



# AMERICAN ACADEMY of ACTUARIES

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September 8, 2005

Honorable Arlen Specter  
Chairman, Committee on the Judiciary  
U.S. Senate  
Washington, D.C. 20510

Honorable Patrick Leahy  
Ranking Member, Committee on the Judiciary  
U.S. Senate  
Washington, D.C. 20510

Dear Chairman Specter,

The Workers' Compensation Subcommittee of the American Academy of Actuaries<sup>1</sup> (Subcommittee) offers the following comments addressing the treatment of workers' compensation insurance and subrogation claims in Sec.135 of S.852, the "Fairness in Asbestos Injury Resolution Act of 2005" (the "FAIR" Act) as reported from Senate Judiciary Committee. Our comments are intended to make Congress aware of the likely impacts of Sec. 135. We believe that careful consideration should be given to both the direct and indirect effects of this potentially costly provision that extinguishes subrogation rights, could result in double payments to claimants, imposes new liabilities on policies previously priced without anticipation of those liabilities thereby straining the financial underpinnings of the workers compensation insurance system, and invites the filing of asbestos claims in the workers' compensation system, a system that historically has had only a *de minimus* number of asbestos claims.

The current version of S.852, which was passed by the Senate Judiciary Committee, extinguishes an insurance company's subrogation rights under Sec. 135. Sec.135 states in pertinent part that:

(a) In General — The payment of an award under section 106 or 133 shall not be considered a form of compensation or reimbursement for purposes of imposing liability on any asbestos claimant receiving such payment to repay any — (1) insurance carrier for insurance payments; or (2) person or governmental entity on account of worker's compensation, health care or disability payments."

Section (b) of Section 135 invites claimants under the FAIR Act to also file claims in the workers' compensation system by providing that, even if claimants have been paid by the FAIR Act, they can still file a workers' compensation insurance claim. This result is certain to occur because the workers' compensation insurer's lien and/or subrogation rights have been extinguished in Section 135(a). Consequently, the claimant will be paid twice for the same injury — once under the no-fault FAIR Act and a second time under the no-fault workers' compensation system. The state subrogation and lien statutes were explicitly designed to avoid an outcome which Section 135 now enables; namely, a windfall to claimants at the expense of workers' compensation insurers.

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<sup>1</sup> The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. The Academy is nonpartisan and assists the public policy process through the presentation of clear, objective analysis, and serves as the public information organization for the profession. The Academy regularly prepares testimony for Congress, provides information to federal officials and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also supports the development and enforcement of actuarial standards of conduct, qualification and practice and the Code of Professional Conduct for all actuaries practicing in the United States.

## **Background**

By way of background, workers' compensation is a no-fault system providing compensation to injured workers for lost wages and medical expenses, with benefit levels defined by state statutes. Employers are generally responsible for providing workers' compensation insurance coverage and may do so either by purchasing an insurance policy or by becoming authorized to self-insure their workers' compensation obligations. Either way, workers' compensation represents a significant part of the overall cost of doing business for (the many) employers engaged in relatively hazardous manufacturing and construction enterprises.

If an asbestos claimant, who is receiving workers' compensation insurance benefits, also files a tort claim and receives an award (through settlement or verdict), then the workers' compensation insurer is normally entitled to exercise its right of subrogation. How the subrogation rights apply varies by state. The public policy behind subrogation — and the related concepts of a lien or “holiday” — is to avoid paying claimants twice for the same injury.

The historical data on asbestos claims indicate that one percent or less of total workers' compensation insurance benefit payments relate to asbestos cases. This suggests that the tort system has been the predominant source of compensation to asbestos claimants, while the subrogation feature of workers' compensation insurance policies has served as a gatekeeper to prevent duplicate payments to claimants.

Under a subrogation action, whenever a claimant recovers tort damages against a negligent third party, the workers' compensation insurer has a lien against the employee's recovery in order to prevent duplicate payment. In some jurisdictions, the lien may be satisfied by a cash payment from the claimant to the workers' compensation insurer. In other jurisdictions, the lien may be satisfied by applying a “holiday” scenario. The lien is the total amount paid by the workers' compensation insurer up to the time of the tort recovery. If the tort settlement amount exceeds the workers' compensation lien, any net “excess” is reserved for the employee. If the workers' compensation insurer has future continuing obligations to the claimant, then the workers' compensation insurer is allowed a future credit against any “excess” money received by the claimant.

