



LIMITED-SCOPE PERFORMANCE AUDIT REPORT

Kansas Insurance Department: Evaluating the State's Workers' Compensation Insurance Plan Contract

AUDIT ABSTRACT

State law requires the Kansas Workers' Compensation Insurance Plan, a plan to provide workers' compensation insurance for high-risk companies. In early 2014, the board that oversees the plan reviewed bids from two vendors interested in administering the plan. As a result of that review, the board awarded the contract to the National Council on Compensation Insurance (NCCI). We compared the cost estimate in NCCI's bid to requirements in the state's request for proposal (RFP) and determined that it appeared to include the required costs. However, we also found that NCCI receives other administrative payments related to the plan that were not captured in its cost estimate. Although inclusion of those payments did not appear to be required by the RFP, the RFP language was not entirely clear and resulted in inconsistent cost estimates between the two vendors.

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
April 2015**

From the Legislative Post Auditor:

This limited-scope audit was authorized by the Legislative Post Audit Committee at its February 18, 2015 meeting. It addresses the following question: Did the National Council on Compensation Insurance's (NCCI) bid include all relevant information and identify all payments related to its administration of the plan?

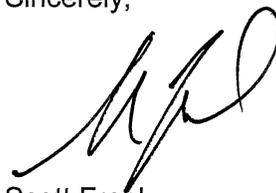
To answer this question, we interviewed officials from the Workers' Compensation Insurance Plan Board to better understand the plan and their involvement in the recent bid process for the plan contract. We also reviewed relevant bid documents from the Office of Procurement and Contracts in the Department of Administration. Finally, we interviewed NCCI officials about their cost proposal to determine whether it included all administrative payments it actually receives to administer Kansas' plan and related services. We were not able to determine all of the administrative payments NCCI actually receives because some of those payments were outside the scope of the plan contract and because NCCI considers them proprietary information.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Overall, we believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit standards require that we report on any work we did related to internal controls, but a review of internal controls was not part of the scope of the audit as approved by the Legislative Post Audit Committee.

This audit was requested by Senator Jim Denning and conducted by Kristen Rottinghaus. Justin Stowe was the audit manager. If you need any additional information about the audit's findings, please contact Kristen at (785) 296-3792.

Sincerely,



Scott Frank
Legislative Post Auditor
April 28, 2015

Did the National Council on Compensation Insurance’s Bid Include All Relevant Information and Identify All Payments Related to Its Administration of the Plan?

