Impacts of Legislation on Construction Companies: A Study on Workers' Compensation

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ABSTRACT: In the last two decades, several states have assessed possible alternatives to their state-chartered workers' compensation funds, specifically with respect to privatizing those funds. Such a decision in a state is critical for the construction industry (which typically employs a significant portion of the work force) in that state as privatization may have implications on the premiums that the companies pay, on the level-of-service they receive, and even on their ability to secure insurance. Within this context, the overall purpose of this study is to gather, synthesize, and present information with respect to the privatization of state-chartered workers' compensation funds to educate the members of the construction industry on this topic. In other words, this paper looks at workers' compensation history and key privatization issues in an effort to raise awareness among construction industry professionals. As such, this paper presents: (i) a general discussion on the state-chartered workers' compensation fund concept, (ii) a detailed discussion on the privatization experiences of four states, and (iii) overall findings of this study with respect to the issues that need to be considered when contemplating the privatization of a state-chartered workers' compensation fund. A qualitative research methodology was used which included an in-depth review of published documents and follow-up interviews with the stakeholders. The study is exploratory in nature and the limited results are used only to provide a case study reference, supporting the assertion that the construction industry needs to pay more attention to legislative issues. While not a direct outcome of this paper, since most of the cost drivers and requirements for workers' compensation are controlled by sources outside the corporate umbrella, it is suggested that construction industry as a whole increases its involvement in the legislative process to ensure that the potential impacts of pending legislation is understood by the construction companies.

Introduction

The construction industry is impacted by external costs, many of which result from regulations imposed by outside entities. While this is nothing new, the understanding of regulatory impacts plays an important role in both risk management and profitability. In many cases, regulatory costs of legislation may not be fully understood or be of such a peripheral nature that they are not followed until there is a significant negative impact. Increased awareness and involvement in the legislative process ensures that the construction industry is not only an informed constituent but a well-represented one. This paper looks at workers' compensation history and key privatization issues in an effort to raise awareness among construction industry professionals.

The relevance of understanding workers compensation from a construction management, construction engineering, and contractor's point of view is multifaceted. One of the first things owners wants to know about a general contractor or a subcontractor is their safety record. The standard measure of the safety record of a contractor is the experience modification rate (EMR). The standard industry EMR is 1 and a number higher that one indicates that your insurance provider has paid a claim. The impacts of this claim typically mean that your company will pay higher workers compensation premiums for three years. The information in this paper is content that supports the understanding of the impact of the EMR that is taught in most safety courses. The topic of profitability is also important to construction education. One of the ways to help students understand the impact of an accident on a company's profitability is to use an incident cost calculator such as the one provided by

OSHA at https://www.osha.gov/Region7/fallprotection/safetypays.html. This tool helps in estimating your company's cost to pay for an accident or increase in an insurance premium based on your company's profit margin.

The concept of workers' compensation in the United States dates back to early 20th century. Every state, with the exception of Texas, requires employers to have workers' compensation insurance to cover workplace accidents[1, 2, 3]. Workers' compensation insurance pays benefits (typically medical expenses and lost wages) to the injured worker without a court appearance, as well as paying death benefits to certain survivors of a deceased worker. In return, the employer is protected from litigation[2].

There are several topics currently being studied related to workers' compensation, few of which are pertinent to the construction industry: older workers, higher wages, and the Patient Protection Affordable Care Act (PPACA). Many "baby boomers" are postponing retirement for various reasons and this is evident in the construction industry as one walks into the jobsite. While the loss costs for older workers are similar between ages 35 to 64, the older worker may command a higher salary and salary is one of the review criteria for workers' compensation premium determination[4]. The PPACA may also have an impact on workers' compensation premiums. The PPACA requires businesses, starting in 2011, to comply with the medical loss ratio (MLR) provision of the act. The employer's choice of how to handle a MLR rebate from health insurance provider is one area that businesses should watch over the next several years as the PPACA is fully implemented[5]. One topic that has not received much attention (with respect to its impacts on construction companies) though, is the rather recent trend of privatization of state chartered workers' compensation funds.

