Compendium on Workmen's Compensation

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Chapter 16

Administrative Costs

The administrative costs of workmen's compensation include the expenses and profits of private insurers and State funds, the cost of administering self-insurance plans, industrial commission expenses, and other charges to the public for administering workmen's compensation laws. In essence, they cover all expenses of the program except payments for cash benefits and medical and rehabilitation services. The relative magnitude of these costs provides one measure of the efficiency of the workmen's compensation system.

PRIVATE INSURER EXPENSES AND PROFITS

Because private insurers write more than 80 percent of the workmen's compensation premiums, their administrative costs are proportionally important. An additional reason for investigating their expenses and profits is that the role of private insurers in a social insurance program is chronically open to challenge.

Premium Components

Private workmen's compensation premiums must provide for benefits, expenses, and a margin for profit or contingencies.

Services provided by expense and margin components.—The conventional listing of the expense and margin components is:

(1) Acquisition and field supervision expenses (sales);
(2) Inspection and bureau expenses;
(3) Claim adjustment expenses;
(4) General administration and payroll audit expenses;
(5) Taxes, licenses, and fees; and
(6) Profit and contingencies.

Acquisition and field supervision expenses include: commissions to agents and brokers, salaries for sales representatives and sales managers, advertising costs, and other expenses incurred in acquiring business.

Safety programs and membership in or subscribership to the services of rating bureaus and other boards and associations are supported by the second expense component.

The third produces the salaries for staff claims adjusters, fees to independent adjusters, and other monies needed to adjust claims.

The general administration and payroll audit component provides for the payroll audits needed to determine the employer's final payroll for the year (and hence his premium) and for all the other expenses incurred by the insurer in connection with the issuance and servicing of the insurance.

States premium taxes and fees are the fifth component.

Federal income taxes are paid out of profits and a contingency fund. This component also provides a margin for dividends and reserves against unusual charges for benefits (losses) in excess of the volume anticipated by premiums. The actual profit or margin for dividends depends upon how actual losses and expenses compare with the loss and expense allowance in the premium.

Some expenses are incurred to provide direct benefits to insured employers. Expenditures by insurers can be presented from this point of view.[1]

Administrative expenses of direct benefits to insured employers:

Claims adjustment expenses (to the extent they represent service to employers);

Safety program expenses;

Expenses incurred in analyzing the employer's exposure, advising how it should be handled, and arranging for the proper insurance protection; and

Portion of margin returned to employers as dividends.

General administration expenses.

Pure selling expenses.

Profit and contingencies allowance:

Distributed to others than the insured;

Retained as surplus.

Adjustment of claims, to the extent that they represent determinations that the employer himself would handle otherwise, are for his benefit; to the extent that they are incurred to protect the insurer, they are administrative expenses of the insured. Expenses for safety programs are, in the long run, almost exclusively for the benefit of insured employers and protection of employees, though insurers may benefit to the extent that losses are prevented or reduced without a compensating reduction in rates. If the employer did not purchase insurance, he would either have to pay for other safety services or forego their benefits. Although expenses incurred for risk analysis and insurance advice result in direct benefits to the insured, the need for such advice arises out of the decision to buy insurance. Policyholder dividends are a clear benefit to insured employers. The items not of direct benefit to the insured plus the investment earnings of the insurer attributable to workmen's compensation premiums, are regarded by some observers as the true net costs of administering workmen's compensation insurance.[2]

Expense and margin allowances in premiums.—In establishing the premiums paid by employers paying less than $1,000 annually, the National Council on Compensation Insurance generally assumes that insurers need about 39 percent of the premium to meet their expenses and provide a 2½ percent profit and contingencies allowance.

The percentage for each expense component in a fairly typical State, Minnesota, is as follows:

	Percent
Acquisition and field supervision expense (sales)	17.5
General administration expense	8.4
Claims adjustment expense	8.2
Taxes	2.7
Profit and contingencies	2.5
Total	39.3

For employers paying less than $500 annually, an expense constant, a loss constant, or both is added to the premium in most States. The expense constant is usually $15 for premiums up to $200 and $10 for higher premiums: in effect, 15 percent additional on a $100 dollar premium; 2 percent on $500.

Employers paying at least $1,000 annually are rated under either the premium discount or retrospective rating plan described in the next chapter. Both of these plans reduce the expense and profit loading as a percentage of the premium because it costs relatively less to sell and administer insurance for large companies. Two sets of discounts are used for large firms: one set for stock insurers (or others electing the stock discounts) and the other for non-stock insurers (or others using the nonstock discounts). The nonstock discounts are lower because insurers electing this discount pay dividends which may reflect expense savings. On the portion of the premium in excess of $100,000, for example, the expense and profit loadings for stock and nonstock insurers are as follows:

[In percent]

	Stock insurers	Nonstock insurers
Acquisition and field supervision expense	6.0	18.0
General administration expense	4.6	
Claim adjustment expense	8.2	8.2
Taxes	2.2	2.4
Profit and contingencies	2.0	2.3
Total	23.0	30.9

Most of the difference reflects allowances for acquisition and field supervision and for general administration and payroll audit expenses.

Actual Expenses

The actual expenses incurred by insurers are less than the 39 percent expense loading minus the 2.5 percent profit and contingencies allowance. Table 16.1 shows for 1950 through 1970 the expenses incurred by nonparticipating stock insurers, participating stock insurers, and mutual insurers expressed as a percent of premiums earned.

