

**FINAL REPORT
OF THE
SPECIAL DISABILITY TRUST FUND
PRIVATIZATION COMMISSION**

February 10, 2000

**Colleen Castille, Office of the Governor
Pete Mitchell, Office of the Treasurer
Allen Moayad, Office of the Comptroller**

I. INTRODUCTION

A. Overview of Special Disability Trust Fund

The Special Disability Trust Fund (SDTF) was established in 1955 to encourage the employment of the handicapped by providing a source of funds to pay increased costs of workers compensation claims by disabled workers.. The SDTF's two main functions are to receive and review claims to determine whether they are eligible for reimbursement and to audit requests for reimbursement on accepted claims. The SDTF is funded through an assessment on Workers' Compensation carriers/funds, and self-insured employers. The SDTF's assessment rate for the past several years has been at the rate of 4.52 percent, which is the maximum rate currently allowed by statute.

The SDTF was prospectively abolished in 1997 and is only accepting claims arising from accidents which occurred prior to January 1, 1998. Despite the prospective abolishment of the SDTF, the unfunded liabilities are considerable. The legislature has recognized that the SDTF's unfunded liability is substantial and that it is the State's obligation to extinguish these liabilities in a timely and cost effective manner. In 1998, the legislature formed the Special Disability Trust Fund Privatization Commission to explore the feasibility of privatization as a method of meeting the state's goal of extinguishing the unfunded liability.

B. Overview of Commission (including actions taken, advisors retained)

During the 1998 Legislative Session, SB 1372 was passed by the Legislature creating the Special Disability Trust Fund Privatization Commission (Commission). The Commission is composed of three members, one each selected by the Governor, the Comptroller and the Treasurer. The Commission consists of the following designees: Colleen Castille, Office of the Governor; Pete Mitchell, Office of the Treasurer and Allen Moayad, Office of the Comptroller. The initial appointees to the Commission were Bob Bradley (then Gov. Lawton Chiles's designee), Rene Lewis, Office of the Comptroller and Pete Mitchell, Office of the Treasurer. Colleen Castille replaced Bob Bradley in January of 1999 and Allen Moayad replaced Rene Lewis in November of 1999. The purpose of the Commission is to evaluate and determine the feasibility of privatizing the SDTF.

The legislation requires the Commission to:

- determine the liability of the SDTF as of December 31, 1998.
- determine the State of Florida's cost to administer the SDTF.

The Legislation authorizes the Commission to:

- contract to transfer the liabilities of the SDTF to a Qualified Entity, only if the Commission determines such an arrangement would substantially reduce the costs and be more effective than the current administration of the SDTF;
- contract with an Administrator to review, allow, deny, compromise, controvert, and litigate claims of the SDTF in a more efficient and timely manner than currently provided by the Division; and
- appoint and employ such officers, agents and employees as it deems advisable to operate and manage its affairs, including employees of the Division of Workers Compensation or the State Board of Administration.

Since September 1998, the Commission has held numerous meetings to gain an understanding of the functions and the operations of the SDTF. Anne Marie Craft, Supervising Attorney of the SDTF, Messrs. Lee Weaver and Charles Williams of the Department of Labor and Employment Security made presentations to the Commission. In addition, the public and interested parties were asked to participate via public testimony and written comments to the Commission at all meetings. All presentation materials and minutes of the meetings are available upon request.

In November 1998, the Commission voted to employ a Coordinator to assist in the functions and responsibilities of the Commission. The Coordinator is responsible for noticing meetings, preparing meeting materials, and correspondence to interested parties. On November 30, 1998, Anne Mackenzie was hired as the Coordinator for the SDTF Privatization Commission.

The Commission was authorized to hire consultants and make use of staff of the Departments of Insurance and Labor and Employment Security and the Division of Bond Finance. Consultants were hired to assist in providing an actuarial determination of the fund's liability and estimate the Special Disability Trust Fund's costs to administer all claims. The Commission retained Dain Rauscher to serve as financial advisor and KPMG to conduct a cost analysis of the SDTF. In addition, FDLES retained Milliman and Robertson to determine the liability of the SDTF. As authorized by the statute, the Commission issued Requests for Proposals for an Administrator and a Qualified Entity to assume the SDTF liabilities, as more fully discussed herein.

