluntary market.<sup>12</sup> The subcommittee's primary concern was that the present statutory formula relies upon market percentages as determined solely by premium volume. This measure tends to devalue attempts to write voluntary coverage for small businesses while emphasizing voluntary coverage of large employers with higher premiums. The subcommittee is concerned that this emphasis is misplaced. Since large employers are relatively desirable as voluntary risks for insurers in any event, the statute should be encouraging greater attempts to write voluntary coverage for small employers, who are not so desirable. The subcommittee, however, chose not to recommend an amendment to the statute at this time. We recognize that the statute provides the Superintendent with a great deal of discretion in determining what factors may be considered in establishing an "equitable" distribution of any collectable deficit. We recommend that in making this determination, the superintendent consider an insurer's attempts to write coverage in the voluntary market for small employers.

#### **D. Notice of rate increases**

**Finding:** Many employers are receiving inadequate notice of workers' compensation insurance premium increases. The lack of adequate notice can create severe cash flow problems for small businesses.

The subcommittee heard repeated testimony concerning the fact that many employers receive inadequate notice of premium increases when their workers' compensation insurance policies are renewed. This practice can severely disrupt a small employer's cash flow and expected budget; small employers cannot simply produce the funds for an unexpected large increase in their workers compensation premium on short notice. Even though the workers' compensation insurance industry has developed a "pending rate filing endorsement" that notifies an employer that a rate filing is pending when his policy is renewed and that the rates for the employer's policy may vary depending upon the final approved rates, this endorsement does not notify the employer of the amount of the rate increase requested by NCCI, nor does it notify the employer of the amount his individual premium is likely to be increased. The subcommittee finds that many employers are receiving inadequate notice of workers' compensation premium increases and that the lack of this notice can create severe cash flow problems for small businesses.

**Recommendation:** Insurers should be required to provide their insured employers with at least 30 days' notice of any increase in premium.

The subcommittee recommends that insurers be required to provide their insured employers with at least 30 days' notice of any increase in premium. Requiring this notice will not unduly burden insurance carriers but will provide at least a minimal degree of advance warning before an employer's workers' compensation insurance premium is increased.

### **III. MAJORITY RECOMMENDATION REGARDING THE CREATION OF A COMPETITIVE STATE FUND**

A majority of the subcommittee makes the following findings and recommends that the State establish a competitive state workers' compensation insurance fund as described below. The following subcommittee members join in this recommendation: Senator Raynold Theriault, Representative Charlene Rydell, Representative Ruth Joseph and Representative Anne Rand.

#### **A. Majority Findings**

##### **1. The current workers' compensation market is not meeting the needs of small businesses in Maine.**

The majority finds that small businesses are suffering disproportionately from the current workers' compensation insurance market in Maine and that this situation is unlikely to change substantially.

The problems testified to by the owners of small businesses amply justify the conclusion that insurance carriers do not provide a sufficient level of services to small businesses. These problems include the lack of safety audits and other loss control services, insufficient claims management, the lack of communication with the employer regarding outstanding claims or policy questions and the lack of guidance through a system that can only be described as tortuous to even its most seasoned practitioners. This is not meant as a condemnation of the private insurance industry; small businesses do not generate sufficient premium income to the insurers to economically justify the investment of vast amounts of carrier time and resources to these employers. It is impractical to suggest that a carrier provide a safety audit for every small business that it insures; the resource commitment would be immense and the economic return would be minimal. These economic justifications offer little solace, however, to the owner of a small business, who often feels adrift in the workers' compensation storm. Just because it is economically inefficient to provide the same level of services to large and small employers alike does not mean that small businesses do not need these services and cannot benefit from them.

The testimony of Steve Hoxsie, controller for Thomas Moser Cabinetmakers, Inc., eloquently pointed out some of the difficulties Maine employers face in the current workers' compensation insurance market. His employer's workers' compensation insurance premium jumped dramatically as a result of recent rate increases and, because the firm was placed in the residual market, the application of premium surcharge penalties in the Accident Prevention Account. Due to the firm's excellent safety program, however, it was able to locate an insurer that was willing to write coverage for it in the voluntary market. While Mr. Hoxsie's earlier efforts to secure

coverage in the voluntary market had been unsuccessful, due to the dramatic effects of the premium surcharge and the resultant publicity surrounding the event, Thomas Moser Cabinetmakers was able to obtain coverage in the voluntary market. The company hadn't changed; its safety program hadn't changed; its loss experience hadn't changed. But now an insurer was willing to write their policy where only weeks before no insurer would do so.

Unlike Thomas Moser Cabinetmakers, most small businesses are still unable to secure coverage in the voluntary market. Although the subcommittee did receive testimony that some insurers value their small business insureds,<sup>13</sup> we find that generally, insurers do not actively seek out small businesses on a voluntary basis. As stated by the insurer from Idaho (the only insurer testifying before the subcommittee who does not have a stake in the Maine market), his company doesn't want to write any business with less than \$10,000 in premium; it isn't economically efficient to do so.<sup>14</sup> This finding is supported by data from the National Council of Compensation Insurers described in an article from the NCCI Digest.<sup>15</sup> It noted that historically, a substantial portion of the residual market has been composed of small businesses due to the "disproportionate expense associated with small premiums." According to NCCI data, over 80% of all businesses in Maine that purchased workers' compensation insurance in 1986-87 paid under \$5,000 in premium (equivalent to approximately \$8,000 at current rates) and over 90% of businesses in the 1988 Maine residual market paid under \$10,000 in premium.<sup>16</sup> We must recognize that, like the State of Idaho, most employers in the state are not attractive risks for commercial insurers. Clearly, most Maine employers need an additional workers' compensation insurance option in order to escape falling into the residual market. Without reform of the current system, most small businesses will continue to end up in the residual market, being assigned to a carrier that they did not select and who they believe does not want to insure them.

This practice further aggravates the problems faced by small businesses, who find few options when they seek to purchase workers' compensation insurance at a discount. There are limited possibilities for them to purchase coverage with a premium deviation or a dividend plan; they usually end up paying the standard manual rate, as modified by their particular experience. Even the special packages offered by the Hanover Insurance Co. target only selected groups of businesses.<sup>17</sup> Currently, Hanover Insurance Company's innovative "Citizens" plans are available to businesses in only 6 insurance classifications. Although many small businesses fall within these 6 classifications, many large employers do also. It is not clear how many "small" businesses will be eligible under these plans. Further, even within these classifications, Hanover will not write coverage for every employer who requests it. The plans are limited to employers

who meet the eligibility criteria established by Hanover. Some employers will undoubtedly benefit from their participation in a "Citizens" plan, and Hanover Insurance Company is to be commended for its initiative in this area, but most small employers, even those with excellent loss experience, continue to find that the door to the voluntary market remains closed to them.

## **2. A competitive state fund would better meet the needs of small businesses in Maine.**

The majority further finds that a competitive state fund would better meet the needs of small businesses in Maine.

Experience in other states demonstrates that a competitive state fund tends to write coverage for most of the small businesses in the state.<sup>18</sup> The state fund administrators who spoke to the subcommittee suggested two primary reasons for this fact. In the first instance, a state fund would almost certainly provide better services to small businesses. The proposed state fund would write only workers' compensation insurance and would write insurance only in Maine. These two factors give the proposed state fund an advantage over large multi-state (or in some cases, multi-national) private carriers. The state fund would have an immediate interest in all Maine employers, who would compose its only client base. The state fund would employ claims adjusters who would, through experience, become expert in working under the Maine workers' compensation law. These adjusters would be located in the state, not working out of a home office in Hartford or Boston. The state fund's loss-control experts would gain expertise with Maine businesses and the types of problems unique to those businesses. The state fund directors who testified to the subcommittee both remarked on situations where a state fund client improved its loss experience after insuring with the state fund. In one case, the business returned to a private carrier to take advantage of its improved experience rating, only to revert to the state fund when its experience deteriorated under the private carrier. Such improved loss control services would benefit both Maine employers (through lower costs) and Maine employees (through the prevention of injuries). The ultimate motivation of the state fund and its employees would not be to maximize the state fund's profit; it would be to serve their clients, the employers of Maine, in the best way possible.

Secondly, the proposed state fund would not only provide better services to Maine's employers, but would be able to do so at a reduced cost to the employer. The state fund would not have to operate more efficiently than a private carrier to reduce costs (although, due to the reasons discussed above, it may well do so). This is true for several reasons. First, the state fund would not be seeking to make a profit, rather, its primary goal would be to provide the best services at the lowest possible cost to its insureds. Any excess premium

collected by the state fund would be returned to its policyholders in the form of dividends (although it should be noted that no dividend would be likely in the state fund's initial years, until it is assured of its financial stability). Second, the state fund would not have to pay an expensive agent's fee every time it wrote a policy for an employer. Although the proposed state fund would be authorized to write insurance through agents, it could also write policies with no agent involvement upon a direct request from an employer. In fact, this is the usual method of doing business for most state funds.<sup>19</sup> These two factors provide a built-in cost savings over commercial stock insurers, most of whom write insurance primarily through agents. In addition, state funds tend to have lower overhead costs than private carriers, including private mutual carriers, enabling them to write even small businesses economically. A 1982 study showed the average state fund administrative expense ratio to be 5.6% of earned premium, compared to the private industry average of 11.5%. When average agents' commission expenses were included, the state fund administrative expense ratio rose to only 5.7%, while private industry's increased to 16.8%.<sup>20</sup> These figures have been replicated in other studies as well, including one which found the 5-year average administrative expense ratio for state funds to be 7.1%, while private mutual carriers were at 13.8% and private stock carriers were at 18.8%.<sup>21</sup> These savings, over 10% on average, would in turn be passed on to the state fund's clients through lower rates and dividends.