Background

Over the course of time, during challenging economic cycles, private insurers stopped operating in some states or refused to provide workers' compensation insurance to businesses of a hazardous nature, businesses with poor safety records, or small businesses [1, 6]. Even in stable economic times, some companies could not find a private insurance company willing to underwrite their policies due to their risk factors. This issue resulted in a dilemma: State laws require employers to have workers' compensation insurance coverage although that coverage was not available in certain cases. States tried to resolve this dilemma by creating state-chartered workers' compensation funds[1]. These funds are designed to be the insurer of last resort. The insurer of last resort provides insurance to employers with risk factors, safety records, or business sizes (i.e., small businesses) that cause private insurers to step away from providing coverage.

In the last two decades, several states have assessed possible alternatives to their state-chartered workers' compensation funds, specifically with respect to privatizing those funds. A few of those states have decided to privatize their state-chartered workers' compensation funds based on their assessments. As discussed in subsequent sections, the assessment of the privatization option by different states typically came about during times of financial hardship faced by those states.

Purpose and Outline

The decision to privatize the state-chartered workers' compensation fund in a state is critical for the construction industry (which typically employs a significant portion of the work force) in that state as privatization may have implications on the premiums that the companies pay, on the level-of-service they receive, and even on their ability to secure insurance as discussed later in this paper. Therefore, different organizations representing members of the construction industry (e.g., Associated General Contractors, National Association of Home Builders, etc.) as well as individual construction companies and construction professionals need to be educated on this topic of privatizing state-chartered workers' compensation funds to be able to better understand the implications of a given privatization scenario and also to be able to provide critical input to the legislators when/if called upon to help them make a better-informed decision as to whether privatization is the right course of action. Within this context, the overall purpose of this study is to gather, synthesize, and present information with respect to the privatization of state-chartered workers' compensation funds to educate the members of the construction industry on this topic.

To reach the abovementioned purpose, first a general discussion on the state-chartered workers' compensation fund concept is provided. This is followed by a detailed discussion on the experiences of four states with respect to the privatization of their workers' compensation funds. This is followed by the findings of this study with respect to the issues that need to be considered when contemplating the privatization of a state-chartered workers' compensation fund. The final section of this paper presents the overall conclusions and directions for future research.

Methodology

The research is exploratory in nature and the limited results are used only to provide a case study reference supporting the assertion that industry needs to pay more attention to legislative issues. A qualitative research methodology was used and is appropriate for this type of research. This methodology requires data collection and inductive data analysis going from particulars to general themes. Creswell[7] suggests that in qualitative research, different data collection procedures can be used. This research utilized two of those procedures: (i) review of public documents such as official reports, case briefs, and newspaper articles and (ii) semi-structured interviews. Once the data was collected through these procedures as discussed below, the researchers made interpretations of the meaning of such data as required by the qualitative research methodology[7].

The first phase of this research entailed a comprehensive review of the numerous documents published about the state-chartered workers' compensation funds and experiences of different states in privatizing those funds. A significant amount of information was collected through this review; and this information was synthesized. The following sections present this synthesis of the experiences of different states in privatizing their funds. Furthermore, this review also allowed for drawing together common themes between the experiences of different states. This resulted in the generation of important findings to be considered when contemplating the privatization of a state-chartered workers' compensation fund. These findings are discussed in the section entitled "Issues to Consider." While this type of data collection has many advantages, it also has the limitation related to the authenticity and accuracy of the reviewed documents[7]. To address this limitation, multiple references were utilized to gather information about each state's experience. In the instances when conflicting

information was identified, such information was noted to then seek clarification through interviews which formed the second phase of this research.

The second phase of the research entailed expert interviews. The purpose of these interviews was to gather further information on state-chartered workers' compensation funds and their privatization and to seek clarification on the few cases where conflicting information was gathered in the first phase of this research. A semi-structured interview approach was used which included a few established questions seeking general information on important aspects of state-chartered workers' compensation funds and privatization experiences of different states. However, the interviews were not strictly restricted to the original set of questions and this allowed for additional questioning, either for clarification or to expand on an answer if necessary. This additional discussion helped the researchers better understand the issues surrounding the privatization of state-chartered worker's compensation funds. The interviewees included four insurance agents with substantial experience and knowledge on the workers' compensation insurance concept and the construction industry in general and two executives of a company (that went through a privatization phase) which underwrites workers' compensation insurance policies. The number of interviewees was not standardized between different states and insurance companies as interviews were only used when necessitated by a lack of information in the literature for a given state's privatization efforts

General Discussion on the State Chartered Workers' Compensation Funds

As the insurer of last resort, a state-chartered workers' compensation fund is required to insure any business, regardless of whether it is a part of the voluntary market or the residual market. The voluntary market consists of employers that can obtain workers' compensation insurance without any difficulty. If a certain number of private companies (usually two or three) refuse to provide workers' compensation coverage to an employer, that employer is considered as a part of the residual market and is eligible to obtain insurance from the state fund due to its obligation as the insurer of last resort[2, 8].