II. Analysis of Current SDTF Processes

A. The Division of Workers Compensation's Analysis

On March 26, 1999, Charles Williams, the newly appointed Director of the Division of Workers Compensation in the Department of Labor & Employment Security, presented the Division's views on privatizing the functions of the SDTF to the Commission. The Director's comments were two fold. First, he recommended that the SDTF should continue to streamline its operations as outlined in the Fund's Year 2000 work-plan. The SDTF will review Proofs of Claim, implement a pilot project to send settlement letters on 2500 files, audit 7500 SDF-2 reimbursement requests as well as review all processes currently in place and implement improvements to them. A primary focus of the SDTF for calendar year 2000 will be exploring ways to move claims to closure. The SDTF has identified approximately 8000 accepted claims that are open, meaning that further reimbursement requests are anticipated. The SDTF plans to send letters on at least 2500 files verifying whether the underlying workers' compensation claims remain open and if so, partnering with the employer/carrier to move the claim to closure.

The SDTF has also changed its approach in responding to carriers who request SDTF approval to settle a claim. In the past the SDTF was conservative about approaching companies for requests for settlement approval; requiring employer/carrier to reach a tentative agreement with the claimant and only afterward would the SDTF comment on whether they agreed it was reasonable. Now the SDTF will work with the employers/carriers to provide a range of settlement authority earlier on in the negotiations.

The second issue raised by Mr. Williams was the matter of the decreasing premium base. Two trends contributing to this decline are the purchase of large deductible policies by a large number of formerly self-insured employers and the exclusion of ceded reinsurance premiums from the premium base. These issues have also been discussed in a report entitled "Staff Update on the Status of Funding for the Workers Compensation Administration Trust Fund and the Special Disability Trust Fund," dated November 23, 1999, prepared by the Staff of the House of Representatives, Committee on Insurance. Both of these issues are causing a continuing decrease in the revenues to the Special Disability Trust Fund on which the State could rely to pay the claims and/or debt service on any proposed financing arrangement.

B. Special Disability Trust Fund Liabilities

Actuarial Report by Milliman & Robertson, Inc.

The Department of Labor & Employment Security selected the firm of Milliman & Robertson, Inc. (M&R) through statutory bidding procedures to determine the liability of the SDTF. Milliman & Robertson provided three actuarial analyses of the Fund's liability over the last three years. According to section 440.49, Florida Statutes, the Commission was directed to determine the liability of the Fund as of December 31, 1998. Based on M&R's familiarity with the SDTF and their experience with actuarial analyses of the Fund's liability, the Commission voted to extend the Department's contract with M&R to determine the Fund's liability in accordance with section 440.49, Florida Statutes. Milliman and Robertson provided a presentation and a report to the Commission entitled, "State of Florida Special Disability Trust Fund Projection of Fund Cash Flows As of December 31, 1998," dated February 9, 1999. An updated projection of Fund liabilities was completed as of September 30, 1999 and presented to the Legislature as required by law on December 1, 1999. The following table presents selected information from these reports.

<u>Item</u>	<u>As of 12/31/98</u>	<u>As of 9/30/99</u>
▪ Undiscounted liability	\$3.56 billion	\$3.24 billion
▪ Discounted liability	\$1.69 billion	\$1.64 billion
▪ Average time to reimburse accepted claims	21 months	28 months
▪ Cumulative backlog of unreimbursed claims	\$281.21 million	\$359.71 million
▪ Est. Date of assessment revenues sufficient to pay reimbursement claims due during current fiscal year (assumes 1% premium growth)	FY 2002-03	FY 2003-04
▪ Est. date for elimination of cumulative shortfall (assumes 1% premium growth)	FY 2013-14	FY 2014-15

Source: Milliman & Robertson, Inc. "State of Florida Special Disability Trust Fund Projection of Fund Liabilities as of December 31, 1998" and "State of Florida Special Disability Trust Fund Projection of Fund Liabilities as of September 30, 1999."