### **3. A competitive state fund would help restore a competitive workers' compensation insurance market in Maine.**

The current voluntary market in Maine has been estimated as approximately 15-20% of the entire market by premium volume (it is, of course, less by number of risks). This contrasts with the generally-accepted industry standard of 85 to 90% for a normal, healthy market and with the current national average of approximately 80%.<sup>22</sup> Clearly, the workers' compensation insurance market in Maine remains problematical. We agree with the minority that current signs are hopeful; more carriers are beginning to seek more voluntary business in Maine as time passes. We applaud the initiative of these carriers and encourage their further efforts. On the other hand, we do not see the creation of a competitive state fund as interfering with this trend in any way. An article written by the 1988-89 Board Chairman of the National Council of Compensation Insurers identified 2 states in which the existence of a competitive state fund was a primary factor in keeping the residual markets in those states below 10%.<sup>23</sup> The creation of a competitive state fund would actually enhance the competitiveness of the marketplace in Maine. It would provide one more option for Maine employers to consider when searching for workers' compensation insurance coverage. It would also provide an additional source of price and service competition with the private sector. If the state fund begins to offer better rates and services than the private carriers, the private sector will

have to respond in kind to maintain its market position.<sup>24</sup> Healthy free-market competition will benefit all employers in Maine; both those who insure with the state fund and those who choose to insure with a commercial carrier.

The majority further does not view the establishment of a state fund as an impediment to those employers who are currently seeking to self-insure. We do not see the option of insuring with a state fund as excluding any of the other options currently offered an employer to comply with the State mandate of workers' compensation coverage. All such options would continue to be open for any employer to pursue, including those employers who spoke with the subcommittee, such as the members of the Maine Merchants' Association and the former Northern Maine Loggers' self-insurance group, who are currently exploring or have already already initiated the process for authorization to self-insure. We do, however, see the large number of Maine employers rushing to self-insure as symptomatic of a deeper problem. The primary motivation behind their decision to self-insure is usually not cost (although that certainly is one factor); it is a desire to achieve greater control over their claims and experience.<sup>25</sup> This tends to show that the current insurance market is not meeting their needs with regard to claims management and loss control services. As stated above, this is an area that the proposed state fund may improve upon. Additionally, as more employers choose to exercise their option to self-insure, the pool of employers remaining to share the risk decreases. This factor may influence private carriers' attitudes toward participating in the Maine workers' compensation insurance market and result in future withdrawals or, at least, more conservative marketing. The proposed state fund could fill this void if it arises.

**4. A state fund would provide a benchmark against which the performance of private carriers and the validity of rate requests could be measured.**

No detailed exposition is necessary to support the statement that workers' compensation insurance rate levels have long been a contentious subject in Maine. There are many in the business community and beyond who question the validity of the data provided by insurers to support rate requests. This debate has continued to rage largely because there has never been an independent source of such data. The state fund would provide such a source. State funds in other states have been instrumental in evaluating rate requests and have often provided information that has been the basis of a rate hike denial or reduction.<sup>26</sup> Similarly, data supplied by a state fund could support the need for a rate increase, thereby defusing the political time bomb inherent in such requests. Rather than increasing the possibility of politicizing rate hearings, as suggested by the minority, a state fund that is properly insulated from political pressure may actually de-politicize the rate-making process.

**5. A state fund would ensure the availability of workers' compensation coverage to all Maine employers.**

With few exceptions, every employer in Maine is required by law to carry workers' compensation insurance coverage or self-insure.<sup>27</sup> When the State mandates that a certain type of insurance must be carried, it is incumbent upon the State to ensure that the required coverage is available and affordable. In 1987, Maine faced the possibility of beginning 1988 with no private insurance carrier willing to write workers' compensation coverage in the state. Staring into the face of the havoc that certainly would have resulted, the Legislature hurriedly enacted a major workers' compensation reform package.<sup>28</sup> The controversy over the propriety of that action lingers to this day. Whether or not the claims made by the insurance industry at that time were justified (a question that data from a state fund may well have answered), the creation of a state fund would ensure that Maine would not have to consider a similar dilemma in the future. The Legislature could carefully investigate and debate the issues, secure in the knowledge that, if necessary, the state fund was available to write workers' compensation insurance in the state. A state fund could perform this function in other lines of insurance as well. A similar industry pull-out was recently threatened in Idaho over the cost of providing malpractice insurance.<sup>29</sup> At the Legislature's request, the state workers' compensation fund began preparations to write malpractice insurance if the threatened exodus actually occurred. It did not.

**6. When all the facts are known, support for the creation of a state fund will grow.**

Like the minority, we were disappointed to see the apparent lack of interest in the state fund issue. This spirit of ennui carried in both directions, however. Very few persons were either strongly against or strongly in support of the creation of a state fund, despite the fact that the subject of workers' compensation, in general, remains one of the most contentious issues in the state. We believe that this lack of interest is primarily due to a lack of knowledge about what a state fund can do for the employers of this state and how it does it. When the subject was discussed in greater detail with employers who appeared before the subcommittee, several of them agreed that perhaps the state fund could help them. The subcommittee heard additional testimony from other states that both the insurance industry and the business community originally opposed the creation of state funds, but that after the state fund had been in operation, both parties tended to favor its continued operation.<sup>30</sup> The Idaho insurer who testified before the subcommittee went so far as to say that every state should have a state fund because it tends to stabilize the insurance market and serve market niches that are not very attractive to private insurers.<sup>31</sup> Small employers in Idaho are now enthusiastic supporters of the state fund. We believe that Maine employers would be similarly supportive of the creation

of a state fund here if they were better informed of the potential benefits to them. This is shown by the fact that nearly one-half of the small businesses polled by the Maine NFIB supported the creation of a state fund.<sup>32</sup> Obviously, some employers have investigated the benefits possible under a state fund and decided that it was right for them.

For many employers, the fundamental obstacle to the creation of a state fund is philosophical. The argument is that government has no business attempting to perform a function traditionally performed by the private sector. This argument ignores the fact that government has been in the insurance business for years. The federal government provides flood insurance. The Maine State Housing Authority insures mortgage loans.<sup>33</sup> The state and federal governments provide unemployment insurance, not through private carriers, but through government agencies.<sup>34</sup> This argument also fails to consider that the State would not be excluding private enterprise from this area. Unlike a monopolistic state fund, private carriers would remain free to compete with the state fund and employers would remain free to insure with a private carrier if they so choose. Finally, and perhaps most importantly, we believe that it is particularly appropriate for government to provide an option for obtaining insurance where the State has, by law, required every employer to obtain that type of insurance. Where the State has established such an obligation, the State must guarantee that an affordable means to satisfy that obligation is available to all Maine employers.

## **B. Majority Recommendations**

### **1. The State should enact legislation establishing a competitive state workers' compensation insurance fund, to take effect upon funding being provided to implement the legislation.**

The majority recommends that the State enact legislation establishing a competitive state workers' compensation insurance fund, to take effect upon funding being provided to implement the legislation. The suggested legislation to implement this recommendation appears as Appendix II to this report. The foregoing analysis demonstrates both the need and propriety for the State of Maine to create a state fund. We further recommend that this result be achieved in two separate pieces of legislation. We do not believe that any uncertainty over the method of raising the necessary funds should prevent the State from acting immediately upon the authorizing legislation. The State of Hawaii enacted similar authorizing legislation in 1985 but has not yet provided the necessary funding to implement the legislation.<sup>35</sup> Perhaps coincidentally, Hawaii has since experienced a reduction in workers' compensation rates of over 40%.<sup>36</sup> While we do not believe that a similar result would necessarily follow in Maine, we see no need to delay action on the authorizing legislation while funding issues are resolved.

**2. The State should enact a constitutional amendment prohibiting the use of state fund money for any purpose other than use by the state fund.**

The majority further recommends that the State enact a constitutional amendment to prohibit the use of state fund money for any purpose other than use by the state fund. The suggested legislation to implement this recommendation appears as Appendix III to this report. As noted in the minority report, the reserves of state funds in other states have sometimes been "raided" by the state legislature to obtain money in tight budgetary times. These reserves are not money for the general use of the State. They are established to provide funds for the future payment of benefits in incurred claims. Since one legislature cannot bind the hands of a future legislature, we support the passage of a constitutional amendment to prevent any temptation to "raid" the state fund's reserves in the future. A similar constitutional provision exists regarding the assets of the Maine State Retirement System.<sup>37</sup>

**3. The state fund should be insulated from political influences to the greatest degree possible.**

As the minority report suggests, the mission of a state fund can be distorted through undue political pressure. Although this criticism can be made of any state agency, it may carry greater weight where the agency in question deals with such a controversial area as workers' compensation. The State of Maine has a very good history of recognizing and respecting the independence of quasi-public state-affiliated agencies. While we hope that this record continues in regard to the state fund, we believe that the mere possibility of political pressure being exerted upon the state fund requires preventive measures. For that reason, in order to ensure that the fund pursues its legislatively-mandated goals, a majority of the fund's board of directors will be appointed by the Governor, with the remainder elected by the fund's policyholders. All board members must be policyholders of the state fund. This structure is similar to the structure recommended by an independent consultant to the State of Rhode Island concerning the preferred composition of a proposed state fund in that state.<sup>38</sup> It is based upon the recently-created Minnesota State Fund, which was described by that consultant as being "extremely successful" and, in its opinion, "the ideal model for any new competitive state fund to follow."<sup>39</sup> While the attached suggested legislation is roughly based upon the Minnesota model, it has been drafted to include provisions that reflect the unique needs of Maine as well.

