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Supreme Court upholds Workers' Comp interpretation of reform law

Supreme Court upholds Workers' Comp interpretation of reform law The Workers' Compensation Commission has properly applied the stricter benefit standards and other measures from last year's legislative overhaul of the state's insurance system for on-the-job injuries, the Supreme Court concluded Thursday. The ruling sides with the commission in rejecting a consolidated trio of challenges to its enactment of Senate Bill 2013 and its sweeping provisions. The 38-page, unsigned opinion said the commission properly set July 1, 2003, as the date for applying provisions that reduced partial permanent disability payments and to make permanent total disability awards more difficult to obtain. Injured workers had filed two of the challenges, arguing the date the injury occurred should govern which set of rules apply. An employer, Wampler Foods, filed the third challenge and argued the tighter standards should apply to cases that were decided by the commission before July 1, 2003, but are now under appeal. The commission contends the old rules apply in that setting and the Supreme Court agreed. The majority said the ruling should allow the commission to operate the system and apply the 2003 changes "in a fiscally responsible and sound manner." The ruling is unsigned, as it sets no legal precedent. Chief Justice Elliott "Spike" Maynard and Justice Warren McGraw both agreed with and dissented from the majority ruling, and may file separate opinions. Last month in an interview with The Associated Press, Workers' Compensation Executive Director Greg Burton said an adverse Supreme Court ruling would jeopardize the program because it would have required the state to pay about \$1.1 billion in claims. On Thursday, Burton praised the court for its ruling. "This decision by the court is the right decision for two reasons: it confirms that we are compensating injured workers fairly and in compliance with the language in Senate Bill 2013, and it allows us to continue with full implementation of the bill's provisions," he said. Lawyers for the injured workers and for Wampler Foods, now Pilgrim's Pride, did not respond to request for comment or could not be reached Thursday. The Legislature adopted the legislation to keep the program, which covers the state's injured workers, from bankruptcy. In the year the law has been in effect, the program has been able to save \$150 million by eliminating escalating payments for total disability claims based on changes in cost of living and the state's average weekly wage. It also has saved \$60 million by terminating benefits once claimants reach 70 years of age, and \$20 million by recognizing a new definition for permanent total disability claims. The agency plans to review nearly 7,000 such claims to determine continued eligibility, Burton said. CRIPPLING INJURY West Virginia's workers' compensation program is helping thousands of needy recipients. But it's also breaking the bank. People from all across the country used to come to McDowell County, in southern West Virginia, to dig for coal. The coal-field jobs are mostly gone now, but thousands of mine workers are still there, and unable to find work of even the most menial sort. Half the residents have not graduated

from high school, and the median household income is less than \$17,000--one of the lowest in the nation. There's a new leading industry in McDowell: workers' compensation. Residents take in as much money from the state workers' comp fund as they do from all wages put together. For many of the poorest, in McDowell and elsewhere, the fund has been a lifeline. But for the state itself, workers' comp is a disaster. A system intended to help injured employees has morphed into a social welfare program that the treasury cannot afford. Of the employees that receive workers' compensation in West Virginia, 25 percent are on "permanent total disability," compared with an average of 5 percent nationwide. Most PTD employees receive 67 percent of their salary tax free, and cost the state an average of \$500,000 over their lifetimes. As a result, the West Virginia workers' comp fund currently is in debt more than \$3 billion, which is the same amount that the entire state general fund spends in one year. Most states, at some point, have had problems with their workers' compensation systems. But in West Virginia, nearly everything that could go wrong with worker's comp has gone wrong. Last year, after learning that the system was projected to go bankrupt in 2005, the legislature made significant changes. But the system is still bleeding money--albeit a \$50 million loss this past fiscal year compared with \$250 million the year before. Whether the state can make workers' comp break even in the short term--and deal with the \$3.3 billion debt in the long term--may determine the fiscal health not only of the system but of West Virginia