The February 1999 M&R report attributes the decrease in liability to a decrease in the expected number of ultimate claims accepted by the SDTF and a decrease in the average amount payable on accepted claims. The report emphasizes that the projections contained therein are best estimates of the expected value of outstanding liabilities based upon the available data from the SDTF. Circumstances exist that may cause substantial variation from the projections. Results in the report are presented as being as accurate as can be expected from any actuarial analysis given the available

data, with the caveat that the actual results could differ significantly from the results projected in the analysis. The M&R reports are included herein as Appendix C.

C. Determine the State's Cost to Administer the Fund

KPMG Report

According to F.S. 440.49, the Commission was also directed to determine costs to presently administer the SDTF. The Commission contracted with KPMG to conduct a cost analysis of the Fund. KPMG provided a presentation and a report to the Commission entitled, "Costing Analysis Special Disability Trust Fund," dated March 12, 1999.

The report outlines the following costs associated with the primary functions of the Fund:

Reviewing a Claim	\$130.32
Auditing a Claim	\$115.28
Processing a Claim Payment	\$ 29.79
Total Processing Costs	\$275.39
Litigating Costs per Claim	\$253.09
Total Cost to Administer Each Claim	\$528.48

The KPMG report is attached herein as Appendix D.

D. Dain Rauscher -- Financial Advisor to the Commission

Under an existing competitively bid contract for independent financial advisory services with the Division of Bond Finance of the State Board of Administration, the Commission contracted with Dain Rauscher to provide analyses of various financial considerations related to the issuance of debt obligations in connection with privatization of SDTF liabilities. Their report presented to the Commission on June 4, 1999, includes a discussion of the current status of the assessment revenues, noting that the assessment rate is currently at the maximum allowable rate of 4.52%, and that assessment revenues have been somewhat volatile over the past six years, resulting in decreasing revenues in the last four years (\$172.8 in 1996 to \$135.9 in 1998).

III. Analysis of Privatization

A. Request for Proposal Process

Senate Bill 1372 authorized the Commission to contract for privatization of the fund. The Commission determined that the Request For Proposal process would be utilized to assist it in making a determination as to whether privatizing the SDTF was in the best interest of the State of Florida. One entity, the Administrator, would be responsible for reviewing, allowing, denying, compromising and controverting Proofs of Claim. The Administrator would also be responsible for auditing Reimbursement Requests and litigating Proofs of Claims not transferred to the Qualified Entity. The other entity, dubbed the "Qualified Entity," would be responsible for the assumption of liabilities of the Fund, making reimbursement payments to carriers/employers and handling all necessary litigation on transferred files. This structure effectively prohibited the respondents from contracting for both functions as required by the statute.

The Commission voted to issue the RFPs at its June 18, 1999 meeting and the Department of Labor and Employment Security, acting as the Commission's administrative agent, issued both RFPs on July 1, 1999. The RFPs were constructed to allow respondents flexibility and creativity. The Department reserved the right to reject any and all proposals. The Commission approved an evaluation team for each RFP using the resources of FDLES, Department of Insurance, the Division of Bond Finance, Florida State University and the financial advisor. The evaluation period for the Administrator RFP was August 27, 1999 through September 14, 1999. The evaluation period for the Qualified Entity RFP was September 23, 1999 through November 3, 1999.

The purpose of the RFPs was to answer the following threshold issues for the Commission so a determination whether or not to privatize functions of the SDTF could be made.

1. Would privatization substantially reduce the overall costs of reviewing and reimbursing claims?
2. Would privatization settle and extinguish the liabilities of the SDTF in a more cost efficient and more timely manner than presently provided by the Division?
3. Would privatization be more effective than the current administration of the SDTF?
4. Is privatization in the best interest of the State, insurers, employers and employees?

B. Credit Constraints (Dain Rauscher Report)

In its report to the Commission on June 4, 1999, Dain Rauscher made the following summary comments:

- The existing revenue stream is not sufficient to finance the entire actuarial present value of \$1.69 billion that is estimated by the actuary as the total SDTF liability.
- The nature of the assessment revenue stream and present lack of mechanism to increase or maintain revenues translates into credit constraints that negatively impact the amount that can be borrowed.
- A favorable determination by the Internal Revenue Service regarding tax-exemption for debt of the Corporation will substantially lower borrowing costs and increase the amount that can be borrowed.