**4. To the extent possible, the state fund should be treated the same as any other insurance carrier.**

The majority recommends that, to the maximum extent possible, the state fund be treated the same as any other insurance carrier. On this issue, we are in agreement with the recommendations of the former "Menario Commission" that the proposed state fund should compete with private insurance carriers on an "equal footing."<sup>40</sup> The state fund would be subject to regulation and be required to participate in the assigned-risk pool and pay premium and other taxes just as a private carrier.

**5. The State, as an employer, should insure for workers' compensation with the state fund.**

The majority recommends that the State, as an employer, insure for workers' compensation with the state fund. This requirement provides a guaranteed base upon which the state fund can establish its operations. Most state funds have a similar requirement that all public employers must insure with the state fund.<sup>41</sup> Given the success experienced by the group self-insurance plan organized by the Maine Municipal Association, we hesitate to go so far in our recommendation. We believe it sufficient to require the State alone to insure with the state fund.

This requirement will also ensure that the State receives professional claims management and loss control services, as well as providing a more stable budgetary base for workers' compensation expenditures. Under the current system, workers' compensation benefits are paid to injured State employees out of the budgets of each individual department but no separate line item is established in department budgets for these expenses. It has proven to be difficult for the State to estimate these expenditures and properly plan for future workers' compensation expenses. Additionally, an injured employee's opportunity to return to work, with or without rehabilitation, can vary according to the department he works in and the supervisor he works under. Perhaps most importantly, the State does not currently benefit from comprehensive loss control services that can reduce the likelihood of workplace injuries. The absence of such a program harms both the State, through higher workers' compensation costs, and the State's employees, through a higher incidence of injuries.

It should be pointed out that the State's initial workers' compensation insurance costs will be higher than it currently pays. This is true because the State's current system is a pay-as-you-go approach that does not require the establishment of reserves to cover future costs of incurred claims. If the State purchases insurance from the proposed state fund, its premium will be calculated to ensure that the state fund

receives enough money to cover the present value of all incurred liability. In addition, the State will have to continue to pay for claims incurred before the State's new insurance policy is effective. At least initially, the State will have to pay more for workers' compensation coverage than it now does. This is not, however, the result of any real "increase" in costs. The State's present method of paying for its workers' compensation liability creates an illusion of economy as compared to insuring with the state fund. Current expenditures are limited, not because of any real diminution of ultimate liability, but because the State does not establish reserves for future costs. If the State insured for its liability, it would not be paying any more in actual costs, it would just be paying it sooner. The State would also experience some reduction in costs since it would no longer be necessary to expend the same resources upon claims management now performed by the State, both by its own employees and by independent contractors. In addition, the State would almost certainly reduce its ultimate liability when insuring with the state fund because it would benefit from the provision of loss control services and comprehensive claims management. Both the Idaho and Oklahoma state funds insure all public employers and, due to their good experience, have been able to give the public employers a discount (20% in Idaho, 33% in Oklahoma) on the standard insurance premiums.<sup>42</sup> We further recommend that any State employees displaced by this requirement be given priority in any suitable employment positions within the state fund.

**6. The state fund should give preference to Maine investments when investing money of the state fund, except where more prudent investments of equal return are available.**

The majority recommends that the state fund give preference to Maine-based investments when it invests money of the state fund, except where more prudent investments of equal return are available. We are certainly aware of the fact that the state fund's investment strategy must be directed toward maximizing its return while protecting its investment. The majority firmly supports this policy, but also deplores the flow of money from Maine employers to points outside the state. There is no guarantee whatsoever that the funds provided to commercial insurers by Maine businesses will be placed in investments that will benefit the state of Maine. Almost certainly, those funds will be invested elsewhere, resulting in a flow of financial resources out of the state. Therefore, the majority recommends that where investments of equal value exist, the state fund must give preference to an investment that will benefit the people of Maine. This requirement will ensure that while the financial integrity of the state fund remains the paramount investment guide, to the maximum extent possible, the money of Maine businesses will stay in the state to improve the quality of life for Maine people.

7. The State should authorize a bond issue or provide a General Fund appropriation in the amount of \$10,000,000 to provide initial funding for the state fund. This money should be provided to the state fund in the form of a loan, to be paid back to the State as the state fund operates.

The majority recommends that the State authorize a bond issue in the amount of \$10,000,000 to provide initial funding for the state fund. Suggested legislation to implement this recommendation appears as Appendix IV to this report. Although it appears that this method of funding is the most practical at the present time, the Legislature may choose to provide funding through a General Fund appropriation instead. Whichever method is ultimately selected to raise the needed funds, the majority recommends that the money be provided in the form of a loan to the state fund. As the state fund operates, it will use part of any earned surplus to repay the loan.

The amount needed to establish the state fund is also flexible. Essentially, the more money that is provided to capitalize the state fund initially, the more insurance coverage it can write and remain fiscally sound. Based upon the actuarial report submitted to the Menario Commission in 1984, a capitalization level of \$10,000,000 (assuming a premium to surplus ratio of 2:1) would have allowed the state fund to initially write \$20,000,000 in workers' compensation insurance.<sup>43</sup> Making the same assumptions, but considering the growth in the volume of premium written in Maine since 1984, a capitalization level of \$10,000,000 would allow the state fund to write approximately 8-10% of the current market. Since the State, as an employer, would account for approximately 3% of the current market,<sup>44</sup> the state fund could insure only another 5-7% of the market, by premium volume. But if the state fund were to write only 5% of the market, and this 5% of the market was composed primarily of small employers, as we expect it would be, the state fund could conceivably insure over 1/2 of all Maine employers.<sup>45</sup> The majority recommends an initial capitalization level of \$10,000,000. Although a small portion of this initial funding will be used for start-up administrative expenses, the remainder will be sufficient to allow the state fund to write workers' compensation insurance coverage for the State and a substantial number of other Maine employers as well. If the proposed state fund were to utilize reinsurance, it could conceivably expand on this initial market share.<sup>46</sup>

#### **IV. MINORITY RECOMMENDATION REGARDING THE CREATION OF A COMPETITIVE STATE FUND**

A minority of the subcommittee makes the following findings and recommends that the State not establish a competitive state workers' compensation insurance fund at this time. Senator Collins supports this recommendation.

##### **A. Minority Findings**

##### **1. The necessary support for the creation of a state fund does not exist.**

If one factor remained constant throughout the course of this study, it was the consistent lack of support for the creation of a state fund. Although some individual employers testified in favor of a state fund, their support appeared to be engendered more by desperation than purposeful investigation. Of over 100 questionnaires on the subject of a state fund that were sent by the subcommittee to businesses and local Chambers of Commerce throughout the state, only 2 were returned.<sup>47</sup> Neither response favored the creation of a state fund. In the Maine Chamber of Commerce & Industry's own survey, only 25% of the employers responding favored the creation of a state fund.<sup>48</sup> None of the lobbyists for the established business groups rose to support the creation of a state fund. In fact, no organized support for a state fund appears to exist outside of some members of the Legislature. The majority recommendation appears to be putting the proverbial cart before the horse.

It is axiomatic that if a state fund is to be successful, it must be able to attract clients and receive some measure of support from the public. The director of the Idaho State Fund testified that he thought the primary factor in the success of that state fund was the widespread respect and support that existed for the agency. I believe that it would be a mistake for the Legislature to foist an unwanted state program upon an unwilling business community. If a state fund is to work in our state, it must be greeted with the support of the business community, not with indifference or outright hostility.

##### **2. The proposed state fund may be inefficient.**

The subcommittee majority finds support for the proposed state fund from the supposed efficiency that they believe is inherent in a state fund. This belief, however, has not always been borne out by the facts. The effectiveness of state funds varies widely among the 13 states that have enacted competitive state funds. The testimony from the director of the Idaho State Fund was quite compelling regarding the efficiency of his program, however, every state is not an Idaho. Different factors will determine the success or failure of a state fund in different states. Even in Idaho, which on balance, appears

to have a well-run state fund, the efficiency of the state fund is questioned by some.<sup>49</sup> The situation in some other states is far worse. For instance, the competitive state fund in Oregon is experiencing massive controversy regarding mismanagement and an impending financial catastrophe.<sup>50</sup> A study provided to the subcommittee indicated that many state funds would be forced into bankruptcy if they were private companies.<sup>51</sup> These examples demonstrate that it is impossible to simply legislate economic success.

The truth is that there is no guarantee that the proposed state fund would actually be well-managed and financially successful. First, it will be difficult to attract quality personnel in fields where the pay in the private sector is well beyond what the proposed state fund could pay. We must remember also that there are 20 other states that are competing for the same personnel, and as the evidence indicates, they have not all been successful. Second, history teaches us that government has not fared well when it attempts to perform a function in competition with the private sector. Private enterprise simply provides greater motivation to discover more efficient mechanisms to address a problem. If not one of the hundreds of competing private commercial insurers nationwide has found a way to more efficiently insure for workers' compensation in Maine, how does the proposed state fund intend to do it? The addition of one more competitor can do little to promote greater efficiency. If the apparent problems cited by the majority do exist in the current insurance market, they are most likely the result of systemic problems within the workers' compensation system itself. Until these problems are addressed, the proposed state fund will suffer from the same inadequacies.

### **3. The creation of a state fund carries with it potential risks.**

The proposed creation of a state fund carries with it the possibility of grave risks. The first of these is the need to provide capitalization of the state fund. The regional economy is clearly slowing down, if not heading into a recession. While it is difficult to justify the expense of capitalizing the proposed state fund on its own merits, I find it doubly so when it must compete with other worthy requests for State funding at a time when State revenues appear to be in short supply. This is not the time to enact major new programs requiring such large expenditures, particularly when the efficacy of the expenditure itself is so doubtful.