Workers compensation insurance is typically handled through a market based provider system. States may have several private carriers operating in that state who offer this coverage. When companies are declined workers compensation coverage by providers in the private market they then obtain insurance from the provider of last resort. The insurer of last resort may be a state run fund or an assigned risk pool. It is important to note that the insurer of last resort is not always the state fund. Another way of covering the residual market is through a mechanism called assigned risk pool. This mechanism works as follows: After an employer is declined coverage (usually from two or three carriers) in the voluntary market, that employer submits its workers' compensation insurance application along with the declination letters to the administrator (National Council on Compensation Insurance, the state, or another entity) of the assigned risk pool mechanism[2]. The administrator processes the application, determines the premium rates and issues the policy. The policy is then sent to a servicing carrier to handle all of the claims administration. Generally, one to three insurance carriers licensed in the respective state are designated to be the servicing carriers and they handle the claims administration for the policy for an additional fee- usually 25 percent to 45 percent of the total premium. It is important to note that all other workers' compensation insurance carriers in the state participate in the pool by sharing the profit or loss of the pool based on their voluntary market share. In other words, the pool combines the experience of all the policies issued through this mechanism and then allocates any profit or loss to all participants proportional to their voluntary market share.

State funds may operate exclusively (i.e., monopolistic states) or on a competitive basis depending on the laws under which they were created. States with exclusive funds require all employers to purchase their workers' compensation insurance from that fund. Competitive funds allow for private competition[9]. Competitive state funds play an important role in the workers' compensation insurance marketplace by assuming two important responsibilities: (i) acting as an insurer of last resort and (ii) acting as a competitive force in the voluntary market by creating rate competition[8]. In other words, in addition to providing insurance to the residual market, competitive funds insure any other company in the voluntary market who chooses to use those state funds[1]. Most competitive state funds pay dividends to policyholders. Employers are also able to self-insure in several states[9]. State funds in some format currently exist in the following states and territories [9, 10]:

1. Exclusive State Funds (i.e., monopolistic states): North Dakota, Wyoming, Puerto Rico, and the U.S. Virgin Islands.
2. By either State Fund or Authorized Self-Insurance: Ohio and Washington.
3. Competitive State Funds (i.e., allows for competition from private companies): Arizona, California, Colorado, Hawaii, Idaho, Kentucky, Louisiana, Maine, Maryland, Minnesota, Missouri, Montana, New Mexico, New York, Oklahoma, Oregon, Pennsylvania, Rhode Island, Texas, Utah (It is important to note that Utah's fund is not a state agency; it is a privately owned non-profit mutual insurance company as discussed later in this paper), and West Virginia.

The fact that a state workers' compensation fund serves as the insurer of last resort for the residual market is an important factor in its federal tax exemption[2]. The specific criteria that need to be met for a workers' compensation fund to be recognized as federally tax-exempt under I.R.C. § 501(c)(27)(B) are as follows[2]:

1. The organization "is created by state law."
2. The organization "is organized and operated under state law exclusively" to provide (i) workers' compensation insurance that is either required by state law or for which state law provides substantial disincentives for failure to purchase such insurance, and (ii) "related coverage which is incidental to workers' compensation insurance."
3. The organization must provide workers' compensation coverage to any employer in the state that seeks such coverage.
4. The state must "make a financial commitment with respect to [the] organization either by extending the full faith and credit of the state to the debt of the organization or by providing the initial operating capital of the organization."
5. Assets of the organization must revert to the state upon dissolution or state law must not permit dissolution of the organization.
6. A majority of the board of directors or "oversight body" of the organization is appointed by the governor or another executive branch official of the state, by the state legislature, or by both.

