

2. A revision to the formula used to calculate fund discounts.
3. A 5 percent increase in the rates for fourteen payroll classifications, which, when combined with the 4.5 percent general rate increase, will produce a total increase of 9.5 percent for these fourteen classifications.

These changes will increase total contributions paid to the Pool by 2.5 percent to 3 percent, or approximately \$1.375 to \$1.65 million, before considering payroll changes. However, the impact will vary for individual members depending on their loss experience and their payroll classification distribution.

There are three primary components of Workers' Compensation contributions; losses, rates and payrolls. The impact of the 2004-05 rate increases and the discount formula change will be offset to some degree for those members with improving loss experience, as their experience modifiers decline in response to lower losses. On the other

hand, for those members with loss experience that has worsened, Workers' Compensation contributions for 2004-05 will reflect that poorer experience in addition to the rate increases and change in the discount formula. Payrolls that increase, decline or are classified differently than in past years will further impact contributions to be paid during 2004-05.

The Pool's Field Services Representatives are available to discuss these changes more fully and to talk about each individual member's particular situation. The most effective way to address increasing costs in the Workers' Compensation system is to prevent losses from occurring in the first place. The Pool's Loss Prevention Representatives are available to assist you in your Loss Prevention efforts.



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# Coverage



TML Intergovernmental Risk Pool Newsletter

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## Rates for 2004 – 05

### Liability and Property – No Increase in Rates!

During their April meeting, the Pool's Board of Trustees adopted Workers' Compensation, Liability and Property rates for 2004-05. Liability and Property rates will remain at current levels for another twelve months. Although rates will not change, contributions will reflect changes that have occurred since exposures were last reported such as vehicles purchased or sold, payroll increases or decreases, and properties that have been purchased or sold. New experience modifiers, that include 2002-03 loss experience, will be applied to 2004-05 contributions.

### Workers' Compensation – Rate Changes

Each year, the Pool contracts with consulting actuaries to perform a study of the adequacy of the Pool's Workers' Compensation rates. When formulating their opinion about the adequacy of the Pool's rates, the actuaries look at factors such as claims costs, reinsurance expense and interest earned from investments. One year ago, the actuaries indicated an 8 percent Workers' Compensation rate increase was needed for 2003-04. The Pool's Board of Trustees voted not to implement a general rate increase because many of the Pool's members were facing budget cuts and personnel reductions due to the general economic downturn and its impact on revenues, primarily sales tax. Although last year's action served to delay rate increases, loss costs continued to rise while interest rates stayed at historically low levels, making rate increases necessary for 2004-05.

#### Higher Losses

Rising Workers' Compensation losses are not unique to the Pool. The Texas Research and Oversight Council on Workers' Compensation published a report in 2001 that examined the cost and quality of medical care in the Texas Workers' Compensation system. The report concluded that;

- Texas had the highest average medical cost per claim in a nine-state study, and
- The average cost of a claim in Texas grew by more than 10% per year for the three years preceding 2001.

The Pool's rates have not increased to keep pace with 10 percent per year cost increases.

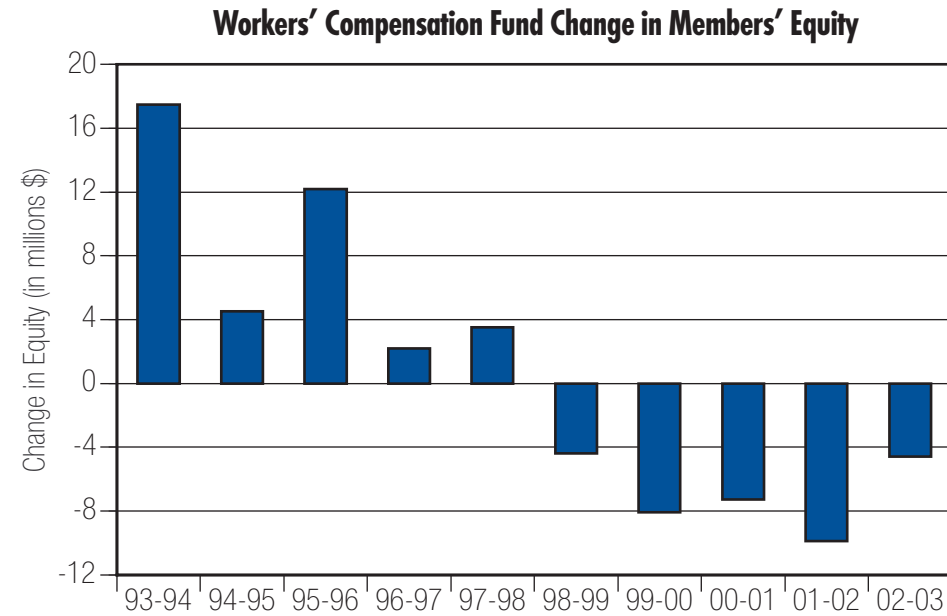
#### Lower Interest Rates

The Pool has two sources of revenues – contributions and investment income. The following chart illustrates the impact of lower interest rates on investment income. During 2001-02, interest rates were at levels that produced investment income sufficient to pay 76 percent of the Pool's contract service fees and general and administrative expenses. Through the first six months of 2003-04, investment income covered only 51 percent of contract service fees and general and administrative expenses.

