

# **TUMBLEWEED RUNAWAY PROGRAM, INC A CASE STUDY OF WORKERS' COMPENSATION INSURANCE COSTS**

A Report Prepared for the  
**Economic Affairs Interim Committee**

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January 15, 2010

**Legislative Fiscal Division**



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## INTRODUCTION

The purpose of this case study is to provide the legislative members of the Economic Affairs Interim Committee with the components driving premium increases through an example of a nonprofit organization, the Tumbleweed Runaway Program, Inc. (Tumbleweed) which was insured with the Montana State Fund (MSF) for workers' compensation insurance until January 1, 2009. The study will show the mechanisms and factors used by the Montana State Fund and Victory Insurance, with which Tumbleweed insured beginning January 1, 2009, to assist the agency in reducing significant increases in premium costs resulting from a reclassification of payroll in FY 2008.

## CLASSIFICATION CODES

The National Council on Compensation Insurance (NCCI) classifies industries into 5 groups based on their common exposure to risk. Within the industries NCCI further refines risk by an individual classification or class code. The amount of premium charged to a business is based on the assessed risk the employee in the individual class code will incur a work related injury during the year. The estimated cost of paying for claims and benefits and the costs of administering the claims is the loss cost.

Figure 1 on the following page shows the historical premium calculation for Tumbleweed during the period it ensured with MSF.

During the majority of the period Tumbleweed was assessed premiums under two class codes:

- 8742 Salespersons or collectors
- 8810 Clerical Office Employees

During the period, Tumbleweed incurred a single workers' compensation claim in FY 2005. Total costs for the claim were \$408. MSF audited Tumbleweed twice during the period. The audit conducted in FY 2004 did not change any of the code classifications. The audit conducted in FY 2008 determined that the use of class code 8742 "Salespersons or collectors" was incorrect and that code 8861 "Charitable/Welfare Organizations" should be used. A letter dated 12-21-2007 from MSF to Tumbleweed stated that MSF "reviewed the policy and to help alleviate the adverse impact this change will have on your premium, we (MSF) have applied a 40% credit to your policy and changed the Rate Tier which lowered your rate to \$4.32."

Figure 1  
Tumbleweed Runaway Program Inc  
Workers' Compensation Insurance Premiums  
Montana State Fund

Policy Year	Class Code	Description	Reported Payroll	Tier	NCCI Rate Per \$100	MSF Rate Per \$100 Billed	Reported Manual Premium	Total Manual Premium	Minimum Employers Liability	Subject Premium	Experience Modification	Scheduled Rating Unique Risk	Terrorism	Audit Changes	Final Premium
2004	8742	Salespersons, Collectors	\$284,341.61	2	0.00	\$0.71	\$2,018.83				0	0			
	8810	Clerical Office Employees	85,760.76	2	0.00	0.63	540.29	\$2,559.12			0	0	\$74.02		\$2,633.14
2005	8742	Salespersons, Collectors	409,885.27	2	0.81	0.83	3,402.05				0				
	8810	Clerical Office Employees	38,271.99	2	0.61	0.63	241.11	3,643.16			0	0	89.63		3,732.79
2006*	8742	Salespersons, Collectors	521,310.00	2	0.91	0.86	4483.27				0				
	8810	Clerical Office Employees	43,227.00	2	0.68	0.64	276.65	4,760.00	100.00	4,860.00	0	0	113.00		4,973.00
2007*	8742	Salespersons, Collectors	534,355.43	3	0.95	0.95	5,076.38				0				
	8810	Clerical Office Employees	22,959.25	3	0.81	0.81	185.97	5,262.35	100.00	5,362.35	0	0	111.46	24.91	5,498.72
2008	8742	Salespersons, Collectors	585,428.00	3	1.09	1.10	6,439.71				0				
	8810	Clerical Office Employees	64,354.00	3	0.79	0.80	514.83				0	0			
	8861	Charitable/Welfare Org	0.00	3	4.57	4.62	0.00	6,954.54	118.23	7,072.77	0		129.96		7,202.73
6 mo 2009	8742	Salespersons, Collectors	0.00	3	1.07						0.95	20%			
	8810	Clerical Office Employees	36,074.76	3	0.73	0.73	263.35				10,601.67				
	8842	Group Homes -All Employees	0.00	3	4.57	4.41	0.00								
	8864	Social Services Organization	\$242,851.58	3	4.57	\$4.41	\$10,709.75	\$10,973.10	\$186.55	\$11,159.65	(\$557.98)	(\$2,120.34)	\$55.79	\$0.00	\$8,537.12

