# MAJOR REGULATIONS STANDARDIZED REGULATORY IMPACT ASSESSMENT SUMMARY

## STANDARDIZED REGULATORY IMPACT ASSESSMENT SUMMARY

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1. Statement of the need for the proposed major regulation.

During the past 15 years, from 2003 to the present, four insurance companies have gone insolvent largely because of their involvement with high deductible workers' compensation insurance policies. Nationally, these four companies had an estimated $624 million in combined incurred losses that were passed to the guaranty associations of the various states. Of the combined incurred losses, approximately $360 million occurred in California and were passed to the California Insurance Guaranty Association. Then through special assessments the remaining solvent insurers have to cover for the failings of other workers' compensation insurers who had insured employers with insufficient collateral. These insurer insolvencies can make it harder to pay for and secure medically necessary treatments for injured employees. The proposed regulation levels the competitive marketplace by stipulating that insurers require employers to properly collateralize their deductible obligations. The benefit of avoiding such future insolvencies lessens the risk of a situation where the remaining solvent insurers have to pay for the underwriting shortcomings of insurers who have not properly mitigated risks and might then face new assessments. This regulation will protect insurers, employers, and employees.

2. The categories of individuals and business enterprises who will be impacted by the proposed major regulation and the amount of the economic impact on each such category.

The regulation is expected to impact all industries (excluding federal, state and local governments as they are nearly all self-insured). Specifically, it is expected to impact employers with more than 100 employees that utilize workers’ compensation insurance policies with deductibles of $100,000 or more. Because insurers currently do not separate collateral by state or insurance line, the Department assumes that the total impact of the regulation will include impacts to California business enterprises that also operate in other states. The Department believes that given the size and complexity of the California economy, it is not reasonable to assume that the potential for adverse economic impact on California business enterprises is limited to only physical locations in the state. The Department prepared detailed economic impact estimates by industry at the upper-, middle-, and lower-range scenarios with variation in two key assumptions. These scenarios include the costs of securing collateral of 1, 2 and 3 percent as well as a range of current collateralization at 60, 70 and 80 percent, respectively (see SRIA Appendices A, B and C). Additionally, the Department prepared Appendix B-2, a subset of Appendix B that calculates California specific job and business impacts at the midrange cost and collateral assumptions.

3. Description of all costs and all benefits due to the proposed regulatory change (calculated on an annual basis from estimated date of filing with the Secretary of State through 12 months after the estimated date the proposed major regulation will be fully implemented as estimated by the agency).

The costs are estimated to be equal to the cost of fully collateralizing the deductible amount of an employers' workers' compensation policy (plus any additional deductible on a multi-line policy). The cost of securing collateral was estimated to be between 1 and 3 percent. The amount of collateral needed was estimated at three different ranges, based on the industry average and the Department's assumptions about the impacted insurers. At the mid-range estimate, which the department believes to be the most likely outcome, the aggregate direct costs to employers, including employers with multi-state policies is $21.4 million, and the estimated impact on total economic output is $46.4 million. At the same cost and collateral assumptions for physical locations in California, the estimated direct cost is $6 million, and total loss to output is $13 million.

The benefits are due to the anticipated managing of the risk of insurer insolvencies. As a result the guaranty fund would not need to assume claims responsibility for these insurers and would not have to assess the remaining solvent insurers and ultimately policyholders. The benefits are the same across the three different cost scenarios, as the variability with the estimates on the cost side is not anticipated to affect the benefits. The Department estimated that the total direct benefit, including employers with multi-state polices is $41.6 million (including a $1.7 million benefit to insurers, because assets will not need to be liquidated to pay claims), with the total benefit to output exceeding $90 million.

Specific to employers within California, the estimated direct benefit is $24 million (including a $1 million benefit to insurers, because assets will not need to be liquidated to pay claims). The estimated beneficial impact on total economic output is $52.1 million.
While the costs are predicted to be mostly stable, there are some variations anticipated due to the cost of obtaining collateral and the amount of collateralization currently required by each insurer. At the upper-range cost scenario estimate (SRIA Appendix C) the projected loss to output of $92.0 million, including multi-state policies, exceeds the $50 million threshold. This uppermost estimate assumes a 3 percent cost of securing collateral and the worst of the three possible shortfalls in the amounts employers have already collateralized, i.e. 60 percent.

The Department sought public input through a pre-notice public discussion held on March 16, 2018. Members of the public and interested parties were able to discuss the proposed regulation via video conference. The robust discussion included topics such as the size of impacted employers, insurers preferred types of collateral, the cost of obtaining the different types of collateral and industries that potentially would be impacted. In its invitation to the pre-notice public discussion, the Department listed two alternatives that were discussed and ultimately incorporated into the proposed regulations, and asked for additional alternatives. For more detail on what was discussed please see the attached pre-notice public discussion invitation.
The Department consulted industry experts, the 2016 Workers' Compensation Large Deductible Study published by the NAIC, and various statistical data including employment, receipts, and size of business. The Department's actuarial office provided empirical data and was able to analyze workers' compensation payout patterns to determine the aggregated direct cost and benefit impacts. Then size of business data was used to estimate the number of businesses that would be affected and the average impact on each business. The Department utilized RIMS II multipliers, published by the Bureau of Economic Analysis, to calculate the indirect and induced economic impacts and the industry specific job gains/losses.