Different States' Experiences in Privatizing Their Workers' Compensation Funds

This section presents a detailed discussion on the experiences of four states with respect to the privatization of their workers' compensation funds.

The Case of Michigan

Michigan's state-chartered workers' compensation fund, the "Accident Fund," was established in 1912 by the Michigan Legislature. As a quasi-state agency, the Accident Fund operated with a degree of self-governance and independence for several decades [11, 12, 13].

After many years of controversy over the Accident Fund's status, in 1993, the Michigan Legislature initiated the process to privatize it. According to A.M. Best, a compiler of data on the insurance industry, the Accident Fund had a policyholder's surplus of $110.4 million at the end of 1993. Finally, the Accident Fund was privatized in 1995. Blue Cross/Blue Shield of Michigan won the right to buy the Accident Fund, now known as Accident Fund Insurance Company of America. The legislation authorizing the privatization stated that the company acquiring the Accident Fund needed to provide workers' compensation insurance to small employers and act as the insurer of last resort in the same manner as it had during the year before the privatization. In return, the Blue Cross/Blue Shield of Michigan retained some tax advantages that other insurance firms did not. Different reports cite conflicting figures for the amount of the transaction as the state receiving $255 million or $262 million from the separation[8, 11, 12, 14].

It is important to note that during the early 1990s, Michigan, like other states, faced a recession that reduced its state tax revenues, and the state used this privatization opportunity to generate more financial resources[11, 12, 14].

According to the 2005 Privatization Report by the Reason Foundation, in evaluating the 10-year performance of the private insurance carrier, the sale of Michigan's Accident Fund "generated a large, one-time revenue hike for the state treasury, while it increased, by all indications, the quality of services provided to the fund's many customers"[11, 12].

Currently, the Accident Fund has the largest market share in Michigan. It is licensed in 49 states and the District of Columbia. It is the 9th largest writer of workers' compensation insurance in the United States. It had an A.M. Best rating of A in 2010 which was subsequently downgraded to A- in 2011[15, 16]. In the press release accompanying the announcement, A.M. Best[17] cited the following as justification for the downgrade: Underwriting in recent years were less than expected, reserves were less than needed for the amount of risk, and business acquisitions did not perform as expected. However, these were somewhat offset by a solid capitalization, a record of strong operating performance, use of predictive modeling, and geographic diversification, and access to capital by its parent company, Blue Cross and Blue Shield of Michigan.

The Case of Nevada

Nevada followed Michigan in privatizing its state-chartered workers' compensation fund. Nevada began working on the transition in 1995, and in 1999 the state passed legislation to facilitate the effort[11, 12].

Nevada's workers' compensation fund was established in 1913. In the early 1990s, it faced the risk of being insolvent due to a large deficit[18]. At that time, the state workers' compensation fund had a projected unfunded liability of $3 billion[19]. Nevada was a monopolistic (non-competitive) state in that the state fund was the only provider of workers' compensation insurance; businesses either had to be self-insured or buy workers'

compensation coverage from the state. The state had about 65 percent of the market. Ideas to address the concerns with respect to the large deficit of the fund were discussed in four consecutive legislative sessions and resulted in a privatization bill, which was enacted in 1999[18]. In 2000, the state workers' compensation fund was converted into a private mutual insurance company owned by the policyholders and that was no longer required to offer coverage to the residual market[19, 20]. Nevada Division of Insurance set up a special fund to take care of the residual market[18].

In 2007, the private mutual insurance company became a stockholder-owned company, Employers Holdings. To buy itself from its policyholders, it distributed $850 million in stock and cash to 6,600 Nevada businesses that had been its owners[18, 19, 20]. Currently, Employers Holdings provides workers' compensation insurance in 30 states and collects more than $400 million in premiums. It has an A.M. Best rating of A-. Employers Holdings' share of the workers' compensation market in Nevada is about 6 percent[18, 21, 22].
Workers' compensation insurance rates have dropped consistently in Nevada since the privatization. This rate decrease can be attributed to the fact that the privatization also ended the monopoly (i.e., the exclusive state fund status of Nevada as discussed earlier) and opened up the market to competition from private insurance companies. Currently, Nevada's workers' compensation rates are much lower than what they were before the privatization[18, 20, 23].