The application of the credit is called a “holiday,” meaning that the workers' compensation insurer's obligation for future benefits is suspended in whole or in part (depending upon the jurisdiction) until the amount of workers' compensation insurance benefits withheld equals the total amount of the tort settlement paid to the claimant. When the “holiday” is over, the workers' compensation insurer resumes paying if the claimant continues to be eligible for workers' compensation insurance benefits.

It is important to recognize that workers' compensation insurance premiums have been determined based on the assurance that such subrogation rights will apply. Moreover, in the event that subrogation rights are precluded, as currently provided under Sec. 135, the vast majority of workers' compensation insurance policies provide no opportunity to collect additional premiums on previously issued policies.

With the benefit of the above background, the Subcommittee has the following specific concerns relating to Sec. 135.

### **Potential for Double Recovery**

In the absence of standard workers' compensation insurance subrogation rights under the FAIR Act, we expect that a significant number of asbestos claimants will be encouraged to file workers' compensation insurance claims in addition to pursuing the awards offered under the FAIR Act. This practice will be virtually risk-free to claimants and their attorneys. Double recovery for the same condition will therefore become a strong financial incentive driving claimants' decisions. Health conditions as a result of exposure to asbestos have already cost the U.S. economy many billions of dollars. The provision allowing for double recovery will significantly add to that cost. This issue is further discussed below.

### **Unintended Consequences to State Workers' Compensation Systems**

As stated above, claims related to asbestos have historically amounted to less than one percent of total workers' compensation benefit costs. This is because of the greater recovery potential under the tort liability system and existing workers' compensation subrogation rights. If the FAIR Act is enacted in its current form, the resulting financial incentives and likely changes in claimant behavior could lead to many more claimants pursuing workers' compensation benefits. The Congressional Budget Office (CBO) has estimated that 1,736,000 asbestos claims may be filed over the 50-year expected life of the trust fund that would be established by the FAIR Act. If even a nominal portion of claimants pursue workers' compensation insurance benefits, the additional claims filings could place significant demands on state workers' compensation administrative agencies. Since the added costs of these new claims were not previously reflected in insurers' premiums or self-insurers' funding levels, and because a number of large workers' compensation insurers have become insolvent in recent years, it is likely that some of these claims will need to be paid by state guarantee associations.

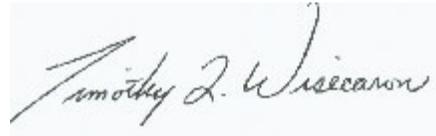
### **Summary of Potential Cost Increases to Workers' Compensation Systems**

Because of the limited historical data for workers' compensation insurance asbestos claims and the fundamental change in claimant behavior that Sec. 135 may precipitate, estimating the potential cost impact of Sec.135 is challenging. Nonetheless, if even a small portion of potential trust fund claimants pursue and obtain workers' compensation benefits, there may be tens of billions of dollars in additional costs to the workers' compensation system. These new and previously unanticipated additional costs will place a significant strain on those insurers and self-insured employers still in business, and will further stress state guarantee funds for those claims covered by insurers that are now insolvent. These added costs also need to be considered when evaluating the total cost of the FAIR Act.

Once again, we stand ready to assist Congress in understanding the impact of this important issue on workers' compensation systems. As our analysis demonstrates, Sec.135 could result in significant financial consequences to insurers, self-insured employers, and state guarantee funds. If you have questions regarding this letter or would like further assistance from the Academy, please do not hesitate to call Greg Vass, Senior P/C Policy Analyst at the Academy (202) 223-8196.

The Honorable Arlen Specter  
September 7, 2005  
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Sincerely,

A handwritten signature in cursive script that reads "Timothy L. Wisecarver". The signature is written in dark ink on a light-colored background.

Timothy L. Wisecarver, MAAA, FCAS  
Chairperson, Workers' Compensation Subcommittee  
American Academy of Actuaries

CC: Members of the Senate Judiciary Committee