C. Administrator Proposals

Insurance Servicing and Adjusting Company (ISAC) was the sole respondent to the Administrator RFP. At the November 16, 1999 Commission meeting, evaluation team members presented their review and analysis of ISAC's proposal. ISAC proposed that the first year they would administer claims for \$488 per claim and the cost would rise each year thereafter to a cap of \$508 per claim. While this cost to administer the claim was a low amount, the rest of the proposal did not offer enough information for the Commission to determine if the firm was capable and had the staff and expertise to competently handle the claims administration for this contract. Additionally, because the number of claims would be declining each year, the Commission concluded that the cost to administer the fund should drop on an annual basis. After discussion, the commission voted unanimously not to award the Administrator RFP and further recommended improvement in these functions within the Special Disability Trust Fund. The Cost Proposal from ISAC is attached as Appendix B.

D. Qualified Entity Proposals

Two consortiums responded to the Qualified Entity RFP. American International Group, General Reinsurance Corporation, Swiss Re Atrium Corporation, and Lehman Brothers (SwissRe) comprised one group and Zurich Financial Services Group, First Union Corporation and Guy Carpenter & Company, Inc. (Guy Carpenter) formed the second. SwissRe presented three alternative proposals and Guy Carpenter submitted two. Each of the proposals contemplated the issuance of debt obligations by leveraging the revenue assessments to generate an upfront premium for the consortium's assumption of SDTF liabilities. The premium and investment earnings thereon would be used to make reimbursement payments to carriers/employers and pay fees of the Qualified Entity. The proposals varied in the amount of: specific loss coverage provided (ranging from \$4 billion to \$1 billion); the upfront premium for such coverage (ranging from \$1.56 billion to \$1.4 billion); term of the contract and utilization of the assessment revenues (ranging from 58 to 20 years); and estimates of annual assessment revenues

required for payment of debt service on the bonds issued to fund the premium (ranging from \$135 million to \$165 million). Some proposals limited the specific annual amounts of reimbursements payable or number of claims payable. Various financing scenarios to fund the premiums were presented assuming ranges of interest rates, length of maturities, debt service coverage and credit constraints. All proposals stated coverage up to a specific amount (some of which equaled or exceeded the actuarially determined undiscounted liability); however, none provided for an assumption of all liabilities of the SDTF. An Outline of Coverage and Cost of Financing is attached as Appendix A.

Several meetings were devoted to presentations by the evaluation team, the respondents and the financial advisor. The Commission was unable to determine that any of the proposals would either transfer all liabilities of the SDTF to the Qualified Entity or that such arrangement would substantially reduce the costs and be more effective than the current administration of the SDTF. On January 21, 2000, the Commission voted unanimously not to privatize at the present time, and approved a list of recommendations. The Commission's findings and recommendations follow.

FINDINGS

The Commission found the following:

1. The revenue stream into the SDTF is volatile, and has declined over recent years. The declines are due in large part to a decreasing assessment base due to the attractiveness of workers compensation policies with million-dollar deductible clauses and premiums ceded to reinsurance companies, which may potentially be subject to refund.
2. It is not possible to establish with certainty the liabilities of the SDTF at this time. Our best estimate, provided by Milliman and Robertson, Inc., has resulted in a \$1.69 billion dollar deficit on Florida's financial statement.
3. No proposal presented to the Commission established that privatization would substantially reduce the costs to the State.
4. The terms of the proposals presented to the Commission did not sufficiently accomplish the Legislative requirement of eliminating all of the liabilities of the SDTF.
5. The cost of administering the SDTF could be reduced by establishing quick-settlement procedures for paying claims on a first-in, first-out basis, rather than the current process of being lined up in the payment queue, which presently has a 29-month payment lag.

6. The SDTF has adopted a work-plan for the year 2000 which implements specific measures designed to streamline its operations.
7. Privatization of the SDTF at this time is not in the best interests of the State, insurers, employers or employees.