itself. "It's not so much political as an economic preservation issue," says state Senator Brooks McCabe, the architect of the 2003 reform bill. "If we want to stay afloat as a state, we have to fix workers' comp." Legislatures and commissions all over the country are tinkering with workers' comp these days, driven by unexpected costs and fears that higher fees to business may prove damaging to the economic climate. California made major changes earlier this year, reforming a system that had seen 15 percent increases in premiums every year for the past four years. Tennessee and Vermont passed reform legislation this year as well. No state, however, faces a dilemma like West Virginia's. A STATE EXPENSE Workers' comp is an entirely state-run program everywhere, but the rules differ radically from one place to another. In some states, the insurance coverage is provided by a combination of public and private sources; in others, the insurers are entirely private. Only five states run their systems the way West Virginia does, with the state itself as the exclusive insurer and bearer of risk. The method of funding is a major reason that workers' comp has run a deficit in West Virginia every year since the program was launched in 1913. "Everyone has their fingerprints on this problem," says Greg Burton, director of the state's Workers' Compensation Commission. "Previous governors, the Supreme Court, the legislature, claimants, lenders, attorneys. You can't blame one more than the others." Even so, a considerable amount of resentment has been directed toward former Governor Arch Moore, who announced in the mid-1980s that he was going to draw businesses to the state by cutting their premiums by one-third while keeping benefits at the same levels. West Virginia kept its benefit rates level, true to Moore's word, and the state treasury simply made up the difference--creating a bigger fiscal problem with each succeeding year. Legislators and governors who came after Moore were politically unwilling either to raise premiums back to the levels needed to break even or to cut benefits to match the system's assets. Shoddy accounting obscured the extent of the deficit until recently and there has been chronic mismanagement. Over a period of several years, employees of the workers' comp agency showed up for just 17 percent of claims appeals hearings, and a move to a "paperless" filing system was made before the computers were ready, permanently losing files in the process. Meanwhile, there was little effort to monitor fraud by claimants, employers or doctors. All of this occurred as the state's coal industry continued to contract, drawing down the system's income even further. "West Virginia's system has been a basket case for a number of years," says John Burton, dean of the school of management and labor relations at Rutgers University and a leading expert on workers' compensation. "Once the coal industry got less and less viable, the whole system began collapsing." The extent of the collapse became evident early last year. After the legislature's first attempt at reform legislation fell victim to a filibuster on the last day of the regular 2003 legislative session, Governor Bob Wise appointed a study commission to craft a reform bill. In the four months the group worked, the estimated unfunded liability of the system grew from \$2.5 billion to \$3.5 billion (largely because of accounting corrections). By the time the reform bill was

passed in June 2003, the system was projected to be two years away from bankruptcy, and the fund was paying out nearly \$1 million per day more than it was taking in. The fund's managers had to sell off many of their stock market investments just to keep cash flowing, and didn't have enough money on hand to make settlements that would have saved them money in the long run. For the short term, \$225 million was transferred into the system in order to keep it solvent. The funding came from a variety of sources, including federal tax-relief money and aid earmarked for victims of black-lung disease. But the state's overburdened general fund also had to swallow some of the expense. The Workers' Compensation Commission became a separate state agency with an independent Board of Managers, no longer replaceable at the whim of the governor. The commission was given new powers to crack down on fraud, with a fraud division twice the size of the previous one. And on the benefits side, the time period for temporary total disability was shortened from four years to two. Rehabilitation services, which previously had no time cut off, were limited to 52 weeks. The cuts in benefits--with no accompanying rate increases for businesses--are still a source of bitterness for labour groups, who feel that they are unfairly shouldering the burden. "We got a raw deal," says Jim Bowen, president of the state AFL-CIO. "It shouldn't be a total abuse of claimants. The legislature took it all out on the workers." DANGEROUS WORK Even if all the major