In 1970 participating stock insurers had the highest expense ratio, about 30.9 percent. Participating stock insurers and mutual insurers both had substantially lower ratios: 25.2 percent for par stocks and 24.0 percent for mutuals. Nonparticipating insurers spent considerably more on acquisition and field supervision expense than did the other two classes of workmen's compensation insurers.

For comparison with other social insurance programs at the close of this chapter, the ratio of these expenses to benefits paid was for nonparticipating stock insurers, 48.4 percent; for participating stock insurers, 41.4 percent; and for mutual insurers 38.1 percent.

Table 16.1.—LOSSES AND EXPENSES INCURRED AS A PERCENTAGE OF NET PREMIUMS EARNED, BY TYPE OF EXPENSE AND BY TYPE OF INSURER, 1950-70

Year	Losses	Expenses						Statutory underwriting gain
		Loss adjustment	Commissions and brokerage	Other acquisition, field supervision, and collection expense	General administration	Taxes, licenses, and fees	Total	
Nonparticipating stock insurers								
1950	61.4	10.3	13.5	3.9	9.4	3.8	40.9	−2.3
1951	66.5	9.6	12.9	3.8	8.9	3.9	39.1	−5.6
1952	64.1	8.8	12.4	3.6	8.3	3.8	36.9	−1.0
1953	60.6	9.1	12.2	3.4	8.1	3.7	36.5	2.9
1954	56.4	8.8	12.3	3.3	8.5	3.5	36.4	7.2
1955	59.9	8.7	12.5	3.3	8.5	3.5	36.5	3.6
1956	60.2	9.0	12.6	3.4	8.4	3.4	36.8	3.0
1957	62.1	9.0	12.4	3.2	8.2	3.8	36.6	1.3
1958	63.5	9.0	12.2	3.2	8.4	3.4	36.2	0.3
1959	65.9	9.2	12.1	3.1	8.3	3.7	36.4	−2.3
1960	64.9	9.4	12.2	3.2	8.5	3.6	36.9	−1.8
1961	65.9	9.2	11.9	3.3	8.4	3.6	36.4	−2.3
1962	63.0	9.2	11.9	3.3	8.4	3.6	36.4	0.6
1963	63.6	9.0	11.9	3.2	8.2	3.8	36.1	0.3
1964	63.4	8.7	11.8	3.0	7.7	3.8	35.0	1.6
1965	64.0	8.9	11.6	2.9	7.5	3.7	34.6	1.4
1966	64.3	8.7	11.4	2.6	6.9	3.6	33.2	2.5
1967	63.7	8.6	11.1	2.6	6.9	3.7	32.9	3.4
1968	63.2	8.2	10.4	2.3	6.8	3.7	21.4	5.4
1969	64.1	8.5	10.2	2.3	6.7	3.7	31.4	4.5
1970	63.9	8.5	9.8	2.2	6.6	3.8	30.9	5.2
Participating stock insurers								
1950	60.3	8.2	8.0	3.5	6.5	2.4	28.6	11.1
1951	69.0	8.7	7.8	3.3	6.2	2.6	28.6	2.4
1952	61.6	8.2	8.2	3.4	6.4	2.7	28.9	9.5
1953	57.0	8.4	8.7	3.5	6.1	2.3	29.0	14.0
1954	52.5	8.3	8.0	4.3	6.3	2.2	29.1	18.4
1955	52.4	7.9	7.8	4.1	6.2	2.3	28.3	19.3
1956	55.2	7.9	7.6	4.1	6.2	2.0	27.8	17.0
1957	58.9	7.5	7.0	4.2	6.6	2.1	27.4	13.7
1958	59.5	8.1	8.3	4.1	5.7	2.3	28.5	12.0
1959	62.4	8.1	8.6	3.6	5.6	2.2	28.1	9.5
1960	64.3	8.3	8.0	3.0	5.2	2.3	26.8	8.9
1961	65.3	8.8	7.6	3.2	5.3	2.4	27.3	7.4
1962	65.4	8.6	7.5	3.1	5.2	2.4	26.8	7.8
1963	65.0	8.5	7.4	2.9	4.8	2.4	26.0	9.0
1964	62.6	9.2	7.5	2.7	4.6	2.4	26.4	11.0
1965	63.1	8.1	6.8	3.1	4.8	2.3	25.1	11.8
1966	64.1	8.1	7.1	2.5	4.7	2.6	25.0	10.9
1967	60.7	8.0	7.1	2.3	5.2	2.5	25.1	14.2
1968	59.1	7.6	5.2	3.0	5.6	2.7	24.1	16.8
1969	57.7	7.5	5.1	3.3	5.5	2.7	24.1	18.2
1970	60.9	8.7	5.1	3.3	5.3	2.8	25.2	13.9

Table 16.1.—LOSSES AND EXPENSES INCURRED AS A PERCENTAGE OF NET PREMIUMS EARNED, BY TYPE OF EXPENSE AND BY TYPE OF INSURER 1950-70—Continued