A second financial risk must be considered when evaluating the desirability of creating a state fund. As discussed above, not all state funds are fiscally sound; in fact, most appear to be in relatively questionable financial health. What will happen if the proposed state fund does not operate in the black but begins to lose money? The State could hardly stand idly by

as one of the largest insurers in the state goes bankrupt. It will create tremendous pressure upon the Legislature to bail out the faltering state fund. In such a situation, it should not be the responsibility of the taxpayer to subsidize an inefficient government insurer.

A third financial risk involves the potential for Legislative "raiding" of surplus funds held by a state fund. Such "raids" have occurred in New York and Oklahoma, when the state faced budgetary shortfalls.<sup>52</sup> This "surplus" is in reality reserves set aside by the state fund to cover future costs of incurred claims. Any money that is taken from these reserves will have to be replaced from some source eventually. Any legitimate "surplus" that may exist does not belong to the state but rightfully belongs to the policyholders of the state fund. Despite all the best intentions, we are unable to prevent a future legislature from "raiding" the proposed state fund except by way of a constitutional amendment.

The final risk associated with the creation of a state fund is, perhaps, the greatest. The proposed state fund is intended to act just like every other insurer in the state. Although it would be a public (or quasi-public) agency, its mission would be to provide workers' compensation insurance in the same manner as any private carrier would. Unfortunately, it remains an arm of state government and, like any other governmental agency, subject to political pressure. This reality poses the risk that the state fund's decisions and practices will be subject to political influence. Its testimony before legislative committees may be slanted to achieve a desired political goal. Its rates may be set artificially low or dividends set too high in order to support a political goal of pressuring private insurers to reduce their rates. Similarly, its supposedly "neutral" data may be altered to provide a more politically palatable rate decision. We have experienced the unfortunate results that follow when the insurance rate-making process is set under a political agenda through legislation, rather than by the decision of the Superintendent of Insurance with regulatory goals. Having only recently returned the rate-setting process to its regulatory home, I am hesitant to open it up to political pressure from another avenue.

The majority recognizes these dangers and suggests that they can be avoided by insulating the state fund from political pressure. This is more easily said than done. As long as the state fund remains a "state" fund, it can no more be insulated from political influences than can any other agency of state government. The only guarantee against political influence is the continued self restraint of Maine's elected officials, and this is no guarantee at all. While Maine may presently respect the independence of its regulatory agencies, there is nothing to prevent this situation from changing in the future.

#### 4. The current Maine workers' compensation insurance market is returning to a "normal" status.

The market forces that drove the state to the brink of a workers' compensation "crisis" in 1987 were not created overnight, but were the product of many years of legislative tinkering with the workers' compensation system. So too, the journey away from that precipice will take both time and patience. The complex and far-reaching amendments to the workers' compensation law and the insurance rate-setting law require time to fully take effect. It will take even longer to be able to analyze what those effects have been, but the early signals are promising.

The uncontroverted testimony to the subcommittee was that the private carriers are re-entering the voluntary market and expanding their efforts to write policies in the voluntary market. Hanover Insurance Co., in particular, has established an innovative program to attempt to write more voluntary coverage for selected small employers.<sup>53</sup> Although the movement may not have been as fast as some of us might like, the early signs are good. In fact, a major deterrent to an expanded voluntary market appears to be the reluctance on the part of some employers to "shop around" for a better deal. Several employers testified that they preferred to simply work with a single agent to obtain all their lines of insurance and did not attempt themselves or encourage their agent to search for voluntary coverage elsewhere. Further, we have not even progressed to a point where we can determine the effects of the "Fresh Start" provisions of the rate-setting law. These provisions were designed to encourage greater participation in the voluntary market and are just now beginning to take effect, with the first hearings scheduled to begin early next year. Finally, although the rate increases granted in the past two years were substantial, they were not entirely unexpected. It was clear that the Maine workers' compensation system had become out of balance financially; an adjustment was long overdue. In addition, each succeeding rate request, including the most recent notice of intent just received by the Bureau of Insurance, has been for a lesser increase. The trend is clearly away from the enormous rate requests of past years, indicating that the system is nearing equilibrium.

Other trends in the workers' compensation area also suggest that the creation of a state fund is premature. Several employers are investigating the possibility of self-insuring, either individually or as a group.<sup>54</sup> The Maine Merchants' Association is one such group. If successful, they have the potential for including over 3,000 employers, many of them small to medium-sized, in their group. The self-insured employers testified that they have no interest whatsoever in the proposed state fund.<sup>55</sup> To them, the state fund would simply be another insurer. They prefer to retain greater control over their claims by self-insuring.

## **B. Minority Recommendation**

### **1. The State should not create a state workers' compensation insurance fund at this time.**

All of the trends discussed above indicate one thing; it is simply too soon to analyze the effects of the 1987 reforms. It must be remembered that some of the major benefit reforms will have no effect until at least 1994.<sup>56</sup> When the early signals are so promising, it is premature to suggest that the State undertake such a major effort as the creation of a state fund. The creation of a state fund may well de-stabilize the market by sending the wrong message to insurers when the market is in such a fragile state. It is simply wrong to suggest that private insurers are inefficient or untrustworthy at a time when the State is trying to attract those same insurers to re-enter the Maine workers' compensation market.

This is not to say that all is well with the Maine workers' compensation system. To the contrary, most of the testimony to the subcommittee from employers centered upon problems regarding the amount of benefits received by employees, medical expenses associated with injuries or fraudulent claims.<sup>57</sup> I do not believe that the current system has been completely healed and that all of the problems that led to the 1987 "crisis" have been addressed, but we have taken the first steps in doing so. While I can support the minor "fine-tuning" achieved by the unanimous subcommittee recommendations in Part II of this report, I cannot at this time join in recommending such a major effort as the creation of a state fund.

APPENDIX I.

SECOND REGULAR SESSION

ONE HUNDRED AND FOURTEENTH LEGISLATURE

Legislative Document

No.

STATE OF MAINE

IN THE YEAR OF OUR LORD  
NINETEEN HUNDRED AND NINETY

AN ACT To Amend the Workers' Compensation  
Insurance Law

Be it enacted by the People of the State of Maine as follows:

Sec. 1. 24-A MRSA §2366, sub-§4, ¶B, is repealed and the following enacted in its place:

B. The plan shall provide for premium surcharges for employers in the Accident Prevention Account based on their specific loss experience within a specified period or other factors which are reasonably related to their risk of loss.

(1) No premium surcharge shall be applied to a risk whose threshold loss ratio is less than 1.00. The threshold loss ratio shall be based upon the ratio of "L" to "P" where:

(a) "L" is the actual incurred losses of a risk during the previous 3-year experience period as reported, except that the largest single loss during the 3-year period shall be limited to the amount of premium for the year in which the loss occurred; and

(b) "P" is the premium charged to a risk during that period.

(2) Premium surcharges apply to a premium that is experience or merit rating modified.

(3) Premium surcharges shall be based on an insured's adverse deviation from expected incurred losses in this State. The surcharge shall be based on the ratio of "A" to "B" where:

(a) "A" is the actual incurred losses of a risk during the previous 3-year experience period as reported; and

(b) "B" is the expected incurred losses of a risk during that period as calculated under the uniform experience or merit rating plan multiplied by the risk's current experience or merit rating modification factor.

(4) The premium surcharge shall be as follows:

<u>Ratio of "A" to "B"</u>	<u>Surcharge</u>
<u>Less than 1.20</u>	<u>None</u>
<u>1.20 or greater, but less than 1.30</u>	<u>5%</u>
<u>1.30 or greater, but less than 1.40</u>	<u>10%</u>
<u>1.40 or greater, but less than 1.50</u>	<u>15%</u>
<u>1.50 or greater</u>	<u>20%</u>

**Sec. 2. 24-A MRSA §2366, sub-§6, is amended to read:**

**6. Mandatory deductible.** A deductible shall apply to all workers' compensation insurance policies issued to employers in the Accident Prevention Account which meet the following qualifications:

A. A net annual premium of ~~\$12,000~~ \$20,000 or more subject to adjustment pursuant to this section in this State; and

B. A premium not subject to retrospective rating; and

C. The employer's threshold loss ratio, as determined under subsection 4, paragraph B, subparagraph (1), is 1.00 or greater.

The deductible shall be \$1,000 a claim but shall apply only to wage loss benefits paid on injuries occurring during the policy year. In no event may the sum of all deductibles in one policy year exceed the lesser of 15% of net annual premium or \$25,000. Each loss to which a deductible applies shall be paid in full by the insurer. After the policy year has expired, the insurer shall be reimbursed by the amount of the deductibles by the employer. This reimbursement shall be considered as premium for purposes of cancellation or nonrenewal.

For purposes of calculations required under this section, losses shall be evaluated 60 days from the close of the policy year.

~~The superintendent shall report to the joint standing committee of the Legislature having jurisdiction over insurance by January 30, 1989, regarding the appropriateness of the initial premium level set in paragraph A.~~

~~After any adjustment of the premium level in 1989 in response to the superintendent's report, the superintendent may adjust the premium level through rulemaking if inflationary factors or rate increases warrant any changes.~~

Beginning July 1, 1991, the superintendent shall, by rule, annually adjust the \$20,000 premium level established in this subsection to reflect any change in rates for the Accident Prevention Account and any change in wage levels in the preceding calendar year. Changes in wage levels shall be determined by reference to the change in the state average weekly wage, as computed by the Bureau of Employment Security. Any adjustment shall be rounded off to the nearest \$1,000 increment.

This subsection shall take effect on the effective date of the first approved rate filing after the effective date of this Act.