players manage to adjust to the new rules, however, the fact remains that the state is facing a massive long-term debt. Lawmakers chose not to deal with the debt in the 2003 session, fearful that it would complicate the efforts at short-term reform. "We did not address the significant unfunded liability," McCabe says. "We didn't want to expend political capital until we fixed the underlying problem." Unfortunately, the underlying problem carries a \$4 billion price tag, and to say that there are no easy fixes is to understate the situation dramatically. Paying off the entire workers' comp debt today would require almost \$1,900 for every man, woman and child in the state. The state might consider bonding the debt for a fresh start, but bond payments would likely be at least \$200 million per year for 30 years; revenue would still need to be raised. Additionally, the West Virginia Supreme Court is currently considering a lawsuit charging that all workers' comp benefits should apply to the date that an injury was suffered, not the date that a claim was awarded. If the plaintiffs win, an employee who was injured in June 2003, but whose claim was awarded in August, would receive the more generous benefits of the law before it was rewritten. According to some estimates, an adverse ruling in that case would mean an immediate hit of \$120 million, with costs of more than \$1 billion over 20 years. "If we lose that case," says Greg Burton, the workers' comp director, "the chances of us surviving are slim." Ultimately, West Virginia may try to privatize the whole system. Currently, with \$3.3 billion in debt, that's not an option. "If there's an agency out there that would offer to take us private, we ought to run from them," Burton says. "Who would want to take over our deficit?" Privatization is no panacea in any case. There are private or partially private systems with major troubles, such as those in Florida and California, and state-run systems, such as the one in Ohio, that work well. But privatization might shield the state from ever again facing the degree of fiscal trouble it faces now. Meanwhile, it will be a struggle for West Virginia's workers' comp fund even to stem its cash flow problems under the 2003 reform law. Not everyone is convinced that is possible. "The best manager in the world couldn't fix it," insists economist Michael Hicks of Marshall University. "The best sea captain in the world couldn't fix the Titanic after it hit the iceberg." For legislator Brooks McCabe, on the other hand, there is simply no choice. "The ultimate deadline," he says, "is the survival of the fund. Bankruptcy cannot be allowed to happen." COMPENSATION & BENEFITS NEWS EEOC Okays Age Bias Exemption for Retiree Health Plans The Equal Employment opportunity Commission (EEOC) has approved a final regulation permitting employers to cut or end benefits to retirees when they become eligible for Medicare or comparable state retiree health benefits. The EEOC determined that this action would not violate the Age Discrimination in Employment Act (ADEA). The exemption is intended to address a growing concern that the ADEA might be construed to create an incentive for employers to eliminate or reduce retiree health benefits, according to Cari Dominguez, EEOC chair. The regulation implements a policy change that the EEOC adopted unanimously almost three years ago, and which was proposed as a regulation last July. DOL Says ERISA Will Not Cover HSAs Health savings accounts (HSAs) generally won't be "employee welfare benefit

plans" for the purposes of Title I of ERISA (the Employee Retirement Income Security Act), according to the Department of Labor's Employee Benefits Security Administration's Field Assistance Bulletin 2004-1 (www.dol.gov/ebsa/regs/fab_2004-1.html). "HSAs are personal health-care savings vehicles rather than a form of group health insurance," the bulletin said. It noted that funds deposited into an HSA generally may not be used to pay health insurance premiums, and that HSA beneficiaries have sole control of their accounts and are exclusively responsible for spending the funds in compliance with the tax code requirements. However, the bulletin noted that employer-sponsored high-deductible plans are covered under ERISA. Do Cash Balance Plans Actually Boost Costs? Two recent studies of cash balance plans find that employers' costs may climb higher after converting to those plans. Conversions also often mean new or increased defined contribution plan matches. A study by Watson Wyatt Worldwide (Washington, D.C.; www.watsonwyatt.com) reports that among 55 large companies that made the conversion to cash balance or pension equity plans after 1999, post-conversion costs rose by an average of 2.2%. The increase came after taking into account worker-protection measures used during conversions and to enhance 401(k) plans. In fact, the average cost increase would have been 5.9% if the survey had excluded seven companies that were at or near