Year	Losses	Expenses						Statutory underwriting gain
		Loss adjustment	Commissions and brokerage	Other acquisition, field supervision, and collection expense	General administration	Taxes, licenses, and fees	Total	
Mutual insurers								
1950	61.9	8.0	2.2	5.2	6.5	3.1	25.0	13.1
1951	62.2	7.9	2.2	4.7	6.4	3.2	24.4	13.4
1952	62.3	7.6	2.1	4.6	6.1	3.2	23.6	14.1
1953	59.8	8.0	2.1	4.5	6.0	3.2	23.8	16.4
1954	55.4	7.6	2.1	4.9	6.7	2.9	24.2	20.4
1955	57.2	7.7	2.1	5.4	7.0	2.8	25.0	17.8
1956	58.3	8.1	2.2	5.1	7.1	2.8	25.3	16.4
1957	57.4	8.0	2.3	5.3	7.0	3.1	25.7	16.9
1958	62.0	8.7	2.4	5.3	7.4	3.1	26.9	11.1
1959	63.8	8.4	2.3	5.1	7.0	3.3	26.1	10.1
1960	63.0	8.3	2.4	5.0	6.9	3.0	25.6	11.4
1961	62.9	8.5	2.3	5.1	7.1	2.8	25.8	11.3
1962	61.4	8.7	2.3	5.1	6.9	3.0	26.9	12.6
1963	65.1	8.8	2.4	5.3	7.2	3.3	27.0	7.9
1964	63.0	9.1	2.3	5.2	7.0	3.4	27.0	10.0
1965	61.4	8.9	2.2	5.2	6.8	3.5	26.6	12.0
1966	61.5	8.5	2.3	4.9	6.3	3.5	25.5	13.0
1967	64.3	8.5	2.3	4.9	6.1	3.6	25.4	10.3
1968	60.7	8.0	2.3	4.7	6.2	3.6	24.8	14.5
1969	61.6	8.2	2.2	4.6	5.9	3.9	24.8	13.6
1970	63.1	8.1	1.9	4.5	5.9	3.6	24.0	12.9

Source: Insurance Expense Exhibits (Countrywide), compiled annually by the National Council on Compensation Insurance.

The expense ratios of all three classes of insurers were less in 1970 than in 1950. Nonparticipating stock insurers reduced their expenses by 10 percentage points, participating stock insurers by more than three points, and mutual insurers by one point. The difference between the nonparticipating stock insurer rate and the mutual insurer ratio declined from almost 15 percentage points in 1960 to less than seven points in 1970.

Nonparticipating stock insurers were able to reduce all of their expenses except taxes, licenses, and fees. Participating stock insurers reduced all expenses other than taxes, licenses, and fees and claims adjustment expenses.

Expense ratios, excluding claims adjustment expenses, for workmen's compensation insurance over the 10-year period 1961–70 are compared in table 16.2 with several other major lines underwritten by property and liability insurers. In only one line, group disability income insurance, was the expense ratio lower. Workmen's compensation claims adjustment expenses, between 8 and 9 percent of 1970 written premiums, were substantially greater than the 1 to 2 percent ratio for group disability insurance but less than the 13 to 16 percent experienced in automobile bodily injury injury liability insurance. In comparing workmen's compensation insurance expense ratios with group disability insurance ratios, allowance should be made for the safety services rendered by workmen's compensation insurers, the relative difficulty of adjusting workmen's compensation claims, and the many small companies that purchase workmen's compensation insurance but not group disabilitv insurance.

Table 16.2.—EXPENSES AS A PERCENTAGE OF PREMIUMS WRITTEN AND UNDERWRITING PROFIT AS A PERCENTAGE OF PREMIUMS EARNED, BY LINE OF INSURANCE, 1961-1970

Line of insurance	Percentage of premiums written			Underwriting profit as a percentage of premiums earned
	Commission and brokerage fees	Other underwriting expenses [1]	Total underwriting expenses [1]	
Stock insurers:				
Workmen's compensation	10.0	12.5	22.5	4.9
Fire	24.4	16.5	40.9	-.2
Homeowners multiperil	23.2	12.7	35.9	-7.9
Commercial multiperil	18.9	17.2	36.1	.4
Automobile collision	16.9	12.4	29.3	-.4
Automobile bodily injury liability	15.5	13.1	28.6	-4.7
Automobile property damage liability	15.9	13.5	29.4	-6.3
Group disability insurance	8.5	9.5	18.0	-.1
All lines combined	18.0	14.1	32.1	-1.0
Mutual insurers:				
Workmen's compensation	2.3	14.5	16.8	12.4
Fire	15.6	19.1	34.7	12.6
Homeowners multiperil	19.6	16.2	35.8	-4.1
Commercial multiperil	13.8	21.2	35.0	6.2
Automobile collision	8.1	14.9	23.0	1.7
Automobile bodily injury liability	7.8	15.2	23.0	-1.4
Automobile property damage liability	8.1	15.3	23.4	-5.2
Group disability insurance	2.5	8.6	11.1	.1
All lines combined	9.2	15.5	24.7	2.2

[1] Excludes loss adjustment expenses.

Source: "Best's Aggregates and Averages, 1971," pp. 139-142 and 208-211.

Workmen's compensation expense ratios vary among insurers also. Table 16.3 shows variations in total workmen's compensation underwriting expenses incurred in 1970, less claim adjustment expenses, expressed as a percentage of net premiums written among a sample of stock insurers and mutual insurers writing at least $10 million in premiums each.

Although, the expense ratios may vary among States, it is usual to assume that they do not. The ratios would be expected to vary with the average premium size in the State, premium tax rates, population density, and other factors. On the other hand, one study suggested that the difference between the countrywide ratio and the ratio for Minnesota was not significant.[3]

Profits and Losses

An insurer's total profit depends upon its underwriting gain or loss, its investment profit or loss, and, to a minor extent, other income. Its underwriting gain or loss is measured by how much premiums exceed benefit charges and expenses. Its investment profit includes net investment income (interest and dividends received less investment expenses) and capital gains, both realized and unrealized. Unrealized capital gains are included because insurers are required to record in their balance sheets common stocks at market value.