RECOMMENDATIONS

The Commission makes the following recommendations:

1. The SDTF should continue to implement the 2000 Work-plan, while continuing to review and improve current processes in order to operate in a more efficient and cost-effective manner.
2. The Legislature should address issues affecting the stability of the revenue stream to the SDTF, including but not limited to the clarification of the definition of net written premiums and the redefining the calculation of SDTF assessments for self-insured companies.
3. A mechanism should be developed for establishing a quick settlement process and funding therefore.
4. Upon stabilization of the revenue stream, the Department should explore financing options, which may include extinguishing all of the SDTF liabilities or component parts of the liabilities under terms favorable to the state.
5. It is further recommended that the work product of the Commission be made available to the Legislature and the Department in order to address the issues raised herein.
6. The Commission finally recommends the repeal of the statutory provisions creating the State Disability Trust Fund Privatization Commission.

APPENDIX A

Outline of Coverage and Cost of Financing Premium

Swiss Re, General Re, AIG, Lehman Brothers Proposal A

Total Premium Cost:	\$1.56 billion.
Coverage Provided:	<p>\$3.56 billion total coverage (includes initial payment of \$343 million to extinguish current unpaid approved claim balance).</p> <p>Coverage subject to specified annual limits.</p> <p>Coverage amounts paid over 58-year term of contract.</p> <p>Coverage sufficient to pay actuarial estimates of final liability, i.e., \$3.56 billion.</p>
Economic Benefit to SDTF:	<p>10% savings for claims review.</p> <p>20% savings for discounting claims.</p>
Cost of Financing Premium:	Presents 8 financing scenarios based on various parameters including: ratio of tax-exempt bonds to taxable bonds and term of financing For purposes of comparison, three scenarios which provide proceeds sufficient to pay premium shown above are used.

****Key financing contingency -- Each of the foregoing scenarios assumes that the large deductible policy loophole is closed via legislation. If the loophole is not closed via legislation, then financing premium is not feasible.***

	<u>Scenario 1*</u> <u>(All Tax-Exempt)</u>	<u>Scenario 5*</u> <u>(Primarily Taxable)</u>	<u>Scenario 6*</u> <u>(Primarily Taxable)</u>
Net Proceeds of Bonds	\$ 1.49 billion	\$ 1.49 billion	\$ 1.54 billion
Total Debt Service	\$ 2.65 billion	\$ 3.55 billion	\$ 4.03 billion
Total Interest Cost:	\$ 1.14 billion	\$ 2.04 billion	\$ 2.46 billion
Term of Financing:	20 year	25 year	30 year
Average Annual Payments:	\$132.48 million	\$141.93 million	\$134.17 million

Margin for Service Provider: Unspecified

Outline of Coverage and Cost of Financing Premium

Swiss Re, General Re, AIG, Lehman Brothers Proposal B

Total Premium Cost:	\$1.5 billion.
Coverage Provided:	<p>\$2.53 billion total coverage ((includes initial payment of \$343 million to extinguish current unpaid approved claim balance).</p> <p>No annual limits on coverage.</p> <p>Coverage liability split pro rata 70%/30% between Provider and SDTF. <i>SDTF could pay its 30% share from residual assessments, if any. If no residual assessments available, SDTF would need to find additional funding for its 30% pro rata share.</i></p> <p>Coverage in effect until total coverage amount paid out, subject to earlier termination by SDTF on or after July 1, 2009.</p> <p>Provider's liability subject to certain limits based on specified number of claims.</p>
Economic Benefit to SDTF:	<p>10% savings for claims review.</p> <p>20% savings for discounting claims.</p>
Cost of Financing Premium:	Presents 8 financing scenarios based on various parameters including: ratio of tax-exempt bonds to taxable bonds and term of financing For purposes of comparison, three scenarios which provide proceeds sufficient to pay premium shown above are used.

	<u>Scenario 1*</u> <u>(All Tax-Exempt)</u>	<u>Scenario 5*</u> <u>(Primarily Taxable)</u>	<u>Scenario 6*</u> <u>(Primarily Taxable)</u>
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Term of Financing:	20 year	25 year	30 year
Average Annual Payments:	\$132.48 million	\$141.93 million	\$134.17 million

****Key financing contingency -- Each of the foregoing scenarios assumes that the large deductible policy loophole is closed via legislation. If the loophole is not closed via legislation, then financing premium is not feasible.***

Margin for Service Provider:	<p>\$142 million.</p> <p>Market Value Adjustment Due upon Contract Termination.</p> <p>Contract may be terminated after 2009.</p>
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Outline of Coverage and Cost of Financing Premium

Swiss Re, General Re, AIG, Lehman Brothers Proposal C

Total Premium Cost: \$1.52 billion

Coverage Provided: \$2.0 billion total basic coverage (includes an initial payment of \$343 million to extinguish current unpaid approved claim balance).