bankruptcy when they converted. "The charges that most companies convert to cash balance plans to slash costs or that they don't protect current employees near retirement, are simply not true," said Eric Lofgren, retirement practice director. A previous study by the consulting firm of conversions from 1999 and before did report a 1.4% average savings to companies. The earlier Watson Wyatt study found that companies contributed average pay credits of 5.1% of salary annually toward employees' retirement benefits. The new study found that rate was nearly identical, at 5.0%, despite the increase in overall costs. The new study reported that 89% of the companies provided transition benefits including choosing between the old and new plans (33%), grandfathering older workers under the prior formula (31%), and guaranteeing the "better" of the old or new arrangement to workers (13%). Watson Wyatt reports a steep and steady decline in the number of plan conversions in the past five years, due to the "legal uncertainty surrounding these plans," said Janemarie Mulvey, assistant director of research at Watson Wyatt and a co-author of the study. The Treasury Department has proposed legislation that would require expansive transition benefits to all workers during the conversion, but provides no clarification of the legality of past conversions. The 2004 Survey of Cash Balance Plans by Mellon Financial Corp.'s Human Resources & Investor Solutions (HR&IS) group (Secaucus, N.J.; call 201-553-6400 for a copy of the full report) studies design, cost, and communications of 150 plans that introduced cash balance plans since 1985. Employer accounting costs for such plans were expected to stay about the same or increase in almost two-thirds of the conversions from traditional defined benefit plans, taking into account the shifting of costs to other retirement savings programs such as 401(k) plans. Protection was provided during the conversion process by 90% of respondents, including grandfathering benefits (34%), transition credits (21%), grandfather benefits combined with transition credits (13%), and a choice or requirement to remain in the prior plan (13%).

Coface grows from state monopoly to global player LIKE several of France's most prominent companies today, the third-largest credit insurer in the world, Coface, started out as a state monopoly. Since it was privatized in 1994, it has expanded all the way to China and intends to become a leader on the US credit insurance market, which is still in its infancy. Created in 1946, Coface was originally in charge of credit insurance and state guarantees for French exports. Its monopoly therefore focused primarily on the credit quality of non-French companies. As a result, Coface's database is a lot more international than that of other domestic credit insurers and it has become the world leader in export insurance, in an extremely concentrated global credit insurance market. An estimated 75% of it is controlled by three players: Euler Hermes, Atradius (the former Gerling-NCM) and Coface. COMPANY BALANCE SHEETS "The small number of players in the credit insurance market can be explained by the sheer number of company balance sheets in Coface's underwriting system 40m," says Marc-Philippe Juilliard, insurance director at Fitch Ratings. "It would take a very long time for a competitor to set up something like that. It is a business with colossal entry barriers, with huge fixed costs and expertise requirements. You cannot go into that without a well-designed analysis system that has been thoroughly tested and

validated. The fact that it had a monopoly for decades made it easier for Coface to invest, and IT systems play a critical role." The company was floated in 2000 and, following a takeover bid by Natexis Banques Populaires in 2002, is now 98% owned by the bank. Coface still provides export insurance on behalf of the French state, but the percentage of such activities in its turnover is now under 6%, while it was closer to 50% two decades ago. Coface takes no credit risk in this activity and does not expose its equity capital. It is remunerated as an administrator and follows policy choices made by the French finance ministry, which remains liable for potential losses. Since the late 1980s, Coface has diversified its offering to provide such complementary services as credit information and debt collection. It is also one of very few players in the political risk insurance space, through its Unistrat subsidiary. The company is now fully owned by Coface, after it bought reinsurer Scor's 50% stake on June 2. Like other credit insurers, Coface suffered from the economic slowdown in 2001 and 2002, which boosted the number of bankruptcies and caused insurers to pay for more of their policyholders' outstanding commercial receivables. The company reacted by adopting a more restrictive underwriting policy and by drastically increasing rates. It managed to keep a stable turnover over the whole period. Its