A representative from the Nevada Division of Insurance's property and casualty section reported that there are still some uninsured employers. Furthermore, the residual market was negatively affected by the privatization in that the residual market employers, who already pay higher premiums than businesses that have had fewer losses, are now required to pay surcharges on their workers' compensation insurance rates that add as much as 25 percent to their insurance costs[20]. This surcharge can be attributed to the extra fee that the servicing carriers in the assigned risk pool mechanism assess, as was discussed earlier in this report.

The Case of West Virginia

West Virginia followed Nevada in privatizing its state-chartered workers' compensation fund. The privatization was approved in a 2005 legislative session that called for the conversion of the state fund to a private mutual insurance company named as BrickStreet Mutual Insurance Co. At the time of the privatization, West Virginia was a monopolistic state, and its insurance fund had financial problems, just as in the case of Nevada. BrickStreet started to operate as a private insurer on January 1, 2006, and it remained as the sole provider of workers' compensation insurance until full privatization was completed by opening the market to competition on July 1, 2008[20, 24, 25, 26, 27].

As reported by the Reason Foundation's 2009 Privatization Report and West Virginia Insurance Commissioner Jane Cline, privatization of the state fund resulted in the following[24, 25]:

1. A significant reduction (from $3.1 billion to $1.5 billion) in the outstanding unfunded liabilities of the old state workers' compensation fund was achieved.
2. Workers' compensation insurance rates declined 30.3 percent since privatization, saving employers more than $150 million annually.
3. More than 90 percent of all claims are decided upon within the first 30 days.

4. There were an estimated 8,532 protested claims in 2008, more than 80 percent lower than the average of 46,076 protests filed with the state in 2005 and 2006.
5. The overall appeals process has been improved resulting in the resolution of protested claims in a shorter period of time.

In March 2009, the results of the BrickStreet's first Market Conduct Examination were announced. Market Conduct Examination is a review of insurers' treatment of policyholders and claimants. It specifically covers claims handling, complaint handling, and underwriting practices. According to the results, BrickStreet passed 59 of the 67 applicable standards[24]. The BrickStreet 2012 Annual Report indicates that they are one of the largest writers of workers' compensation coverage in the US. The success of BrickStreet since inception is attributable to focusing their work around their policyholders, the owners of the mutual company. Their financial success was acknowledged by A.M. Best, after collecting 7 years of financial data, with an A- financial rating for 2012. The combined ratio of 100.2% also indicates near profitability without income from investments. As of 2010 they were writing policies in West Virginia, Kentucky, Virginia, Illinois, North Carolina, Indiana, and Pennsylvania. Continued success will result from reducing the total cost of risk for policyholders thru the BrickStreet 360^0 approach to providing comprehensive services to policyholders and committing to meeting all of their needs[28]. BrickStreet is expanding operations into other states for growth and financial diversification necessary for rating agencies such as A.M. Best. When they were a monopoly they were in the top 20 in premiums written and currently they are in the top 25-30 in premiums written (G. Burton, Personal Communication, 1-9-2012).

The Case of Utah

Utah's state-chartered workers' compensation fund, known as Workers Compensation Fund (previously State Insurance Fund), was established in 1917 by the Utah Legislature[29, 30, 31]. In 1988, Workers Compensation Fund (WCF) was determined to be a "nonprofit, self-supporting, quasi-public corporation," an "independent state agency," and a "body politic and corporate." Then, in 1990, the phrases "independent state agency" and "body politic and corporate" were removed by the Utah Legislature. As defined by the Utah Legislature, a quasi-public corporation is "an artificial person, private in ownership, individually created as a corporation by the state which has accepted from the state the grant of a franchise or contract involving the performance of a public purpose relating to the state or its citizens"[32].