\$4.0 billion total enhanced coverage, available at end of third year.

Coverage under basic coverage or enhanced coverage subject to cumulative annual limits.

Coverage amounts paid over 58 year term of contract, subject to earlier termination at July 1, 2003 at option of SDTF if enhanced coverage not provided, and on or after July 1, 2009, if enhanced coverage is provided.

Economic Benefit to SDTF: 10% savings for claims review.

20% savings for discounting claims.

Cost of Financing Premium: Presents 8 financing scenarios based on various parameters including: ratio of tax-exempt bonds to taxable bonds and term of financing. For purposes of comparison, three scenarios which provide proceeds sufficient to pay premium shown above are used.

	<u>Scenario 1*</u> <u>(All Tax-Exempt)</u>	<u>Scenario 5*</u> <u>(Primarily Taxable)</u>	<u>Scenario 6*</u> <u>(Primarily Taxable)</u>
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Term of Financing:	20 year	25 year	30 year
Average Annual Payments:	\$132.48 million	\$141.93 million	\$134.17 million

****Key financing contingency -- Each of the foregoing scenarios assumes that the large deductible policy loophole is closed via legislation. If the loophole is not closed via legislation, then financing premium is not feasible.***

Margin for Service Provider: \$40 million if terminated in 2003 due to enhanced coverage not provided.

\$68 Million for Basic Coverage after 2003 or
\$142 Million for Enhanced Coverage after 2003.

Market Value Adjustment Due upon Contract Termination after 2009 if enhanced coverage provided.

Coverage provider entitled to additional compensation equal to 50% of settlement savings greater than \$65 million.

Outline of Coverage and Cost of Financing Premium

Guy Carpenter, Zurich Financial Services Group, First Union Capital Markets Proposal 2 - Options A and B

Total Premium Cost:	Option A - \$130 million (upfront payment) Option B - \$250 million (upfront payment)
Coverage Provided:	Option A - \$1 billion coverage limit, which is applicable to payment of claims above \$3 billion, which remain responsibility of SDTF. Option B - \$1.5 billion coverage limit, which is applicable to payment of claims above \$2.5 billion, which remain responsibility of SDTF. Coverage amounts paid after SDTF has paid the \$3billion (Option A) or \$2.5 billion (Option B) and last through payment of remaining reimbursement obligations or expenditure of respective coverage amounts. Provides for calculation at Year 20 of remaining obligations and final settlement.
Economic Benefit to SDTF:	Unspecified
Cost of Financing Premium:	Debt service costs are unspecified; although proposal contemplates issuance of traditional municipal finance structure utilizing a defeasance mechanism.
Margin for Service Provider:	\$25 Million Plus 50% of Balance in "Profit Sharing Account"



SEVEN YEAR GUARANTEED RATES

RFP No. 99-046-DB-RFP

1st YEAR RATES	\$488.00 Per Claim
2nd YEAR RATES	\$488.00 Per Claim
3rd YEAR RATES	\$488.00 Per Claim
4th YEAR RATES	\$498.00 Per Claim
5th YEAR RATES	\$498.00 Per Claim
6th YEAR RATES	\$498.00 Per Claim
7th YEAR RATES	\$ 508.00 Per Claim

Contract may be extended in accordance with the terms under section 1.18 of RFP No. 99-046-DB-RFP.

Two one year contract extensions at the following rates:

8th YEAR RATE	\$508.00
9th YEAR RATE	\$508.00

Price increases are rounded percentages based on the minimal average operating expense increase experienced over the last five years within the workers' compensation claims market.

APPENDICES

C & D

AVAILABLE UPON REQUEST

FROM THE

SPECIAL DISABILITY TRUST FUND