Underwriting gain or loss.—One measure of underwriting gain or loss is provided in table 16.1. The statutory underwriting profit of an insurer is determined by subtracting from its earned premiums its losses (benefits paid) and expenses. The earned premiums recognize that some of the premiums written in earlier years were for protection during the current year and that some of the premiums written during the current year were for protection in the future. The benefits and expense totals allow for amounts that will be paid in later years for accidents and services that occurred during the current year.

According to table 16.1, nonparticipating stock insurers had a statutory underwriting profit in all but 6 of the 21 years ending with 1970. In 10 of those years, the profit equaled or exceeded the 2.5 percent target. The last 5 years were all in this category.

Participating stock insurers and mutual insurers had a profit during each of the 21 years. Participating stock profits exceeding 10 percent in 14 of the 21 years, including the last 7. Mutual insurer profits exceeded 10 percent in all but 1 year. These insurers returned part of these profits to their policyholders as dividends. For example, based on a sampling of National Council files, Burton estimated that participating stock insurers paid 9.2 percent of net premiums earned as dividends in 1961–62. Mutual insurers paid 12.2 percent.[4]

Table 16.2 shows adjusted underwriting profits for the 1961–70 decade for stock and mutual insurers for each of the major lines of insurance written by property and liability insurers. Adjusted underwriting profits are corrected for the fact that some expenses should be charged to the next year. Generally, when premium volume is rising, adjusted underwriting profit exceeds the statutory profit.

According to table 16.2, in the sixties stock insurer (participating and nonparticipating) adjusted underwriting profits were 4.9 percent; mutual insurer profits, 12.4 percent. Workmen's compensation insurance profits exceeded those in any other line.

For the 54 insurers whose 1970 expense ratios are shown in table 16.3, the adjusted profit ratios of 40 stock insurers ranged from —5.1 percent to 31.0 percent. The 14 mutual insurers range was 1.5 percent to 22.8 percent.

Table 16.3—DISTRIBUTION OF EXPENSE RATIOS AMONG 54 STOCK AND MUTUAL INSURERS WRITING AT LEAST $10 MILLION IN PREMIUMS, 1970

Percent of expense ratio [1]	Stock insurers		Mutual insurers	
	Number	Percent	Number	Percent
25.0 or more	9	22	1	7
20.0 to 24.9	20	50	6	43
15.0 to 19.9	6	15	2	14
10.0 to 14.9	3	8	4	29
Less than 10.0	2	5	1	7
Total	40	100	14	100

[1] Excludes loss adjustment expenses.

Source: Derived from "Best's Aggregates and Averages, 1971," pp. 122-124 and 197-198.

Incurred benefits relative to premiums earned differed also among the States, with some consequences for profits. In 1970, according to National Council data, among 44 jurisdictions without an exclusive State fund,[5] the number of jurisdictions with loss (benefit) ratios departing from the national loss (benefit) ratio by more than 5 percentage points was as follows:

	National loss (benefit) ratios, excluding effect of reinsurance	States with ratios at least	
		5 points above	5 points below
Nonparticipating stock insurers	0.628	8	12
Participating stock insurers	.610	22	7
Mutual insurers	.637	11	16

A study conducted by Georgia State University for the Commission sheds further light on the 1961–70 profits of workmen's compensation insurers.[6] These investigators analyzed the profits earned by 75 stock and mutual insurers, each of whom wrote at least 0.333 percent of the national workmen's compensation insurance premiums paid private insurers. Together the insurers wrote about 76 percent of the national total (table 16.4). The average workmen's compensation insurance statutory underwriting profit, less policyholder dividends, for the sample insurers was 0.5 percent. The high profit year was 1968, the low profit year 1963. Workmen's compensation insurance underwriting profits were better than total underwriting profits in 8 of the 10 years.

Table 16.4.—STATUTORY UNDERWRITING PROFIT LESS DIVIDENDS AS A PERCENTAGE OF EARNED PREMIUMS FOR WORKMEN'S COMPENSATION INSURANCE AND FOR ALL LINES COMBINED, 1961-70

Year	Workmen's compensation insurance	All lines combined
1961	−1.7	−0.1
1962	−.1	.8
1963	−2.1	−2.5
1964	.6	−2.7
1965	.2	−3.9
1966	.9	−.2
1967	1.0	−1.8
1968	3.7	−3.4
1969	1.8	−4.1
1970	1.0	−2.7
Average	.5	−2.1

Source: The Center for Insurance Research, Georgia State University, "The Profitability of Workmen's Compensation Insurance," Apr. 15, 1972.

Adjusted underwriting profit for the decade, not shown in table 16.4, was 1 percent for workmen's compensation insurance, but all lines combined recorded a loss of 1.5 percent.

Adjusted loss ratios (losses incurred divided by earned premiums less dividends) for the sample insurers varied widely from State to State. The variation could not be explained by the type of agency administration, the level of benefits, the presence of competitive State funds, or market penetration by competitive State funds. Outside exclusive fund States, Arizona had the lowest ratio, .525; Delaware the highest, .783.

Total profit.—Georgia State University also provided estimates of the total after-tax profitability of workmen's compensation insurance compared with all lines combined. Table 16.5 shows an average total after-tax profit of 8 percent of earned premium for workmen's compensation insurance, 7.7 percent for all lines combined. Workmen's compensation profits were higher than profits for all lines in 5 of the 10 years.

Before-tax profits were 9.2 percent for workmen's compensation insurance, 8.3 percent for all lines combined. Of the workmen's compensation before-tax profit about 11 percent was adjusted underwriting profit, 66 percent net investment income, 9 percent realized capital gains, and 15 percent unrealized capital gains. For all lines combined, the respective percentages were: −17, 75, 16, and 27. The lesser dependence of workmen's compensation profits upon capital gains produced favorable earnings for that line.