In 2004, an attempt at privatizing WCF was rejected during the legislative session. At that time, Utah had the second-lowest workers' compensation insurance rates in the United States and WCF had 60 percent of the market share in Utah. Furthermore, it had $220 million in surplus. WCF proposed to pay $50 million to the State of Utah to settle Utah's ownership claims to the agency and agency's $829 million in assets. WCF was said to seek full privatization to be able to keep and expand business in other states while maintaining low premiums in Utah. Before the legislative session, Governor Leavitt had urged policymakers and employers to investigate various options, including the option of selling WCF and allowing state government to retain up to $124 million of its surplus (the information on WCF's surplus amounts—$220 million and $124 million—is based on personal communication with D. Lloyd, Senior Vice President of WCF, March 24, 2010). The idea was that if WCF was a quasi-governmental agency, then the state deserved to receive some money on its initial founding interest in the company[2, 29, 33, 34, 35]. For many years, Utah's business community had resisted proposals to privatize WCF due to fears of rate increases,

removal of its status as Utah's insurer of last resort, and potential raid of its reserves by its future officers. However, before the 2004 legislative session, a business coalition representing Utah's major business and trade associations supported cutting WCF's ties with the State of Utah. The coalition issued a list of principles that should guide the Utah Legislature in doing so[29]. These principles address all of the previous concerns of Utah's business community:

1. WCF should continue to keep its status as a mutual insurance company owned by the policyholders with the main emphasis being costs to policyholders and not profits to stockholders. The reserves of WCF were created from premiums paid by the policyholders; and thus, the policyholders should retain the reserves through their ownership of the mutual company.
2. WCF should continue to be the insurer of last resort to insure the residual market in Utah.
3. WCF should retain its federal income tax exemption to ensure the lowest possible rates.
4. No founder's equity should be paid to the State of Utah. In other words, the State of Utah is not entitled to settlement for relinquishing its minor control over the WCF.
5. The State of Utah should continue as an "anchor client" to WCF.
6. WCF should be allowed to offer insurance to Utah companies working in other states as well as the non-Utah businesses in those states. The main reason for this is that, unless WCF can diversify by operating outside of Utah, it may run the risk of losing money.
7. WCF's board should be elected by policyholders.

In 2004, WCF sought a declaratory judgment action to determine whether the State of Utah had an ownership interest in WCF or its assets other than as a policyholder[36]. The district court concluded that "WCF is entitled to a declaratory judgment as a matter of law that the State has no ownership in the WCF or its assets other than as a policyholder. The Court therefore grants the WCF's Motion for Summary Judgment"[36]. In 2005, the Utah Supreme Court also ruled that WCF's assets were owned by the company's policyholders, not the State of Utah[30, 32].

WCF currently operates as a privately owned non-profit mutual insurance company and thus gives a portion of its profits back to its policyholders, i.e., its owners, in the form of dividends. Since 1992, WCF has distributed more than $300 million in dividends. Although no longer a state agency, WCF still maintains its status as the insurer of last resort and is exempt from federal income tax. Nevertheless, WCF pays state premium taxes and all other taxes like any other insurance company. WCF insures more than half of all Utah employers[30, 37]. Premium rates remains steady at 1992 levels and dividends have increased[37]. It has an A.M. Best rating of A[31]. It provides insurance coverage for Utah employers in other states as well[30, 38].

Issues to Consider when Contemplating the Privatization of a State-Chartered Workers' Compensation Fund

Based on the review of the experiences of four different states with respect to the privatization of their state-chartered workers' compensation funds and expert interviews, a number of issues are identified. These issues (discussed in the subsequent sections) need to be considered when contemplating the privatization of a state-chartered workers' compensation fund. It is important to note that all of these issues have direct implications on

the companies representing the construction industry in the state contemplating the privatization of its workers' compensation fund.

Residual Market

As was discussed earlier, the fundamental reason for the establishment of the state-chartered workers' compensation funds is that they are designed to be the insurer of last resort. As can be seen in Nevada's case, it is possible that, after privatization, the private insurance company may no longer be required to offer coverage to the residual market. As was the case for Nevada, this, in turn, may result the companies in the residual market being negatively affected. For instance, in addition to higher premiums, they may be required to pay surcharges to a special fund that would be formed to handle the residual market.

Operating Out of State

As was seen in the examples discussed earlier, once privatized, the workers' compensation funds tend to extend beyond the states that they were chartered in and sell workers' compensation insurance in other states as well. Crossing state borders brings up the question of whether it will benefit or harm the businesses in the state in which the workers' compensation fund was chartered. Serving in other states and thus diversifying may prove to be a good experience, improving the financial condition of the fund and its level of service to all of its customers. However, it may prove to be a bad experience, resulting in financial loss and decrease in the level of service.