Workers' Compensation Fund		
	9/30/02	3/31/04
Interest Income	\$9,581,464	\$3,387,051
Contract Service Fees	714,851	281,150
General Administrative Expenses	11,888,460	6,384,419
<b>Total</b>	<b>\$12,603,311</b>	<b>\$6,665,569</b>
% of Expenses Covered by Interest Income	76%	51%
Amount Expenses Exceed Interest Income - Annualized	\$3,021,847	\$6,557,036

*continued on page 2*

*“Since 1998-99, the Pool has consumed \$38.4 million in Members’ Equity.”*



**Rate Changes Necessary Due to Higher Losses and Lower Interest Rates**

When revenues drop due to lower interest income or expenses increase due to higher losses, the Pool can either increase contributions by raising rates or use a portion of Members’ Equity to offset the contribution shortfall, or a combination of both. Since 1998-99, the Pool has consumed \$38.4 million in Members’ Equity. To reverse this trend, three changes to the pricing structure for Workers’ Compensation have been approved by the Pool’s Board of Trustees:

1. There will be a general rate increase of 4.5 percent.
2. The formula used to calculate fund discounts will be modified.
3. Rates for fourteen payroll classifications will increase 5 percent.

**4.5% General Rate Increase**

The Pool has not had a general Workers’ Compensation rate increase since 1990-91. However, the effect of increasing losses combined with historically low interest rates makes a general rate increase for 2004-05 necessary. The Board of Trustees approved a 4.5 percent increase in the rates for all payroll classifications.

Unlike the general rate increase, which will apply to all members, the remaining two changes will not impact all members equally. The changes experienced by each member will vary based on their losses and the work that their employees do and how they are classified.

**Revised Discount Formula – How Loss Experience Impacts Contributions**

The Pool’s pricing structure makes two adjustments to contributions that are based on each Member’s unique loss experience. These adjustments are accomplished by applying an “Experience Modifier” and a “Fund Discount.”

**Experience Modifiers**

The formula used to calculate experience modifiers has not been changed for 2004-05. Updated loss experience for the years 2000-01, 2001-02 and 2002-03 will be used to calculate new modifiers. How this experience modifier will compare to the modifier for 2003-04 will depend on each member’s own, unique loss experience.

**Fund Discounts**

The second contribution adjustment based on loss experience is accomplished by applying a Fund Discount. The current discount formula, in effect since 1989, produces discounts based on ½ the difference between a 100 percent loss ratio and each member’s adjusted loss ratio. The discount produced by this formula is capped at a maximum discount of 35 percent.

The current formula has effectively adjusted contributions in response to changing loss experience. This was important during the years when loss experience was either improving significantly, such as immediately following the Workers’ Compensation reforms that became effective in 1991, or deteriorating, such as in more recent years. The responsiveness of the discount to changing loss data also causes volatility resulting in large contribution swings from year-

to-year for individual members. Because the experience modifier also reflects loss experience, the compound effect of the discount and the experience modifier serves to magnify changes and may result in even greater volatility.

To reduce the magnitude of changes to the cost of Workers’ Compensation coverage from year-to-year and to accomplish an increase in overall contributions for 2004-05, the discount formula has been changed from ½ the difference between a 100 percent loss ratio and each member’s adjusted loss ratio to ⅓ the difference. The maximum discount available will be 30 percent rather than the current 35 percent. The revised discount formula will produce lesser discounts and higher contributions than those that would have resulted under the formula in effect since 1989.

The following example illustrates how this will impact a member with a 70 percent loss ratio in 2003-04 and 2004-05.

2003-04
100% Loss Ratio – 70% Loss Ratio = 30%
30% ÷ 2 = 15% Discount
2004-05
100% Loss Ratio – 70% Loss Ratio = 30%
30% ÷ 3 = 10% Discount

This member would have received a 15 percent discount in 2003-04 and will receive a 10 percent Discount in 2004-05.

**5% Increase in Rates for 14 Payroll Classifications**

An analysis of rate adequacy for each payroll classification shows fourteen classifications produced loss ratios greater than 110 percent for the five-year period beginning October 1, 1998. A loss ratio greater than 100 percent occurs when losses caused by injuries to employees in a particular payroll classification exceed the contributions collected for that payroll classification.

The rates for the fourteen payroll classifications shown in the following table will be increased by 5 percent for 2004-05 because the losses for these classifications have exceeded the contributions collected over the past five years by more than 10 percent. It is expected that increasing these rates by 5 percent will produce an overall contribution increase of approximately 1.25 percent because these classifications represent about 25 percent of the total payroll reported to the Pool. This increase is in addition to the 4.5 percent general rate increase, resulting in a total increase of 9.5 percent for the fourteen payroll classifications affected.

**Summary**

Because of higher losses and lower interest rates, the Pool’s Board of Trustees has approved three changes to the pricing structure for Workers’ Compensation:

1. A general rate increase of 4.5 percent applicable to all payroll classifications.

**Rates for Fourteen Payroll Classifications will be increased by 5%**

Classification	Description	Loss Ratio *
7539	Electric Distribution	214%
7580	Sewage Treatment and Collection	184%
7704 & 7704V	Firefighters (Paid & Volunteer)	139%
8107	Heavy Equipment Maintenance	137%
8810	Clerical	171%
8831	Animal Shelters	351%
8832 & 8833	Medical Professionals	165%
8838	Libraries and Museums	223%
8868	Day Care Operations	401%
9102 & 9060	Parks and Recreation including Golf Courses	128%
9402	Street Cleaning	189%

\* Losses ÷ Contributions = Loss Ratio