Profits of other industries are commonly expressed as a percentage of net worth instead of sales. After-tax profits on net-worth for the 75 insurers are in table 16.5.

Table 16.5.—TOTAL AFTER-TAX PROFIT (LESS DIVIDENDS) FOR WORKMEN'S COMPENSATION INSURANCE AND FOR ALL LINES COMBINED, 1961-70

Year	Percent of earned premiums		Percent of net worth	
	Workmen's compensation	All lines	Workmen's compensation	All lines
1961	12.1	17.7	18.3	20.4
1962	1.6	.9	1.8	.9
1963	9.5	11.9	9.2	12.7
1964	10.5	10.6	9.8	10.8
1965	8.8	7.2	7.7	7.3
1966	5.8	8.0	6.0	8.8
1967	10.2	10.5	12.1	13.4
1968	11.7	8.8	13.9	11.1
1969	2.4	−2.1	2.6	−2.9
1970	7.4	4.2	11.3	7.2
Average	8.0	7.7	9.3	9.0

Source: Same as table 16.4.

Workmen's compensation total profits were only slightly higher than the total profits for all lines. The higher adjusted underwriting profits on workmen's compensation insurance were offset by lower investment income and, to an even greater extent, by higher income taxes.

The investigators "found no statistical evidence to indicate that after-tax profit from all sources for workmen's compensation insurance is significantly higher than profit on other lines of insurance."

Comparison with other industries.—In order to determine how the profits of insurers compared with the profits of other industries, the after-tax profits of the sample insurers were compared with the after-tax profits of other industries reported each April by the First National City Bank of New York.

Workmen's compensation insurance return on sales ranked tenth highest among 66 industries; all insurance profits were eleventh highest. On net worth, however, among 62 industries, the workmen's compensation insurance profit was fourteenth lowest. All insurance profits on net worth were eleventh lowest.

The rate of return generally is expected to vary with the risk. The Georgia State University investigators found little relationship between average rates of return for the various industries and the risks implied by their standard deviations or variances. Nevertheless, they applied a regression line to the data. The rate of return indicated by this line for insurers exceeded their actual return.

The investigators were "not prepared to say that the present rate of return on workmen's compensation insurance is inadequate," but they "found no evidence to indicate that the insurance industry as a whole is earning excessive profits on workmen's compensation insurance."

STATE FUND EXPENSES

State funds, on average, have lower expense ratios than private insurers. During the past 20 years, State fund expenses, excluding loss adjustment expenses for certain competitive funds, have averaged about 9.1 percent of premiums written. Exclusive fund expense ratios were about 6.4 percent of premiums; competitive fund ratios about 11.5 percent.[7]

These expense ratios vary markedly. Over the five year period, 1962–66 and during 1970 the expense ratios were as follows: [8]

	1962-66	1970
Exclusive funds:		
Nevada	.12	.11
North Dakota	.09	.08
Ohio	.04	.04
Washington	.11	.14
West Virginia	.05	.04
Wyoming	.10	.07
Competitive funds:		
Arizona	.12	.14
California	.14	.09
Colorado	.11	.04
Idaho	.06	.20
Maryland	.21	NA
Michigan	.23	.27
Montana	.06	.09
New York	.31	.16
Oklahoma	.12	.10
Oregon	.11	.10
Pennsylvania	.35	.08
Utah	.08	.08

NA = Not available.

The lower 1970 ratios for some of the competitive State funds can be explained in part by the exclusion of claim adjustment expenses in the 1970 data but not the 1962–66 data. Because of the lack of uniformity in reporting, State fund operations are difficult to analyze but even these admittedly imperfect ratios suggest low expenses and considerable variation among the States.

If all State funds operated as do most mutuals and competitive funds by charging a higher premium than necessary and returning a dividend, the average State fund expense ratios would be even less than 9.1 percent reported above.

State fund administrative expenses have averaged about 13 percent of benefits paid over the past two decades. Including an estimated allowance for loss (claim) adjustment expenses would raise the expense ratio to between 11 and 14 percent of premiums written and between 16 and 20 percent of benefits paid.

Average State fund expense ratios are less than average private insurer expense ratios first because exclusive funds have no appreciable selling or acquisition charges. Although competitive funds have no monopoly, few employ salesmen and those that do incur selling expenses less than private insurers. Second, State funds incur lower loss adjustment expenses because many provide limited or no local claim service and probably pay lower salaries. Third, most State funds are excused from State and local taxes. All are exempt from Federal taxes. Fourth, general administration costs are less because of lower salaries and, in many State funds, less is spent on safety programs.

Critics of State funds often claim that their expense ratios would be higher if they were not subsidized. Except for the exemption from certain taxes, however, only one fund admits an administrative subsidy by the State.

INSURED EMPLOYER COSTS

Purchasing insurance does not relieve employers of administrative costs entirely. Insured employers must keep records and file accident reports. Also they commonly supplement insurer safety programs at their own expense.

SELF-INSURER COSTS

Self-insurers should have the lowest administrative costs of all. They elect to self-insure in expectation that they will incur fewer administrative expenses than in the insurance premium. Furthermore, they tend to be large employers benefiting from economies of scale. The actual expense ratio of self-insurers is unknown. Many self-insured employers do not keep records of their administrative expenses for workmen's compensation. Many do not recognize all the expenses (e.g., claims adjustment expenses) that they incur. The Social Security Administration estimates the administrative costs of workmen's compensation at from 5 to 10 percent of benefits paid by self-insured employers.