**Sec. 3. 24-A MRSA §2367, sub-§§1 to 3, are amended to read:**

**1. Premium surplus.** If the superintendent determines that premiums collected from the insureds in the residual market and investment income allocable to those premiums are greater than the incurred losses and expenses attributable to the risks in that market, the superintendent shall order an appropriate credit applied to the premiums paid by policyholders in the residual market and employers who were policyholders during the policy year for which the surplus was determined but who have since become self insured.

**2. Premium deficit.** Payment of any premium deficit shall be determined in the following manner.

A. If the superintendent determines that premiums and investment income attributable to those premiums are less than incurred losses and expenses in the residual market, the superintendent shall then determine the rate of return for the insurance industry in the entire Maine workers' compensation market. If the rate of return is found, considering all relevant factors, to be less than reasonable, the superintendent shall order a surcharge on premiums paid by insureds in both the voluntary and involuntary markets and employers who were in either market during the policy year for which the deficit was determined but who have since become self insured.

B. Any deficit determined by the superintendent pursuant to paragraph A shall not be the responsibility of the insurers on an individual or collective basis but shall rather be the financial obligation of all insured employers in the State, including employers who were insured during the policy year for which the deficit has been determined but who have since become self-insured. The surcharge shall be an amount at least to offset the adverse cash flows resultant from the deficiency, provided that the application of such surcharge does not produce a rate of return in excess of a just and reasonable profit in the entire Maine workers' compensation market.

C. Beginning in 1991, the superintendent, after hearing and only if the rates in the entire workers' compensation market are inadequate to produce a reasonable rate of return, shall determine as of March 15th of each year whether insurers have in good faith made their best efforts to maximize the number of risks in the voluntary market. If the superintendent's determination is affirmative, the surcharge in paragraph A shall be applied.

If the determination is negative, then the superintendent shall determine the percentage of workers' compensation insurance, by premium volume, that has been written voluntarily statewide. If the premium volume in the voluntary market is greater than or equal to the amount specified in the table below, then the surcharge in paragraph A shall be applied.

Policy Year	Premium Volume
1989	50%
1990	60%
1991 and later	70%

If the superintendent determines that the percentage of premium in the voluntary market is less than the percentage in the table above, the deficit collectible from insured employers shall be reduced as follows: For each reduction of 5%, or part thereof, below the required percentage, the total deficit amount shall be reduced by 10% subject to a maximum reduction of 50% of the deficit.

**3. Application of credit or surcharge.** Credits or surcharges ordered by the superintendent shall apply to policies issued or renewed during the calendar year after the order of the superintendent is issued or for such other period as the superintendent may order. In the case of an employer who was insured during the policy year for which the surplus or deficit has been determined but who is now self-insured, individually or as part of a group, the superintendent shall determine that employer's premium equivalent upon which the credit or surcharge shall be based. In the case of a credit, the superintendent shall also determine the method of payment of that employer's credit.

Sec. 4. 24-A MRSA §2367, sub-§6, is repealed.

Sec. 5. 39 MRSA §23, sub-§1, ¶A, is enacted to read:

A. If an insurer offers or purports to renew a contract for workers' compensation insurance, but on less favorable terms to the insured or at higher rates or a higher rating plan, the insurer must notify the contract holder of the new terms or rates at least 30 days before those terms or rates are to take effect. The contract holder may elect to cancel the renewal policy within 30 days after receiving this notice. Earned premium for the period of coverage for any time that the renewal contract was in force shall be calculated pro rata at the lower of the current or previous year's rate. If the insured accepts the renewal, the premium increase, if any, and other changes shall take effect no earlier than the 31st day after notice is delivered to the contract holder.

**Sec. 6. Application.** Sections 1, 2 and 5 of this Act apply only to workers' compensation insurance policies issued or renewed on or after the effective date of this Act. Section 3 of this Act applies retroactively to November 20, 1987.

### STATEMENT OF FACT

This bill implements the recommendations of a study conducted by the Joint Standing Committee on Banking and Insurance. The following changes are made to present law.

Section 1 of the bill amends the eligibility criteria for application of the premium surcharge penalty to employers in the workers' compensation Accident Prevention Account. The bill adds an additional requirement that an employer have a threshold loss ratio of 1.00 or greater before the premium surcharge penalty may apply. The threshold loss ratio is calculated by dividing an employer's actual incurred losses over the 3-year reporting period by the premium charged to that employer during the same period, except that if any single claim in the 3-year reporting period exceeds the premium paid by that employer in the year that the loss occurred, that loss will be limited to the employer's premium amount for the year in which the claim was initiated. This formula limits the effect of a single large claim, on an employer's loss experience, preventing employers whose high loss ratio is due primarily to a single expensive claim from falling subject to the premium surcharge penalty.

Section 2 of the bill amends the criteria for application of mandatory deductibles to employers in the Accident Prevention Account. The bill increase the premium threshold for application of mandatory deductibles from \$12,000 to \$20,000 and provides for the annual adjustment of this level,

by rule of the Bureau of Insurance, to account for changes in rates and payroll. Changes in payroll levels are determined with reference to any change in the state average weekly wage. Further, the bill establishes a threshold loss ratio of over 1.0 as a prerequisite to application of the mandatory deductible.

Section 3 of the bill clarifies those provisions of current law that describe those employers who are subject to the potential premium surcharges or credits authorized by the so-called "Fresh Start" provisions. A question has arisen concerning which employers will be subject to a premium surcharge, if any is ordered by the superintendent. The primary question is whether employers who were part of the commercial insurance market in the policy year on which the surcharge is based, but who have since become approved for self-insurance or have joined an approved group self-insurance plan, will be subject to any surcharge. The current statutory language is not clear as to whether these employers are obligated to pay the surcharge or not. The bill clarifies that those employers who were part of the insurance market in the policy year for which a deficit or surplus has been determined but who have since become self insured, either as an individual or as part of a group self-insurance plan, shall pay or receive their proportionate part of the deficit or overcharge.

Section 4 of the bill repeals obsolete statutory language.

Section 5 of the bill requires a workers' compensation insurance carrier to provide an employer with at least 30 days' notice of any impending increase in premium. If this notice is not provided at least 30 days before the policy renewal date, the employer has 30 days after receiving the notice in which to elect to cancel the renewed policy.

Section 6 governs the application of the bill. Sections 1, 2 and 5 of the bill will apply only to workers' compensation insurance policies issued on or after the bill's effective date. Section 3 of the bill applies retroactively to November 20, 1987, the date on which the original "Fresh Start" provisions were enacted. Since section 3 clarifies the meaning of those provisions, it is made retroactive to the original effective date of those provisions.

APPENDIX II.

SECOND REGULAR SESSION

ONE HUNDRED AND FOURTEENTH LEGISLATURE

Legislative Document

No.

STATE OF MAINE

IN THE YEAR OF OUR LORD  
NINETEEN HUNDRED AND NINETY

AN ACT To Create a State Insurance Fund

Be it enacted by the People of the State of Maine as follows:

Sec. 1. 24-A MRSA §401, is amended to read:

§401. "Mutual" insurer defined

A "mutual" insurer is an incorporated insurer without permanent capital stock, and the governing body of which is elected by its policyholders or those policyholders specified in its charter, or by any reasonable combination of its policyholders, guaranty fund stockholders, or guaranty fund certificate holders, or by any other reasonable method. The Maine State Insurance Fund created in Title 39, chapter 7, is deemed to be a "mutual" insurer when organized under this Title.

Sec. 2. 39 MRSA §2, sub-§§7 and 8, are amended to read:

7. **Industrial accident insurance policy.** "Workers' compensation insurance policy" shall mean a policy in such form as the Insurance Superintendent approves, issued by any stock or mutual casualty insurance company or association that may now or hereafter be authorized to do business in this State, or issued by the Maine State Insurance Fund, which in substance and effect guarantees the payment of the compensation, medical benefits and expenses of burial provided for, in such installment, at such time or times, and to such person or persons and upon such conditions as in this Act provided. Whenever a copy of a policy is filed, such copy certified by the Insurance Superintendent shall be admissible as evidence in any legal proceeding wherein the original would be admissible.

8. **Insurance company.** "Insurance company" shall mean any casualty insurance company or association authorized to do business in this State, including the Maine State Insurance Fund, which may issue policies conforming to subsection 7. Whenever in this Act relating to procedure the words "insurance company" are used they shall apply only to cases in which the employer has secured the payment of compensation and other benefits by insuring such payment under an workers' compensation insurance policy, instead of furnishing satisfactory proof of his ability to pay compensation and benefits direct to his employees.

No insurance carrier shall be qualified to issue an workers' compensation insurance policy covering any employees working in this State unless it has and continuously maintains an employee or claims agent within this State empowered to investigate claims arising under this chapter; sign agreements for the payment of compensation as provided by this chapter; and issue drafts or checks in payment of obligations arising under this chapter in amounts of at least \$1,000.

Sec. 3. 39 MRSA c. 7 is enacted to read:

#### CHAPTER 7

#### MAINE STATE INSURANCE FUND

##### §251. Definitions

As used in this chapter, unless the context otherwise indicates, the following terms have the following meanings.

1. **Manager.** "Manager" means the manager of the Maine State Insurance Fund.

2. **Fund.** "Fund" means the Maine State Insurance Fund created in section 252.

3. **Board.** "Board" means the board of directors of the Maine State Insurance Fund.

##### §252. Creation; purpose; organization of the fund

1. **Fund created.** The Maine State Insurance Fund is created as a nonprofit independent public corporation. The fund must be organized as a domestic mutual insurance company under Title 24-A.

2. **Purpose.** The fund is established for the purpose of providing workers' compensation insurance to employers of this state at the lowest possible cost and with the highest level of service consistent with reasonable actuarial principles and the financial integrity of the fund.