loss ratio was 57% in 2000, which soared to 78% in 2001, to 71% in 2002, before coming back down to 52% in 2003, on a comparable basis. "The company gained back 20 percentage points despite the fact that the global economy was not particularly flourishing in 2003, which shows that the recovery is indeed due to risk reduction and rate hikes," Mr Juilliard says. After its privatisation in 1994, Coface intensified its international expansion, which had started two years earlier with acquisitions in the UK and Italy. It then bought majority stakes in Allgemeine Kreditversicherung (AKC), Germany's third-largest domestic credit insurer, in 1996, as well as Austria's number one player, Oesterreichische Kreditversicherung, in 1997. ACQUISITION TRAIL In 2002 AKC acquired Gerling's credit insurance operations in the Netherlands and Denmark. Last year Coface made its first forays into China, by issuing the country's first credit insurance policy with partner Ping An. And in May it acquired the credit insurance business of Australian underwriting agency Dextra. But the company's most prominent strategic move in recent months probably is its plan to grow its business in the US. Coface has been active in the US market for over a decade, through a partnership with Continental Insurance, which later became CNA. "We were working with Coface on the export side," says Mike Ferrante, former head of CNA Credit and now president and chief executive of Coface North America Insurance. "They gave us expertise there while CNA handled the domestic side. Then, in December 31, 2002, Coface acquired CNA's book of business." STATE LICENCES Because of the country's heavy insurance regulations, Coface is still in the process of getting licensed in all 50 states. It currently still uses CNA as an issuing company, while acting as a managing general underwriter. To speed up the licensing process, Coface acquired Arkwright, a largely inactive insurance company, at the end of 2003, because it had licences in several states. "We are now in the process of getting that approved by the various regulators," Mr Ferrante adds. "We hope by the end of this year to be licensed in about 24 states, which will probably cover about 70% of our business. And we'll continue to use CNA in the other states, while we get the company licensed." According to Mr Juilliard, Coface definitely has a competitive edge to conquer this market. "Their big competitor on the US market in terms of export cover is AIG," he says. "There aren't many other players capable of providing credit information on foreign buyers, because you need to combine underwriting capacity, the knowledge of a very large number of companies in the world and good techniques; as well as get referenced in the credit insurance distribution channels." But the relative absence of serious competition also has to do with the fact that demand for credit insurance services in the US is still very low. "There is basically still a market to create," says Mr Ferrante. "Our biggest real competition is still self-insurance. We estimate the US credit insurance market may only represent \$400m, versus several billion in western Europe. It's really a developing market." He continues: "The nice thing about the US growth market is that it really isn't about swapping policyholders back and forth among the competitors. Opportunities come from convincing uninsureds to purchase the product." CNA's book was predominantly focused on the small to medium enterprise (SME) segment, ranging from \$2m to \$100m in sales. Mr Ferrante says the company will now be able to target larger corporations. "We will continue our emphasis on the SMEs," he explains, "but

we've also expanded into the larger segments, which are generally handled, from a distribution standpoint, by the big brokers. AIG, Atradius and Euler have been involved in that segment before CNA was, but we will be active now we are part of Coface." US GROWTH PREDICTION Mr Ferrante expects Coface to be able to obtain double-digit growth factors in the US "in the foreseeable future". "A lot of product awareness still needs to be created and the growth opportunities are outstanding, and we expect our growth rate to be in the 15% range in the next three years," he says. The group is also in the process of obtaining a licence in Canada, where it already operates through CNA, whose business will eventually be transferred to a new Canadian branch of French unit Coface SA. Expansion on the American continent will also involve the creation of a regional office in Mexico that will handle the entire Latin America platform, which comprises offices in Argentina, Chile, Brazil, Ecuador and Venezuela. This centralised office will, in turn, report directly to the Paris headquarters. Some 58 years after its inception, Coface now has little in common with the state monopoly it once was, and should continue to expand the reach of its brand in years to come.

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