FEDERAL EMPLOYEES' COMPENSATION ACT

Under the Federal Employees' Compensation Act, financed through Congressional appropriations, the U.S. Government can be viewed as a self-insurer of its obligations under the Act with the same possibilities for saving expenses as private insurers. In fiscal 1971, total benefit payments were $163,214,939. The administrative cost was $5,279,558, only 3.2 percent of benefits. In fiscal 1967, benefits totalled $89,145,528. Administrative costs were $3,320,644 or 3.7 percent. In comparing this performance with that of other self-insurers, it is necessary to allow for economies of scale in the Federal program and the relatively high FECA benefits.

STATE ADMINISTRATIVE AGENCY COSTS

The administrative costs of workmen's compensation also include expenses incurred by industrial commissions and other State agencies supervising insurers and exercising adjudicative and enforcement powers. According to a National Commission survey of industrial commissions in late 1971, State agency administrative costs exceeded $95 million or about 3 percent of 1970 compensation payments. These expenses do not include the small amounts spent by State insurance departments regulating the workmen's compensation business of private insurers or the costs of administering the program for Federal employees discussed above. They do include expenses incurred in some competitive fund States and all exclusive fund States in administering the State fund.

The extent and types of services provided by the various State agencies affect the cost of administration. Services may be performed directly by the workmen's compensation agency or by other cooperating agencies, depending upon the individual State. Unrelated duties assigned to some State agencies such as the administration of the temporary disability benefits program in New York and the administration of the Tort Claims Act in North Carolina also are reflected in total costs.

The organizational structure of the State agencies makes it difficult to compare their administrative costs. As indicated in chapter 14, while most States have regulatory agencies, some are court-administered and others administer State insurance funds as well as the workmen's compensation law. State agencies using court administration do not have adjudicative duties. State fund jurisdictions supervise payment of claims in addition to their administrative regulatory functions.

Also differences in accounting and budget procedures hamper cost analysis. The degree of such variations among agencies discourages attempts at comparison concerning costs. It is possible, however, to show what States spend individually on the administration of workmen's compensation and to indicate the source of their funds (table 16.6). For the majority of State agencies, the accounting period for the budget presented is the fiscal year.

Table 16.6—WORKMEN'S COMPENSATION AGENCY ADMINISTRATIVE BUDGETS AND SOURCES OF FUNDS

Jurisdiction	Total workmen's compensation administrative budget		Source of funds		
	Amount received	Fiscal year ending	General appropriations	Assessments	Other
Alabama	$75,000	10-31-72	$75,000		
Alaska	166,900	6-30-72	166,900		
Arizona	1,440,827	6-30-71	271,891	$1,105,778	[1] $63,158
Arkansas	405,791	6-30-71		626,253	
California	9,405,085	6-30-72	9,405,085		
Colorado	(*)	(*)	(*)	(*)	(*)
Connecticut	491,314	6-30-71		491,314	
Delaware	69,500	6-30-71	69,500	407,346	
District of Columbia	(*)	(*)	(*)	(*)	(*)
Florida	4,596,479	6-30-71	243,561	3,632,055	720,863
Georgia	771,000	6-30-71		771,000	
Guam	27,373	6-30-71	27,373		
Hawaii	475,761	6-30-72	475,761		
Idaho	226,723	6-30-72		226,723	
Illinois	1,635,500	6-30-72	1,635,500		
Indiana	250,258	6-30-71	250,258		
Iowa	135,820	6-30-71	135,820		
Kansas	344,322	6-30-71	71,870	265,464	
Kentucky	679,831	6-30-71		1,064,180	
Louisiana	NA	NA	NA	NA	
Maine	$195,597	6-30-72	$195,597		
Maryland	1,200,000	6- 1-72		$1,200,000	
Massachusetts	1,729,225	6-30-72	1,593,500	[2] 56,120	$80,000.00
Michigan	1,700,000	6-30-72	1,700,000		
Minnesota	864,000	6-30-71	782,900		[3] 540
Mississippi	530,476	12-31-71		536,931	[4] 2,305
Missouri	1,065,000	6-30-72		1,300,000	
Montana	1,398,103	7- 1-72		1,398,103	
Nebraska	238,485	6-30-72	221,785		[1] 16,700
Nevada	2,459,809	6-30-72			([5])
New Hampshire	31,258	6-30-70	31,258		
New Jersey	1,864,007	6-30-71	1,864,007		
New Mexico	[6] 174,357	6-30-71	174,357		
New York	17,343,000	3-31-72		17,233,000	[7] 110,000
North Carolina	791,499	7- 1-72	758,499		[8] 33,000
North Dakota	66,705	6-30-72	666,705		
Ohio	[9] 9,303,038	6-30-71		8,372,734	[10] 930,303
Oklahoma	279,922	12-31-72	258,906		[8] 21,016
Oregon	3,004,069	6-30-71		4,284,277	37,006
Pennsylvania	1,556,972	6-30-71	1,556,972		
Puerto Rico	9,760,680	12-31-70			
Rhode Island	331,175	6-30-71	105,780	[11] 244,269	
South Carolina	542,922	6-30-72	542,922	1,540,000	
South Dakota	166,000	6-30-72	166,000		
Tennessee	163,700	6-30-72	163,700		
Texas	1,565,221	8-31-72		1,565,221	
Utah	177,700	6-30-72	177,700		
Vermont	129,000	6-30-72	129,000		
Virginia	798,240	6-30-71		856,880	
Virgin Islands	168,868	6-30-71		168,868	
Washington	9,254,220	6-30-71			[5] 9,254,220
West Virginia	1,324,797	6-30-70		1,324,797	
Wisconsin	[12] 2,428,482	6-30-71			
Wyoming	658,000	6-30-71	2,428,482		[13] 658,000

See footnotes at end of table.