3. Board of directors. The fund's board of directors shall consist of seven members. In addition, the Commissioner of the Department of Labor and the manager of the fund shall be ex officio members.

A. The initial board of directors shall be appointed by the governor and shall consist of seven members and the Commissioner of the Department of Labor. The Governor shall initially appoint one member for a one-year term, 2 members for 2-year terms, 2 members for 3-year terms and 2 members for 4-year terms. After the terms of the initial board members expire, the governor shall appoint one board member in each year. The remaining three board members shall be chosen by the fund's policyholders.

B. After the terms of the initial board members expire, each board member must represent a policyholder and may be an employee of a policyholder. At least two board members must represent private, for profit, enterprises. One of the 4 members appointed by the Governor must represent the State. No members of the board may represent or be an employee of an insurance company.

C. Except as provided for initial appointments, each board member shall hold office for a 4-year term and until a successor is appointed and qualifies. Vacancies shall be filled for the remainder of the unexpired term in the same manner as the former board member was selected.

D. The board shall annually elect a chair from among its members and any other officers that it considers necessary for the performance of its duties.

E. Four members constitute a quorum of the board. No business may be acted on without a quorum being present. All board decisions must be made by majority vote of the board. The board shall set its own compensation, which may not exceed \$50 per day and expenses. The board shall adopt by-laws and shall determine the time and place of the board's regular meetings and the method for calling special meetings.

4. Fund management. The board has exclusive management and control of the fund.

5. Powers and duties of the board. The board has full power, authority, and jurisdiction over the fund.

A. The board may perform all acts necessary or convenient in the exercise of any power, authority, or jurisdiction over the fund, either in the administration of the fund or in connection with the insurance business to be carried on by it under this chapter, as fully and completely as the governing body of a private insurance carrier to fulfill the purposes of this chapter.

B. The board shall discharge its duties with the care, skill, prudence and diligence under the circumstances that a prudent director, acting in a similar capacity and familiar with such matters would use in conducting a similar enterprise and purpose.

C. The board may appoint investment managers to manage, acquire or dispose of any of the fund's assets. An investment manager may be designated as an "investment agent."

(1) An investment manager is any fiduciary who has been designated by the board to manage, acquire or dispose of the fund's assets. The investment manager shall acknowledge in writing that it is a fiduciary under the fund.

(2) The board may delegate its investment powers to investment managers of the fund. The purchase or sale of any securities by an investment manager shall be in the name selected by the board. The authority of an investment manager to purchase or sell such securities for the fund must be evidenced by written authority executed by the manager of the fund.

(3) The board may enter into agreements with an investment manager setting forth the investment manager's investment powers and limitations. The board shall require an investment manager to keep the board currently informed as to the nature and amount of the investments made for the fund by the investment manager. An investment manager is subject to the board's instructions.

6. Manager. The fund is under the administrative control of the manager appointed by the board under section 255.

7. Personal liability excluded. The members of the board and officers or employees of the fund are not liable personally, either jointly or severally, for any debt or obligation created or incurred by the fund.

#### §253. Power to insure

1. Insure workers' compensation liability. The fund may insure an employer only against liability for compensation and benefits under this Title or under the United States Longshoremen's and Harbor Workers' Compensation Act, 1927 Public Law, No. 803, 44 Stat 1424, as amended. The fund shall insure the State as an employer against its liability for compensation and benefits under this Title or under the United States Longshoremen's and Harbor Workers' Compensation Act, 1927 Public Law, No. 803, 44 Stat 1424, as amended.

#### §254. General powers

1. Powers. For the purpose of exercising the specific powers granted in this chapter and effectuating the other purposes of this chapter, the fund may:

A. Sue and be sued;

B. Have a seal and alter it at will;

C. Make, amend, and repeal rules relating to the conduct of the business of the fund;

D. Enter into contracts relating to the administration of the fund or claims against employers insured by the fund and for any other purpose consistent with this chapter;

E. Rent, lease, buy, pledge, mortgage, or sell property in its own name and construct or repair buildings necessary to provide space for its operations;

F. Declare a dividend when there is an excess of assets over liabilities and minimum surplus requirements as consistent with Title 24-A;

G. Pay medical expenses, rehabilitation expenses, compensation due claimants of insured employers, pay salaries, and pay administrative and other expenses;

H. Hire personnel and set salaries and compensation. The state personnel law does not apply to the fund's hiring of employees or to any of the fund's employees. The State Employees Labor Relations Act, Title 26, chapter 9-B, does not apply to the fund and its employees;

I. Issue guaranty fund certificates, surplus notes or debentures payable out of surplus, borrow money, and agree to pay any rate of return with respect to any guaranty fund certificate, surplus note, debenture, or other instrument, calculated in any manner, and upon such other terms as the board of directors approve; and

J. Perform all other functions and exercise all other powers of a domestic mutual insurance company.

#### §255. Manager

1. Appointment, qualifications. The board shall appoint a manager of the fund who shall be in charge of the day-to-day operation of the fund. The manager must have proven successful experience as an executive at the general management level. The manager shall receive compensation as set by the board and shall serve at the will of the board.

2. Bond. Before entering on the duties of the office, the manager must qualify by giving an official bond in an amount and with sureties approved by the board. The manager shall file the bond with the secretary of state. The fund shall pay the premium for the bond from the account established in section 257.

#### **§256. Manager's powers**

Subject to the authority of the board and the provisions of this chapter, the manager has the powers and duties prescribed in this section.

1. Safety inspections; loss control services. The manager shall have safety inspections of risks made and advisory services on safety and health measures furnished to employers to the maximum extent possible, consistent with the financial integrity of the fund.

2. Disbursement of funds. The manager may act for the fund in collecting and disbursing money necessary to administer the fund and conduct the business of the fund.

3. Abstract summary. The manager shall have an abstract summary of any audit or survey conducted.

4. Reinsurance. The manager may reinsure all or part of any risk and may enter into agreements of reinsurance in the same way and to the same extent as other insurance carriers.

5. General authority. The manager may perform all acts necessary in the exercise of any power, authority, or jurisdiction over the fund, either in the administration of the fund or in connection with the insurance business to be carried on by the fund under this chapter, including the establishment of premium rates.

#### **§257. Account**

1. State compensation account. There is created and established under the jurisdiction and control of the fund a revolving account known as the "state compensation account." The account shall not lapse. The manager shall deliver all money collected or received under this chapter to the account. The money in the account may be used by the fund in carrying out its purposes under this chapter.

2. Property fund. All premiums and other money paid to the fund, all property and securities acquired through the use of money belonging to the fund, and all interest and dividends earned upon money belonging to the fund and deposited or invested by the fund, are the sole property of the fund and shall be used exclusively for the operation and obligations of the fund. The money of the fund is not state money. The property of the fund is not state property.

3. No state appropriation. The fund shall not receive any state appropriation at any time other than for the purpose of initial capitalization and initial administrative expenses, as provided in section 261.

4. Investment of money in fund. The board may invest money in the state compensation account in investments permitted by law for a mutual insurance company. When selecting investments, the board's primary goal shall be the financial integrity of the fund, but when investments of otherwise equal quality exist, the board shall give preference to any investment that would provide a direct benefit to the people of this State.

#### **§258. Application of state laws**

The fund shall not be considered a state agency or other instrumentality of the state for any purpose. The fund is subject to all state laws governing or applying to a private mutual insurance company, including, but not limited to, Title 24-A, chapters 5 to 17. The insurance operations of the fund are subject to all those provisions of Title 24-A and of this Title applicable to a private insurance company that writes workers' compensation insurance, including, but not limited to, Title 24-A, chapter 25, subchapter II. The superintendent of insurance has the same powers with respect to the board as the superintendent has with respect to a private workers' compensation insurer under Title 24-A and Title 39. The fund is subject to the same income tax liability as a private mutual insurance company in this state under Title 36, Part 8.

#### **§259. Private independent insurance agents**

Private independent insurance agents licensed to sell workers' compensation insurance in this state may sell insurance coverage for the fund according to rules adopted by the board. The board shall by rule also establish a schedule of commissions which the fund will pay for the services of an agent. This section does not prevent the fund from writing insurance coverage for employers without the assistance of private independent insurance agents.

#### **§260. Reports and information**

1. Annual report. The manager shall submit an annual report to the governor and legislature indicating the business done by the fund during the previous year and containing a statement of the resources and liabilities of the fund and any other information considered appropriate by the manager.

2. Statistical and actuarial data. The fund shall compile and maintain statistical and actuarial data related to the determination of proper premium rate levels, the incidence of work-related injuries, costs related to those injuries, and any

other data that the fund considers desirable. The fund shall provide this data to the Superintendent of Insurance, the chair of the Workers' Compensation Commission, and the Department of Labor upon request.

#### **§261. Funding**

**1. Fund becomes operational upon appropriation.** The fund shall become operational only upon the receipt of funds provided by appropriation of the Legislature. The board may defer acceptance of all or part of any such appropriation to the time that it desires, but not more than 2 years from the date of the appropriation. Any amount accepted by the fund, plus interest at the rate of eight percent a year calculated from the time that the fund accepts the appropriation, shall be amortized by the State Treasurer over a ten-year period and shall be repaid by the fund to the General Fund in equal installments at the end of each fiscal year. The State Treasurer shall determine the date of the first payment, provided that the fund shall not begin repayment unless there exists sufficient earned surplus to comply with state law. Repayment shall then begin under this section when sufficient earned surplus exists.