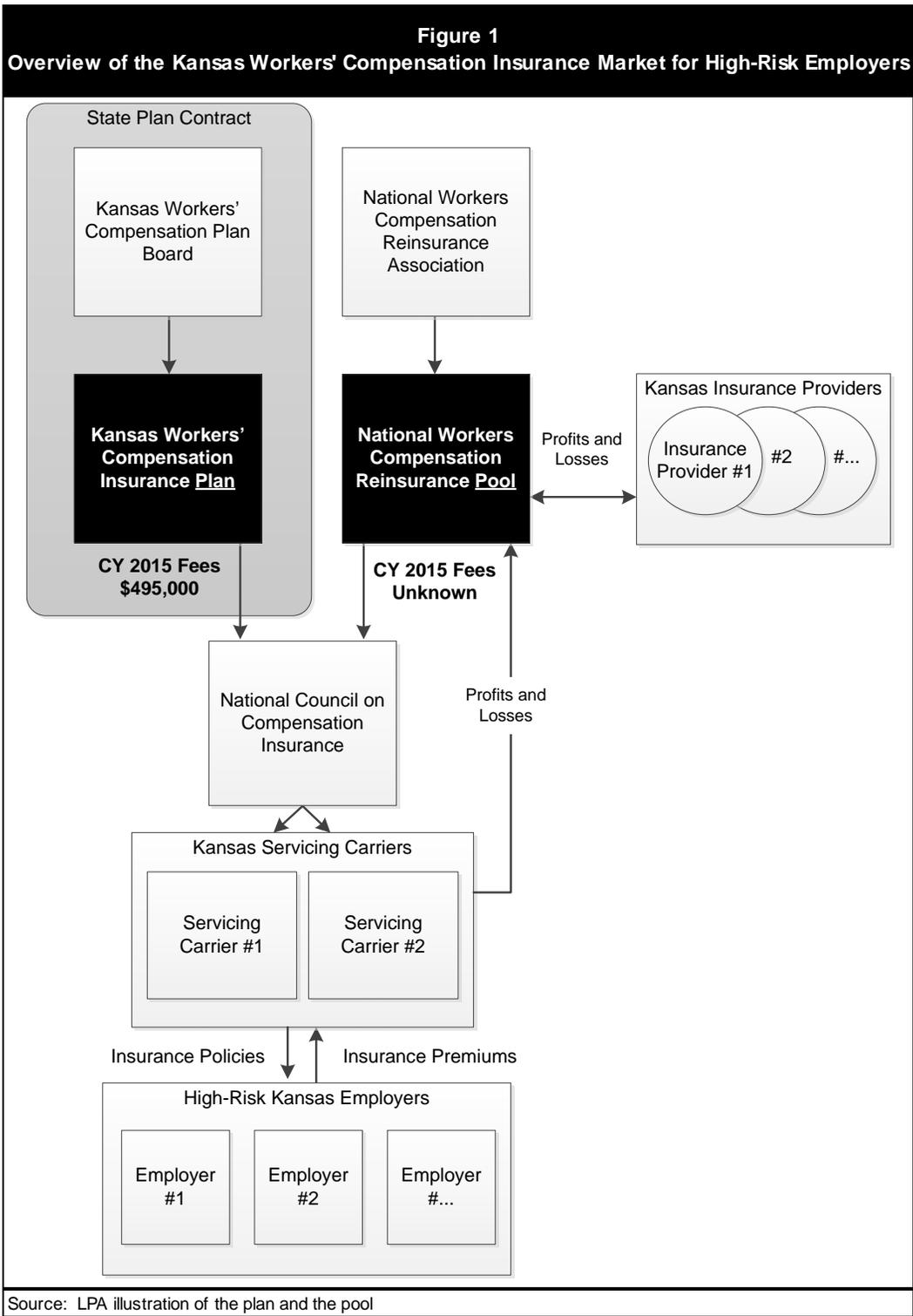
Background Information

State law requires a plan to provide workers’ compensation insurance to high-risk companies called the Kansas Workers’ Compensation Insurance Plan (the plan). Most Kansas employers must provide workers’ compensation insurance coverage for their employees. Typically, providers of workers’ compensation insurance voluntarily choose which employers to insure based on an evaluation of the risks an employer presents. However, some Kansas employers may not be able to find an insurer willing to provide them workers’ compensation insurance coverage. These employers include new companies with no insurance history and companies with dangerous work environments such as the construction industry. For the purposes of this report, we will refer to these companies as high-risk employers. Kansas law requires all insurers that provide workers’ compensation insurance in the state’s voluntary market to collectively create a plan for also providing coverage to these high-risk employers. In Kansas, this plan is known as the Workers’ Compensation Insurance Plan. Although required by state law, the plan creates an obligation for the insurance industry. State law requires a nine-member board, called the Kansas Workers’ Compensation Insurance Plan Board (plan board), to oversee the plan.

For more than 40 years, the plan board has selected the National Council on Compensation Insurance (NCCI) to administer the plan. Among other things, the current contract requires the plan administrator to provide a variety of administrative and management services. Those services include developing management reports, reviewing insurance applications, and establishing performance standards to measure the timeliness and quality of services. Additionally, the contract requires the plan administrator to select and monitor servicing carriers for Kansas. Servicing carriers act on behalf of all participating insurance providers by offering the services those insurers would normally provide in the voluntary market. They provide other plan services such as underwriting, billing for insurance premiums, and claims reporting and investigation. NCCI currently contracts with two servicing carriers for the Kansas plan.