Other Lines of Insurance

State-chartered workers' compensation funds are limited to sell only workers' compensation insurance. This limitation allows the state funds to concentrate resources and experience in this line of insurance. However, after privatization, such limitation may be eliminated, and privatized funds may branch out to other insurance products. As with the case of operating out of state, this expansion could have positive or negative impacts for the businesses in the state in which the workers' compensation fund was chartered, depending on the success of the privatized company in providing other lines of insurance.

Retaining the Federal Tax Exempt Status

The specific criteria that need to be met for a workers' compensation fund to be recognized as federally tax-exempt under I.R.C. § 501(c)(27)(B) were discussed earlier. If a state-chartered workers' compensation fund is fully privatized, it may lose federal tax-exempt status because that status is mainly related to that fund's formation by the state and ongoing relationship with the state, as well as its designation as the insurer of last resort. If such tax-exempt status is indeed lost due to privatization, the fund may face some financial difficulties, which may result in premium rate increases.

Private Company versus State in Running Businesses

Public policy research suggests that privately owned firms are more efficient than state-owned enterprises. A summary of more than 60 studies of privatization in different industries around the world notes that divested firms almost always become more efficient, more profitable and financially healthier[8, 39].

Conclusions and Future Research

Legislation abounds in the construction industry. Understanding both the stated and unintended consequences of the legislative proposals can help a construction company ascertain and plan for financial impacts. Awareness and participation in the legislative process is important to ensure that construction companies have their voices heard. Within this context, the purpose of this study was to gather, synthesize, and present information with respect to the privatization of state-chartered workers' compensation funds to educate the members of the construction industry on this topic. As was discussed throughout the paper, such a decision is critical for the construction industry (which typically employs a significant portion of the work force) as privatization may have implications on the premiums that the companies pay, on the level-of-service they receive, and even on their ability to secure insurance. In addition there typically is a premium cost impact associated with reform efforts. In 2011 the state of Illinois workers compensation program was reformed. The result was a 19.3 per cent reduction in cost statewide from 2011 – 2014, but no reports of premium decreases; insurance companies are only paying out $.94 for each premium dollar earned[40].

The construction industry is a major player in the workers compensation arena. There were an estimated 6.35 million construction workers in February, 2015, or about 4 percent of the nation's workforce[41]. Employment in the construction industry by 2022 is expected to be about 7.4 million workers; a 21 per cent increase over 2014 levels[42]. While this may not appear to be a large part of the US workforce, construction industry accounted for 20.3 percent, 796 out of 3,929, of the overall fatalities in 2013[43].

There are many ways that workers compensation requirements are disseminated to employers as coverage is mandated based on regulations. However, when it comes to involvement in changing the state rules that control the process and the impact of an open or state run system the information sharing mechanisms are not well known. Many construction association groups take the lead in the legislative process as part of the service they provide to their members. Other sources include web sites like www.WorkersCompensation.com[44] provide up to date information on rules, statutes, industry news, and events.

One of the major findings of this study was the issues to consider when contemplating the privatization of a state-chartered workers' compensation fund. The first issue to consider is the potential for the companies in the residual market to be negatively affected as a result of privatization. Another issue that may affect the companies negatively or positively depending on the scenario is the tendency of the workers' compensation funds to start selling insurance in other states once they are privatized. Similarly, privatization may result in the expansion of the services offered by the workers' compensation fund to other lines of insurance which may affect the level of service and the premium rates provided to the companies. An issue that may result in an increase in the premium rates is the potential of the workers' compensation fund to lose its Federal tax exempt status due to privatization. On the other hand, public policy research suggests that divested firms almost always become more efficient; therefore these efficiencies can result in stable premium rates. It is important to note that all of these issues have direct implications on the companies representing the construction industry in the state contemplating the privatization of its workers' compensation fund.

Additional research is needed to perform comprehensive longitudinal studies of workers' compensation rates post-privatization. A comparative study of the few monopolistic state

funds that do not allow competition and those states that allow multiple underwriters may also be beneficial for the construction industry. Construction companies that are on the forefront of this topic may gain a competitive advantage, if only for a short time, as they look for ways to better manage risk and costs as margins fluctuate over time.

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