**2. Guaranty fund certificates, surplus notes or debentures.** Money advanced to the fund under subsection 1 shall be evidenced by guaranty fund certificates that permit the issuance of other guaranty fund certificates, surplus notes, debentures, or other instruments with equal rights to payment out of surplus of the fund. In the event of any insufficiency, payments with respect to guaranty certificates may be made pro rata based on outstanding principal amounts of guaranty certificates, surplus notes, debentures, or other instruments with equal rights. Any guaranty fund certificates or other instruments previously issued to evidence any money advanced to the fund under subsection 1 shall be exchanged by the Treasurer of State for restated certificates in form and substance consistent with this section in order to facilitate the issuance by the fund of other guaranty fund certificates, surplus notes, debentures, or other instruments as provided in this section. Any amounts accrued but unpaid pursuant to the terms of any outstanding guaranty certificate, surplus note, debenture, or other instrument shall be deemed to be money advanced for the purposes of this chapter.

**Sec. 4. State government required to insure with fund.** When the Maine State Insurance Fund becomes operational upon the acceptance of a sufficient amount of a legislative appropriation under Title 39, section 261, the State shall purchase workers' compensation insurance from the Maine State Insurance Fund, covering all State employees. The insurance policy shall take effect on the first day of the next fiscal year following operational status of the Maine State Insurance Fund. All statutes in conflict

with this requirement are repealed, effective on the first day of the next fiscal year. Any State employee whose employment is terminated due to this requirement shall be given preference in hiring for suitable positions within the Maine State Insurance Fund.

### STATEMENT OF FACT

This bill is part of the legislation submitted as a result of a study on the feasibility of creating a state workers' compensation insurance fund, conducted by a subcommittee of the Joint Standing Committee on Banking and Insurance. The bill establishes the Maine State Insurance Fund as an independent mutual insurance company. The purpose of the company is to provide workers' compensation insurance to the employers of this State at the lowest possible cost and with the highest possible level of services consistent with the financial integrity of the fund.

The structure of the Maine State Insurance Fund is patterned primarily after a similar state mutual insurance company established in Minnesota. The fund is not established as a state agency or instrumentality of the State in any way. It is created as an independent mutual insurance company and is subject to all other state laws governing mutual insurers to the same extent as any private mutual insurance company. The fund is under the direction of a board of directors, a majority of whom are appointed by the Governor. The remaining directors are selected by policyholders of the fund. All directors must represent a policyholder. The board of directors is authorized to hire investment managers to assist the board in investing the assets of the fund. The board of directors will select a manager who is responsible for the day-to-day direction of the fund's operation. The fund is authorized, but not required, to use private insurance agents to sell workers' compensation insurance.

The fund retains only limited connections with the State. The fund is required to insure the State for workers' compensation liability. As soon as the fund becomes operational, the State is required to purchase workers' compensation coverage from the fund. The fund will become operational only when it receives sufficient initial capitalization from the State. Separate legislation submitted as a result of the study authorizes a bond issue in the amount of \$10,000,000 to be made available to the fund to cover its initial capitalization and administrative expenses. This money will be loaned to the fund, which can draw upon the full \$10,000,000 as it finds necessary over a period of 2 years. This allows the fund to reduce its interest costs by accepting the State money only as the fund requires it. The fund will repay this money to the State, under a schedule established by the Treasurer of State, through a portion of its earned surplus.

The intent of this bill is to ensure the availability of affordable workers' compensation insurance to the employers of this State, particularly small employers. State insurance funds in other states have proven to be effective vehicles to hold down the costs of workers' compensation insurance and to provide better services to employers who insure with those state funds. This bill ensures that a neutral, non-profit alternative to the commercial insurance industry exists in the State that will assist employers in obtaining workers' compensation insurance at a reasonable cost and will assist the state in regulating and evaluating the performance of private workers' compensation insurance carriers.

APPENDIX III.

SECOND REGULAR SESSION

ONE HUNDRED AND FOURTEENTH LEGISLATURE

Legislative Document

No.

STATE OF MAINE

IN THE YEAR OF OUR LORD  
NINETEEN HUNDRED AND NINETY

SECOND REGULAR SESSION

ONE HUNDRED AND FOURTEENTH LEGISLATURE

Legislative Document

No.

RESOLUTION, Proposing an Amendment to  
the Constitution of Maine to Ensure the  
Financial Integrity of the Maine State Insurance Fund

**Constitutional amendment. RESOLVED:** Two thirds of each  
branch of the Legislature concurring, that the following  
amendment to the Constitution of this State be proposed:

SECTION 20. All of the assets, and proceeds or income  
therefrom, of the Maine State Insurance Fund or any successor  
fund and all premiums paid to or reserves or surplus held by  
the fund shall be held, invested or disbursed exclusively by  
the fund and shall not be encumbered for, or diverted to, any  
other purpose.

**Constitutional referendum procedure; form of question;  
effective date. RESOLVED:** That the city aldermen, town  
selectmen and plantation assessors of this State shall notify  
the inhabitants of their respective cities, towns and  
plantations to meet, in the manner prescribed by law for  
holding a statewide election, on on the Tuesday following the  
first Monday of November following passage of this Act to vote  
upon the ratification of the amendment proposed in this  
resolution by voting upon the following question:

"Shall the Constitution of Maine be amended to prevent the expenditure of the funds of the Maine State Insurance Fund for any purpose other than for the purposes of the Maine State Insurance Fund."

The legal voters of each city, town and plantation shall vote by ballot on this question, and shall designate their choice by cross or check mark placed within the corresponding square below the words "Yes" and "No." The ballots shall be received, sorted, counted and declared in open ward, town and plantation meetings and returns made to the Secretary of State in the same manner as votes for members of the Legislature. The Governor shall review the returns, and , if it appears that a majority of the legal votes are in favor of the amendment, the Governor shall proclaim that fact without delay, and the amendment shall become part of the Constitution on the following January 1st.

#### **STATEMENT OF FACT**

This resolution is part of the legislation submitted as a result of a study on the feasibility of creating a state workers' compensation insurance fund, conducted by a subcommittee of the Joint Standing Committee on Banking and Insurance. The resolution proposes a constitutional amendment to prevent the State from seizing funds belonging to the proposed Maine State Insurance Fund. The amendment ensures that money held by the proposed Maine State Insurance Fund is used solely for its proper purposes.

APPENDIX IV.

SECOND REGULAR SESSION

ONE HUNDRED AND FOURTEENTH LEGISLATURE

Legislative Document

No.

STATE OF MAINE

IN THE YEAR OF OUR LORD  
NINETEEN HUNDRED AND NINETY

AN ACT to Authorize a Bond Issue in the Amount of  
\$10,000,000 to Provide Initial Capitalization  
of the Maine State Insurance Fund

**Preamble.** Two thirds of both Houses of the Legislature deeming it necessary in accordance with the Constitution of Maine, Article IX, Section 14, to authorize the issuance of bonds on behalf of the State of Maine to provide funds for the initial capitalization and administrative expenses of the Maine State Insurance Fund.

**Be it enacted by the People of the State of Maine as follows:**

**Sec. 1. Authorization of bonds to provide funds for the initial capitalization and administrative expenses of the Maine State Insurance Fund.** The Treasurer of State is authorized, under the direction of the Governor, to issue from time to time registered bonds in the name and on the behalf of the State in an amount not exceeding \$10,000,000 for the purpose of raising funds for the initial capitalization and administrative expenses of the Maine State Insurance Fund as authorized by section 6. The bonds shall be deemed a pledge of the full faith and credit of the State. The bonds shall not run for a longer period than 20 years from the date of the original issue of the bonds. Any issuance of bonds may contain a call feature at the discretion of the Treasurer of State with the approval of the Governor.

**Sec. 2. Record of bonds issued to be kept by the State Auditor and Treasurer of State.** The State Auditor shall keep an account of the bonds, showing the number and amount of each, the date when payable and the date of delivery of the bonds to the Treasurer of State who shall keep an account of each bond showing the number of the bond, the name of the successful bidder to whom sold, the amount received for the same, the date of sale and the date when payable.

**Sec. 3. Sale; how negotiated; proceeds appropriated.** The Treasurer of State may negotiate the sale of the bonds by direction of the Governor, but no bond may be loaned, pledged or hypothecated on behalf of the State. The proceeds of the sale of the bonds, which shall be held by the Treasurer of State and paid by the Treasurer of State upon warrants drawn by the State Controller, are appropriated to be used solely for the purposes set forth in this Act. Any unencumbered balances not accepted by the Maine State Insurance Fund within 2 years after the funds are made available to it shall lapse to the debt service account established for the retirement of these bonds.

**Sec. 4. Interest and debt retirement.** Interest due or accruing upon any bonds issued under this Act and all sums coming due for payment of bonds at maturity shall be paid by the Treasurer of State.

**Sec. 5. Disbursement of bond proceeds.** The proceeds of the bonds set out in section 6 shall be expended as provided in the Maine Revised Statutes, Title 39, section 261.

**Sec. 6. Allocations from General Fund Bond Issue; Maine State Insurance Fund.** The proceeds of the sale of bonds shall be expended as designated in the following schedule:

Initial capitalization and	\$10,000,000
administrative expenses of the	
Maine State Insurance Fund	

**Sec. 7. Contingent upon ratification of bond issue.** Sections 1 to 6 shall not become effective unless and until the people of the State have ratified the issuance of bonds as set forth in this Act.

**Sec. 8. Appropriation balances at year end.** At the end of each fiscal year, all unencumbered appropriation balances representing state money shall carry forward from year to year. Bond proceeds which have not been expended within 10 years after the date of the sale of the bonds shall lapse to General Fund debt service.

**Sec. 9. Bonds authorized but not issued.** Any bonds authorized but not issued, or for which bond anticipation notes have not been issued within 5 years of ratification of this Act, shall be deauthorized and may not be issued, provided that the Legislature may, within 2 years after the expiration of that 5-year period, extend the period for issuing any remaining unissued bonds or bond anticipation notes for an additional amount of time not to exceed 5 years.