\* Payroll audited

Figure 2 show the calculation of the premium based on the MSF information provided to Tumbleweed and is based on the audit findings.

Figure 2  
Tumbleweed Runaway Program Inc  
Workers' Compensation Insurance Premiums  
Montana State Fund - Audited Premium Calculations

Policy Year	Class Code	Description	Reported Payroll	Tier	NCCI Rate Per \$100	MSF Rate Per \$100 Billed	Estimated Manual Premium	Total Manual Premium	Experience Modification	Scheduled Rating Unique Risk	Minimum Employers Liability	Terrorism	Final Estimated Premium
2008	8742	Salespersons, Collectors		2	\$1.09	\$1.03	\$0.00			0	40%		
	8810	Clerical Office Employees	\$64,354.00	2	0.79	0.75	482.66			0	0		
	8861	Charitable/Welfare Org	585,428.00	2	4.57	4.32	25,290.49	\$25,773.14	0	(\$10,309.26)	118.23	\$129.96	\$15,712.08

The insurance agent working with Tumbleweed requested a further adjustment in a letter dated 12-21-07. The agent discusses that several audits performed by MSF had verified the use of the previous class codes. He notes that the change in the class codes results in an increase of \$11,249 in premiums annually. He further noted that NCCI had advised using two different class codes for working with nonprofits rather than the class code 8861 "Charitable/Welfare Organizations". Those class codes were 8864 "Group Homes – All Employees" and 8842 "Social Services Organizations". (Changing from one class code to two separate class codes may result in different rates for each class code in the years following the implementation).

MSF responded 1-10-08 that they would be using the class codes 8864 "Group Homes – All Employees" and 8842 "Social Services Organizations" as class codes because class code 8861 "Charitable/Welfare Organizations" was discontinued effective 10-1-2007. The letter further states, "In reviewing this file and the information available, I concur with the auditor that the business was properly classified to code #8861 ("Charitable/Welfare Organizations"), which includes clerical and sales, for the audit period. However, after further review, I have decided to allow an exception for the July 1, 2007 to July 1, 2008 policy. I have reassigned class codes #8810 ("Clerical Office Employees") & #8742 ("Salespersons or collections") for this policy period and will allow payroll to be reported in those classifications until July 1, 2008. I have removed the schedule credit (40 percent reduction) applied to the policy for that period since it is no longer necessary." Further, the letter states that "Upon renewal in July 2008, the policy will be assigned classification code #8864 ("Group Homes – All Employees") and if there are employees strictly involved in clerical work, classification code #8810 ("Clerical Office Employees") may also be assigned."

It should be noted that according to MSF management, rate tiers are assigned based on the experience rating of a company. In those instances when a company is not experience rated and has annual premiums between \$1,500 and \$5,000 a year, such as Tumbleweed, premiums are based on tier 4 rates in the first year of the policy. The rating can stay at tier 4, move as far up as tier 2 or down to tier 5 based on the number of years the employer has the policy and the number of claims filed for the employer's workers. The letters from MSF only discuss changing the tier due to the increased premium costs, not based on the number of claims filed. Further, according to MSF management the scheduled rate modifier (credit) is used to take into account factors which may not show up in the experience modifier. The following general criteria are used to determine the unique risks behind the scheduled rate modifier:

- Premises – 20 percent
- Medical Facilities – 15 percent
- Safety Devices – 30 percent
- Employee Selection/Training – 30 percent
- Management Cooperation – 20 percent
- Safety Organization – 30 percent
- Other Categories – 75 percent

It would seem that the factors for the reduction of \$10,322 for the audited premium should be in place regardless of the cost of the premium, not because the premium costs increased.