Table 16.6—WORKMEN'S COMPENSATION AGENCY ADMINISTRATIVE BUDGETS AND SOURCES OF FUNDS—Continued

[1] Federal grants.

[2] Cost of administering self-insurance assessed against self-insurers.

[3] Refunds.

[4] Registration fees and miscellaneous refunds.

[5] Workmen's compensation premium income.

[6] Budget for entire operation of State Labor and Industrial Commission of which Workmen's Compensation Division is a part.

[7] Penalties.

[8] Court costs.

[9] Entire budget includes Bureau of Workmen's Compensation, Industrial Commission and Safety and Hygiene.

[10] State general fund.

[11] Curative centre fund.

[12] Includes budget for industrial safety.

[13] Interest on amount in reserve fund; for biennium. Exclusive State fund.

*No data.

NA=Not applicable.

Source: Responses from workmen's compensation agencies to questionnaire.

In some States where the agency is not budgeted independently, the workmen's compensation division may find itself bearing a portion of a parent department's expenses. In Wisconsin, such expenses include but are not limited to supplies and a prorata share of rent. Unlike Wisconsin, the Bureau of Workmen's Compensation in Pennsylvania is not charged for services of the parent organization.

Methods of Financing

The principal methods of financing an agency's administrative expenses are appropriations from general revenues, income from State fund operations (including net income from investments), assessments on insurance premiums, licensing fees for writing workmen's compensation insurance, and an earmarked payroll tax.[9] The assessment method of financing is the one recommended by the Council of State Governments. Most administrators prefer to have workmen's compensation costs financed through assessments rather than legislative appropriations.[10] Such a method of financing provides funds on a relatively regular and predictable basis with less need to compete politically with other agencies for public funds.

Regardless of the source of funds, they are usually appropriated by State legislatures before they are available to the agencies. Many agencies, financing by assessment, must turn funds over to the State treasury to be appropriated to the workmen's compensation agency, as if they were financed by general revenues. Exceptions to this general procedure are in Connecticut, Minnesota, Mississippi, New York, Pennsylvania, and Rhode Island.

As indicated earlier, many administrative costs associated with workmen's compensation are borne by private insurers, State funds, and self-insurers. In approximately half the jurisdictions, because the administrative expenses of State industrial commissions and similar agencies are financed through assessments against these insurers and self-insurers and have, therefore, already been included in the costs of insurers and self-insurers, they do not represent an additional cost of workmen's compensation. In the other half of the jurisdictions, where administrative expenses are financed through appropriations from the general treasury, such expenses represent a cost of workmen's compensation additional to that charged in premiums.[11] More than 60 percent of the $95 million in administrative expenses noted above were financed through assessments. Consequently, only about $37 million represents an addition to the costs already reported for insurers and self-insurers.

Assessment as a means of financing has been increasing. Rhode Island has an assessment that is reserved for the cost of operating the rehabilitation facility for workmen's compensation beneficiaries. The Florida assessment method is utilized effectively in supporting the workmen's compensation, rehabilitation, and safety programs. Table 16.7 presents the basis of assessments for each of the States using this method to finance administrative costs.

Table 16.7.—AGENCIES USING ASSESSMENTS TO COVER ADMINISTRATIVE COSTS

Jurisdiction	Basis of assessment	Disposition of money not utilized
Arizona	2 percent on premiums	Reverts to special funds of industrial commission
Arkansas	1½ percent premiums [1]	Remains in workmen's compensation fund for appropriation.
Colorado	0.5 percent on premiums	
Connecticut	Prorated on Compensation payments.	
Delaware	4 percent on premiums	Turned over to general fund.
Florida	Maximum 4 percent on gross earned premiums.	Remains in the fund.
Georgia	Prorated	Escheated to general fund.
Idaho	1.3 percent on premiums	Remains in industrial administration fund.
Kansas	0.0194 on total compensation paid.	Surplus goes into an unappropriated account.
Kentucky	2 percent on premiums [3]	Remains in maintenance fund.
Maryland	Prorated	No surplus, assessment made on actual appropriations.
Mississippi	Prorated on basis of total compensation paid.	Placed in State treasury.
Missouri	3 percent on premiums	Remains in workmen's compensation fund.
Montana	10 percent on premiums (State fund), and 3.25 percent on premiums (private carriers), 0.03 percent on payroll.	Returns to agency account.
New York	0.098 percent on compensation payments.	Carried over to following year.
Ohio	Assessment on premiums based on payroll.	Retained in State general fund.
Oregon	3.72 percent on premiums	Retained in reserves.
South Carolina	4½ percent on premiums	Surplus goes into general appropriation.
Texas	¼ of 1 percent on tne premiums	Reappropriated by legislature.
Virginia	1.5 percent on premiums	Remains in fund.
Washington	13.3 percent on total premiums	Surplus reverts to workmen's compensation funds.

[1] May be increased or reduced by Commission.

[2] Assessment suspended if surplus exceeds $500,000 in any year.

Sources: Analysis of Workmen's Compensation Laws, 1972 edition, U.S. Chamber of Commerce pp. 41–42. Questionnaire responses received from workmen's compensation agencies.