**Sec. 10. Statutory referendum procedure; submission at statewide election; form of question; effective date.** This Act shall be submitted to the voters of the State of Maine at a statewide election to be held on the Tuesday following the first Monday of November following passage of this Act. The city aldermen, town selectmen and plantation assessors of this State shall notify the inhabitants of their respective cities, towns and plantations to meet, in the manner prescribed by law for holding a statewide election, to vote on the acceptance or rejection of this Act by voting on the following question:

"Do you favor a \$10,000,000 bond issue for initial capitalization and administrative expenses of the Maine State Insurance Fund to enable it to write workers' compensation insurance coverage for employers in this State?"

The voters of each city, town and plantation shall vote by ballot on this question and shall designate their choice by a cross or check mark placed within a corresponding square below the word "Yes" or "No." The ballots shall be received, sorted, counted and declared in open ward, town and plantation meetings and returns made to the Secretary of State in the same manner as votes for members of the Legislature. The Governor shall review the returns and, if it appears that a majority of the voters are in favor of the Act, the Governor shall proclaim that fact without delay, and the Act shall become effective 30 days after the date of the proclamation.

The Secretary of State shall prepare and furnish to each city, town and plantation all ballots, returns and copies of this Act necessary to carry out the purpose of this referendum.

#### **STATEMENT OF FACT**

This bond issue is part of the legislation submitted as a result of a study on the feasibility of creating a state workers' compensation insurance fund, conducted by a subcommittee of the Joint Standing Committee on Banking and Insurance. The bond issue provides \$10,000,000 for the initial capitalization and administrative expenses of the proposed Maine State Insurance Fund. These funds would have to be repaid to the State by the proposed Maine State Insurance Fund as provided in other legislation submitted from the study.



APPENDIX V.

STATE OF MAINE


DEPARTMENT OF PROFESSIONAL AND FINANCIAL REGULATION  
BUREAU OF INSURANCE

September 19, 1989

**TO** Gilbert Brewer, Legislative Analyst  
Office of Policy and Legal Analysis  
State House Station #13

**FROM** Richard E. Johnson, Property/Casualty Actuary

**SUBJECT** Workers' Compensation State Fund Study



In response to a request from the subcommittee, I am forwarding to you size of risk data for Maine. The data was obtained from NCCI and is based on policies issued during the period June 1986 through May 1987.

<u>Premium Range</u>	<u>Risk Count</u>	<u>Total Payroll</u>	<u>Total Premium</u>
\$ 0 - 100	3,377	\$ 39,152,033	\$ 156,476
101 - 299	4,963	181,455,763	949,646
300 - 499	3,118	93,903,102	1,223,317
500 - 749	2,643	102,950,948	1,602,963
750 - 999	1,846	89,436,342	1,606,862
1,000 - 1,749	3,291	204,719,832	4,351,488
1,750 - 2,499	1,750	166,423,719	3,647,335
2,500 - 4,999	2,855	301,626,516	10,030,812
5,000 - 99,999	4,197	2,316,564,898	78,697,672
100,000 - 499,999	235	930,400,601	46,171,214
500,000 or more	28	399,999,106	32,812,233
	28,303	4,826,632,860	181,250,018

REJ/jet



## FOOTNOTES

<sup>1</sup>39 MRSA §23.

<sup>2</sup>Summerville & Weisner, A Study of the Feasibility of Establishing a Workers' Compensation Competitive Fund in the State of Rhode Island, September 1988.

<sup>3</sup>American Association of State Compensation Insurance Funds, AASCIF 1988 Fact Book, July 1988.

<sup>4</sup> Hawaii statutes, c. 386A; Conversation with Rep. Dwight Takemine, Chair, Hawaii House Committee on Labor.

<sup>5</sup>L.D. 1788, 107th Legislature, 1975.

<sup>6</sup>See e.g. L.D. 908, 109th Legislature, 1979  
L.D. 1412, 110th Legislature, 1981  
L.D. 495 & L.D. 497, 111th Legislature, 1983  
L.D. 1023 & L.D. 1122, 112th Legislature, 1985  
L.D. 835, 113th Legislature, 1987.

<sup>7</sup>24-A MRSA §2366.

<sup>8</sup>24-A MRSA §2366, sub-§6.

<sup>9</sup>Testimony of Richard Johnson, Maine Bureau of Insurance Actuary.

<sup>10</sup>Figures obtained from Maine Bureau of Employment Security; based on 1988 increase of 5.3% and projected 1989 increase of 4.1%.

<sup>11</sup>24-A MRSA §2367.

<sup>12</sup>24-A MRSA §2367, sub-§2, ¶C.

<sup>13</sup>Response of Hanover Insurance Co. to subcommittee request for information.

<sup>14</sup>Testimony of Gary Robb, vice-president, Industrial Indemnity, Inc. at subcommittee meeting of October 5, 1989.

<sup>15</sup>Huber, The Residual Market: Mending the Safety Net, NCCI Digest, September 1986.

<sup>16</sup>Figures relating to premium paid by businesses in Maine are based on data provided to the Maine Bureau of Insurance by NCCI; data was forwarded to the subcommittee by Richard Johnson, Maine Bureau of Insurance Actuary. This data appears as Appendix V to this report. Figures relating to the composition of the 1988 residual market were provided to the NFIB by NCCI and forwarded to the subcommittee by David Clough.

<sup>17</sup>Hanover Insurance Co. response to subcommittee questionnaire identified 6 business classes covered under their "Citizens" plans for small businesses. Rick Cote, Gen'l. Mgr. for commercial lines with Hanover Insurance, stated in a telephone conversation with subcommittee staff that Hanover was seeking small business accounts in classes where Hanover perceived rate adequacy to exist.

<sup>18</sup>Testimony of Merle Parsley at subcommittee meeting of September 11, 1989; testimony of Richard Young at subcommittee meeting of October 5, 1989; Summerville & Weisner, supra nt. 1 at pp. 21-22.

<sup>19</sup>Martin, Comparing Comp Systems: Study Shows State Funds Are More Efficient, Business Insurance, January 18, 1982.

<sup>20</sup>Ibid.

<sup>21</sup>State Compensation Insurance Funds: Their Purpose and Impact, AASCIF, September 1980.

<sup>22</sup>Huber, supra nt. 15; and Fromm, Depopulating the Residual Market, NCCI Digest, July 1989.

<sup>23</sup>Fromm, Depopulating the Residual Market, NCCI Digest, July 1989.

<sup>24</sup>Supra, nt. 21.

<sup>25</sup>Testimony of Mike St. Peter at subcommittee meeting of October 5, 1989.

<sup>26</sup>Testimony of Richard Young, supra nt. 18.

<sup>27</sup>39 MRSA §21-A, sub-§1.

<sup>28</sup>PL 1987, c. 559.

<sup>29</sup>Testimony of Merle Parsley, supra note 18.

<sup>30</sup>Ibid.

<sup>31</sup>Testimony of Gary Robb, supra nt. 14.

<sup>32</sup>Results of NFIB membership poll conducted in 1989 and provided to the subcommittee by David Clough.

<sup>33</sup>30-A MRSA c. 201.

<sup>34</sup>26 MRSA c. 13.

<sup>35</sup>Supra nt. 4.

- <sup>36</sup>Ibid.
- <sup>37</sup>Constitution of Maine, Art. IX, Section 18.
- <sup>38</sup>Summerville & Weisner, supra nt. 2 at p. 29.
- <sup>39</sup>Ibid at p. 14.
- <sup>40</sup>Report of the Special Study Commission on Workers' Compensation, June 1984.
- <sup>41</sup>Testimony of Merle Parsley and Richard Young, supra nt. 18.
- <sup>42</sup>Ibid.
- <sup>43</sup>Supra nt. 40 at p. 43.
- <sup>44</sup>Estimated premium of approximately \$10,000,000 based upon actual state expenses in 1988-89 of \$8,828,099. 1988-89 cost figures provided by Maine Dept. of Administration.
- <sup>45</sup>Based on NCCI data submitted to Maine Bureau of Insurance, supra, nt. 16.
- <sup>46</sup>Supra note 40 at p. 40.
- <sup>47</sup>Results of questionnaire mailing conducted by subcommittee staff.
- <sup>48</sup>Results of Chamber study provided by Joel Russ at subcommittee meeting of October 5, 1989.
- <sup>49</sup>Testimony of Gary Robb, supra nt. 14, suggesting that state fund services are not equal to private sector services; also Martin, supra, nt. 19, suggesting that state funds generally do not provide services equal to the public sector's.
- <sup>50</sup>Article, unattributed Oregon newsweekly.
- <sup>51</sup>Kenney, Workers' Compensation State Funds: Are they Cheaper, 1989, Alliance of American Insurers.
- <sup>52</sup>Zeman, Insurance Guaranty Funds: The Constitutionality of Raids by State Legislatures, FICC Quarterly, Spring 1986.
- <sup>53</sup>Response of Hanover Insurance Co. to subcommittee questionnaire describing its "Citizens" plans for small employers.
- <sup>54</sup>Comments of Bruce Gerrity, Esq. at subcommittee meeting of October 5, 1989.

<sup>55</sup>Supra note 25.

<sup>56</sup>See 39 MRSA §55-B, benefits for partial incapacity limited to 400 weeks after maximum medical improvement (approx. 7 1/2 years).

<sup>57</sup>Testimony of various employers before the subcommittee; response to subcommittee questionnaire; responses to Chamber questionnaires as described by Joel Russ, Esq. at subcommittee meeting of October 5, 1989.