The last computation included in Figure 1 shows the amount of the premium Tumbleweed paid for the first 6 months of FY 2009 using the assigned classification code 8864.

At this point Tumbleweed began insuring with a private insurance company. The estimated premium calculation made by Victory Insurance is shown in Figure 3.

Figure 3  
Tumbleweed Runaway Program Inc  
Workers' Compensation Insurance Premiums  
Victory Insurance

Policy Year	Class Code	Description	Estimated Payroll	NCCI Rate Per \$100	Victory Per \$100 Billed	Estimated Manual Premium	Total Estimated Manual Premium	Minimum Employers Liability	Subject Premium	Experience Modification	Scheduled Rating Unique Risk	Premium Discount	Expense Constant	Terrorism	Final Premium
6 mo 2009	8742	Salespersons, Collectors	\$13,734.00	\$0.98	\$1.22	\$168.00				\$0.95	25%	3%			
	8810	Clerical Office Employees	34,807.00	0.70	0.83	289.00				10,515.55					
	8842	Group Homes -All Employees	3,273.00		5.04	165.00									
	8864	Social Services Organization	\$203,606.00		\$5.04	\$10,262.00	\$10,884.00	\$185.00	\$11,069.00	(\$553.45)	(\$2,628.89)	(\$236.60)	\$180.00	\$77.00	\$7,907.06

Victory Insurance discussed the classification of the payroll with NCCI to ensure their proposed methodology was appropriate given the duties of the staff included in each classification. As a result, Victory reclassified a portion of the payroll to class codes that have lower rates per \$100. The higher bill rates per \$100 for Victory compared to MSF are a reflection of the loss cost multiplier used by the private insurer. Victory Insurance also provided a scheduled rate modifier to the policy and a premium volume discount. Victory Insurance assigned a higher terrorism premium than MSF, differentiating between the foreign terrorism premium and the domestic terrorism premium.

According to NCCI, the charge per \$100 of payroll for the Terrorism Risk Act of 2007 and the Domestic Terrorism Act is \$.01 per \$100 of payroll. Another charge for catastrophe other than certified acts of terrorism was added and is also \$.01 per \$100 of payroll. Using these numbers both MSF and Victory Insurance may be over assessing for the foreign terrorism premium and not charging for catastrophe premiums.

## SUMMARY

The classification codes used to determine the premiums for Tumbleweed were incorrect prior to FY 2009. MSF determined the error in FY 2008. MSF notified Tumbleweed of the error and the correct codes as part of an audit in FY 2008. As a result of the audit, MSF first proposed to change the tier rating and apply a 40 percent schedule rate modification to the manual premium to reduce the costs for the audited changes in the FY 2008 premiums. MSF then decided to delay the implementation of the classification change, allowed Tumbleweed to pay insurance premiums at the lower class code rates, and revoked the tier rating reduction and 40 percent scheduled rate modification for FY 2008. The basis for the rating tier change and the scheduled rate modification are unclear and may be solely based on higher premium costs. In FY 2009, MSF charged premiums based on the correct classification code, left the previous rating tier unchanged, and applied a 20 percent scheduled rate modification. Tumbleweed changed insurance carriers to a private insurer half way through FY 2009. The private insurer applied a 25 percent scheduled rate modification and a 3 percent premium discount. It appears neither MSF nor Victory Insurance is correctly assessing for terrorism premiums and neither shows a premium assessment for catastrophes on their billing statements.