LONGSHOREMEN'S AND HARBOR WORKER'S COMPENSATION ACT

The final item to be reviewed is the expense of administering the Longshoremen's and Harbor

Workers' Compensation Act and related Federal acts. (The cost of administering the District of Columbia Act has already been included in State agency administrative costs.) Data are available on these administrative expenses but without hard aggregate data on benefits. In 1967 an evaluation of closed cases indicated total cash benefits of about $18,678,000. If, as was true under State programs, medical benefits were about one-third of total benefits, cash and medical benefit payments would have been $28,300,000. Administrative costs were $1.546,000 or about 5.5 percent of benefit payments as estimated above.

The relative cost of administering the Longshoremen's Act is higher than the operating expense of most State agencies. This may be explained in part by the comparatively high salaries paid to hearings personnel and travel and communication costs for operating country-wide with a relatively small number of covered employees.

TOTAL ADMINISTRATIVE COSTS

Summing the expenses and underwriting profits of private insurers, State funds, self-insurers, the Federal Government program, and State administrative agencies produces a total 1971 administrative cost of about $1.4 billion or 43.1 percent of benefit payments. Investment profits of private insurers are not in this total. Private insurer expenses and profit were obtained by subtracting losses incurred from premiums earned. State fund expenses were estimated at 18 percent of their losses paid, Federal Employees' Compensation Act costs at 3.2 percent, and self-insured program costs at 7.5 percent. State administrative agency costs not covered by assessments on insurers and self-insurers were assumed to be $38 million.

In Table 16.8, these administrative costs are compared with those of four other major public programs, all of which, except the railroad retirement program, were described in chapter 5.

The railroad retirement system is administered industrywide by the railroad retirement board, an independent Government agency that covers all employees of interstate railroads, associated companies, and labor and management associations of the railroad industry. This program provides a comprehensive system of cash benefits similar to OASDHI which includes monthly benefits for railroad workers who retire due to age or disability and for their wives or dependent husbands; monthly and lump-sum benefits to widows, children and parents; and residual payments designed to insure that the worker and his family receive at least as much in benefits as the employee has contributed in taxes.

Program changes in recent years have broadened the scope of benefits and liberalized eligibility requirements which have resulted in increased individual benefits, as well as increasing the amount of creditable earnings. The program is financed by equal contributions from employers and employees through payroll taxes on creditable wages. A temporary supplemental annuity program, recently enacted, is financed by a tax on employers of 2 cents per man-hours paid for.

The ratio of workmen's compensation expenses to benefits is about three times the ratio for unemployment insurance and temporary disability insurance, 13 times the OASDHI ratio, and 44 times the railroad retirement system ratio.

Table 16.8.—TOTAL ADMINISTRATIVE COSTS OF SOCIAL INSURANCE PROGRAMS, FISCAL 1971

Social insurance program	In thousands of dollars: Benefit payments	In thousands of dollars: Total administrative costs	Administrative cost as a percent of benefits payments
Workmen's compensation [1]	3,207	1,400	43.7
Old age, survivors, disability, and health insurance	34,482	[2] 1,138	3.3
Railroad retirement	1,910	18,525	1.0
State unemployment insurance	5,229	732	14.0
State temporary disability [1]	718	94	13.2

[1] 1970 calendar year.

[2] Includes $397,045,000 for administrative expenditures of the health insurance to the aged program.

Source: Workmen's compensation estimates explained in footnote 7; other estimates derived from Social Security Administration unpublished data.

Unemployment insurers, as exclusive State funds, incur no selling expenses and pay no premium taxes. They perform no loss prevention services. Temporary disability insurance is written by an exclusive State fund in Rhode Island and by competitive State funds in California, New Jersey, and New York. Private insurers pay only one quarter of the benefits provided under the laws; and their expense ratios, for the reasons explained early in this chapter, under actual expenses, are less than workmen's compensation insurer expense ratio.

OASDHI has no selling expenses, no premium taxes, and no safety program expenses. It also enjoys huge economies of scale and its death and retirement claims are much easier to adjust than workmen's compensation claims. Furthermore, it is provided small subsidies such as rent-free space in Government buildings.

Railroad retirement administrative expenses are low because this program provides only retirement, death, and long-term disability benefits; though it is not as large as OASDHI, it enjoys economies of scale and most of the other cost savings characteristic of that program.

References to Chapter 16

1. Adapted from Ralph H. Blanchard, "Risk and Insurance" (Lincoln: University of Nebraska Press, 1965), pp. 291–292.
2. *Ibid.*, p. 292.
3. Report of the Interim Commission on Workmen's Compensation," submitted to the Minnesota Legislature of 1953, pp. 23–26.
4. John F. Burton, Jr., "Interstate Variations in Employers' Costs of Workmen's Compensation" (Kalamazoo: The W. E. Upjohn Institute for Employment Research, May 1966), pp. 34–35.
5. The District of Columbia plus 43 States. Oregon data were not available.
6. The Center for Insurance Research, Georgia State University, "The Profitability of Workmen's Compensation Insurance."
7. Alfred M. Skolnik and Daniel N. Price, "Another Look at Workmen's Compensation," Social Security Bulletin, XXXIII, No. 10 (October 1970), pp. 22–23.
8. 1962–66 data from Williams, "Insurance Arrangements Under Workmen's Compensation," *op. cit.*, pp. 145, 165. 1970 data from 1971 Argus F.C. & S. Chart, 95th annual edition (Cincinnati: The National Underwriter Co., 1971).
9. "Workmen's Compensation, The Administrative Organization and cost of Administration, *op. cit.*, p. 94.
10. Alfred M. Skolnik, "New Benchmarks in Workmen's Compensation," Social Security Bulletin, vol. 25, No. 6 (June 1962) pp. 17–18.
11. "Rehabilitating the Disabled Worker," *op. cit.*, p. 42.