NCCI charges fees for the administrative services it provides for the plan. Those fees are not charged to the Kansas Insurance Department or the State of Kansas, but are directly billed to all participating Kansas workers’ compensation insurance providers each quarter.

In early 2014, the plan board evaluated bids for a new contract to administer the plan. Two vendors submitted bids for administering the plan—NCCI and Aon Risk Solutions. NCCI estimated it would charge Kansas insurance providers \$495,000 to administer the plan in calendar year 2015. As discussed on page 4, Aon Risk Solutions estimated it would cost up to \$950,000 for that same time period. However, its bid appeared to include additional administrative costs that NCCI’s bid did not include. The plan board awarded the contract to NCCI for a five-year period from July 1, 2014 through December 31, 2019. The contract also includes possible extensions through December 2025.



In addition to administering the plan, NCCI also administers the National Workers Compensation Reinsurance Pool (the pool), which Kansas insurance providers use to share the plan’s profits or losses. In general, the pool receives a profit if the amount of claims filed by high-risk Kansas employers is less than the insurance premiums they pay. Conversely, the pool incurs a loss if the amount of claims filed exceeds the premiums collected. The two

servicing carriers for Kansas pay all losses as they become due and are then reimbursed by the insurance providers who participate in Kansas' pool (called the reinsurance mechanism). Because the insurance providers that participate in the pool do not voluntarily assume the risk of those losses, state law requires the plan to provide rules for distributing the plan's profits and losses across all workers' compensation insurance providers in the state's voluntary market. In Kansas, insurance providers have agreed to participate in the pool as a way of sharing the plan's profits and losses. An independent, national association of insurance providers oversees the pool, and has a separate contract with NCCI to provide the pool's administrative and management services.

Similar to its services for the plan, NCCI does not charge the state for administering the pool, but directly bills all participating Kansas workers' compensation insurance providers. We were not able to determine the amount of fees NCCI received for administering the pool because they are outside the scope of the state's contract and NCCI considers those fees proprietary information.

Figure 1 on the previous page illustrates the relationship between the two components of Kansas' workers' compensation insurance market for high-risk employers that are currently administered by NCCI—the plan and the pool. As the figure shows, NCCI receives fees for the administrative services it provides for both the plan and the pool, but only fees for the plan are included in the state contract.

Finding #1: NCCI Submitted the Required Cost Estimates as Part of Its Bid Documentation

The request for proposal (RFP) for the Kansas Workers' Compensation Insurance Plan required bidders to submit cost estimates for administering the state plan. A variety of services are needed to provide workers' compensation insurance to high-risk Kansas employers, of which the plan is only one component. As described in the background section, the pool is the second component of the services needed to provide worker's compensation insurance to high-risk employers. The request for proposal for Kansas' plan required bidders to include all administrative costs they would incur in providing services for the plan.

However, the RFP did not appear to require bidders to estimate the cost for administering the pool if it was handled outside the state contract. The RFP required bidders to provide a reinsurance mechanism. That mechanism could be the pool, or it could be a different way of distributing the operating results of the plan across all participating insurance providers. A plain reading of the RFP suggests that vendors' cost estimates should have included the annual fees related to the plan that provides those reinsurance services. However, the RFP was not entirely clear about needing to include or exclude the costs of the reinsurance mechanism (the pool) if it was administered separate from the plan. Despite this ambiguity, the plan board members we talked to agreed that the administrative costs of the reinsurance mechanism (the pool) were not required if it was not a cost to the plan.

NCCI's bid included the estimated cost of administering the plan (as required), but did not include an estimate for administering the pool (which was not required). As described in the background section, NCCI estimated the total cost to administer the plan was \$495,000 in calendar year 2015. However, its bid did not include an estimate of Kansas' share of the total cost to administer the pool. NCCI was not willing to provide that amount because it is outside the scope of the state's contract and is considered propriety information. The plan board members we spoke with told us they did not expect NCCI to include the cost of administrative services for the pool in their bid for Kansas' plan.

Although not part of the state's plan contract, administration of the pool is an additional cost to Kansas insurance providers. NCCI charges individual Kansas insurance providers for the administrative services to the pool and the plan. However, the request for proposal for the plan appears to require the cost of plan services only. Therefore, the plan contract does not reflect all costs to insurance providers licensed to write workers' compensation insurance in Kansas.

Aon Risk Solutions' cost estimate was different from NCCI's cost estimate because it appeared to include administrative costs for both the plan and the pool. Aon Risk Solutions estimated its total administrative costs would be up to \$950,000 in calendar year 2015. Aon officials told us that amount included the cost to administer the plan and the pool.

The inconsistency in how NCCI and Aon Risk Solutions treated pool administration costs appears to be the result of the different approaches the two vendors proposed. NCCI officials told us its cost proposal excluded administrative costs for the pool and other related expenses (e.g. insurance agent commissions, taxes, and legal costs) because they viewed the RFP as being written for only the plan services under the plan board's purview. By contrast, Aon's cost proposal appeared to be based on the savings it thought it could achieve on plan, pool, and other related administrative expenses. Aon asked one of the plan board members whether it should include administrative costs for the pool in its proposal and was told that it should. However, that board member told us that his reason for telling Aon to include administrative costs for the pool was based on his understanding that Aon's proposal would result in the pool being administered as part of the plan and not separate from it.

We were unable to determine how significant this difference was in terms of its impact on the bid award. That is because Aon's cost proposal did not distinguish between administrative costs for the plan and the pool, and because the board's decision to award the contract to NCCI was not based solely on price, but was also on the vendors' previous experience with administering workers' compensation insurance to high-risk employers.

Recommendations

1. To address the issue with inconsistent cost proposals (page 4), the Kansas Workers' Compensation Insurance Plan Board should consider whether a plan contract is necessary after the current contract expires and explore other options the state has for maintaining oversight of the plan that do not involve a contract.

If the plan board determines that a plan contract is necessary, it should determine the costs the contract needs to include and exclude and clarify those costs in the next request for proposal and any subsequent contracts.

Agency Response

On April 10, 2015, we provided copies of the draft audit report to the Kansas Insurance Department and the National Council on Compensation Insurance for technical clarifications. We also provided a copy of the draft report to the chair of the Kansas Workers' Compensation Insurance Plan Board for technical corrections and an official response to our findings and recommendation. We made several minor clarifications to the final report as a result of the organizations' reviews, but those changes did not affect any of our findings or conclusions.

The plan board generally agreed with the audit's findings and recommendation, and indicated it plans to consider the recommended changes to the contract at its annual meeting in the late summer. The full text of the plan board's response is on file and available from Legislative Post Audit.

Potential Issues for Further Consideration

We identified several issues that might be worth evaluating in more detail, but because of the limited scope of the audit, we did not have time to fully develop these issues. Although we had unresolved questions about the following issues, more audit work would be needed to determine whether they represent an actual problem or not.

1. The responsibilities of the plan board, Kansas Insurance Department, and Department of Administration appeared to have changed over time and may have contributed to a less detailed and thorough technical review of the most recent bids. We reviewed a couple of documents and spoke to a plan board member who indicated the review committee did not have the subject knowledge or procurement expertise to conduct a detailed and thorough technical review of the submitted bids. Additional work in this area could include a comparison to best practices and other states' plans.

2. In addition to the amount it receives under the state's contract, NCCI also receives other payments for workers' compensation insurance for high-risk employers. However, to identify and quantify all of these payments, we would need full access to the pool's financial records. NCCI currently considers some of that payment information proprietary. Additionally, that payment information is subject to the confidentiality requirements in NCCI's contract with the insurance providers who participate in the pool and would require approval from the National Workers Compensation Reinsurance Association before it could be disclosed. Assuming we could gain access to this information, additional work in this area could include a complete inventory of all payments made to NCCI related to workers' compensation insurance for high-risk employers in Kansas.