



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Julie Edmonds-Mares

SUBJECT: SEE BELOW

DATE: January 19, 2018

Approved

Date

1-19-18

SUPPLEMENTAL

**SUBJECT: WORKERS' COMPENSATION PROGRAM: EVALUATION OF
SERVICE DELIVERY OPTIONS**

REASON FOR SUPPLEMENTAL

At the December 14, 2017 meeting of the Public Safety, Finance and Strategic Support (PSFSS) Committee, the Committee voted to send the report "Workers' Compensation Program: Evaluation of Service Delivery Options" to the City Council for consideration. In the report, staff reviewed the pros and cons of different service delivery options for processing and administering workers' compensation claims. In addition, the report covered the significant risks associated with the upcoming State of California audit of the City's In-House claims administration.

Staff's recommendation to PSFSS was for the Committee to accept the report. Staff planned to bring forward recommendations about a preferred service delivery model in the budget process, which is standard practice. This would allow for more thorough budget analysis and for the service delivery model to be considered in the context of the overall City budget situation.

Instead, the PSFSS Committee voted to recommend a policy direction to the City Council for consideration.

This Supplemental Memorandum updates the Recommendation language from the original staff report to include the policy direction recommended by the PSFSS Committee. In addition, this memorandum provides additional information about questions raised by the Committee and members of the Council following the release of the original report.

UPDATED RECOMMENDATION

- (a) As recommended by the Public Safety, Finance and Strategic Support Committee on December 14, 2017, accept the evaluation of service delivery options for administering workers' compensation claims, including providing services In-House with City staff, through a Third-Party Administrator, and a Hybrid Model that includes both In-House and Third-Party claims administration.
- (b) Additional recommendation by the Public Safety, Finance and Strategic Support Committee on December 14, 2017, direct the City Manager to:
 - (1) Continue the current Workers' Compensation Pilot Program (Hybrid Model) through the completion of the State audit of the In-House program;
 - (2) Develop a work plan for bringing the entire workers' compensation program In-House in stages upon successful completion of the State audit; and
 - (3) Return through the budget process with funding recommendations for bringing the program In-House in stages beginning in 2019-2020.

BACKGROUND

On December 14, 2017, the PSFSS Committee accepted the staff report on Workers' Compensation Service Delivery Options and provided the policy direction and recommendation outlined above.

In addition, the Committee asked a number of questions about the report and the three service delivery models for administering Workers' Compensation claims. The three models are In-House, which uses City employees to administer claims; Third-Party Administrator (TPA), where an outside Workers' Compensation firm administers claims; and a Hybrid model, which combines the In-House and TPA model. Since May 2013, San José has been operating under a Pilot Project using a Hybrid model. Currently, City staff administer claims for the Police Department. Intercare, a TPA, administers claims for all other City Departments.

This supplemental memorandum responds to questions raised at the PSFSS Committee and since the initial report was released.

The analysis of service delivery options is complicated by the fact that the City's In-House team failed a crucial State audit in 2016 and is subject to re-audit in December 2018. Failure to pass the 2018 audit could result in severe penalties up to and including the City of San José losing its ability to self-insure for workers' compensation claims. Should the loss to self-insure occur, the City would need to purchase workers' compensation insurance from a private insurance company. It is difficult to estimate how much more it would cost the City to purchase workers'

compensation insurance for a program that currently has nearly \$27 million in annual claims costs and approximately \$3.7 million in administrative costs. In addition to claims and administration, an insurer would include profits and overhead in the premium cost and insure against the risk of future claims and costs. This easily could raise costs to more than \$35 million per year.

ANALYSIS

At its December 14, 2017 meeting, members of the PSFSS Committee asked staff:

- Whether the City could extend the contract with the current TPA (Intercare) through the completion of the State audit of the In-House program;
- About the cost-competitiveness of the contract with Intercare;
- Whether the existing Hybrid Model had contributed to the 2016 State audit failure; and
- If additional resources were needed to ensure success in passing the 2018 State re-audit of the In-House program.

Following is information about these issues.

Contract with TPA Intercare

At the December 14, 2017 meeting of the PSFSS Committee, the Committee voted to recommend a policy direction to the City Council to continue the current Workers' Compensation Pilot Program (Hybrid Model) through the completion of the State audit of the In-House program. Additionally, the Committee accepted staff's recommendation that, if the City Council approved moving to an In-House program, the transition would occur in phases.

The initial term of the contract with Intercare began November 29, 2016 through June 30, 2018. Originally, staff proposed including an option to extend annually through June 30, 2021, however, when the City Council approved the contract on November 29, 2016, the Council voted that any extensions or amendments were to be approved by the City Council prior to execution.

If Council concurs with the PSFSS Committee's recommendation, staff would negotiate and bring back to Council for approval an extension of the contract with Intercare through the completion of the State Audit of the In-House Program and implementation of an In-House program. That negotiation would include an effort to lower the current contract costs.

TPA Cost

At the December 14, 2017 meeting of the PSFSS Committee, the Committee and staff discussed the cost of outsourcing the entire program to a TPA versus bringing the entire program In-House. This option, if executed in early 2018, would result in cancellation of the State audit.

Based on the current contract with Intercare, the cost to manage all open claims would be \$3.7 million for 2017-2018. This is potentially more costly than bringing the program In-House. However, staff has conducted market research and found that Intercare is expensive for the services provided. Based on this research, staff learned that many industry-leading TPAs would charge approximately \$3.3 million or less to handle the City's claims, depending on caseload. In the report to PSFSS, staff stated that the City could, in the long-term, initiate a new RFP process to evaluate lower cost options for a TPA.

The Committee asked about staff's evaluation, given that Intercare was selected in November 2016 following an RFP process. Staff has reviewed the November 2016 RFP process and determined:

- Some industry leaders did not respond to the 2016 RFP;
- At the time of the RFP, the Human Resources Department was lacking management staff with specialized workers' compensation experience;
- A new RFP would be differently structured and bid utilizing the expertise the Department now has; and
- Intercare was not the lowest-cost provider in the 2016 RFP process.

It is important to note that the success of a TPA model is not based on the cost of the service. Instead, success requires strong management of the contract from the City. This was seen with the City's experience with the first TPA (Athens Administrators). During the initial Pilot Project period with Athens (June 1, 2013-December 31, 2016), the Human Resources Department had two different directors (including a period where Human Resources and the Office of Employee Relations were jointly managed) and the program lacked management expertise in workers' compensation. In November 2016, the City filled the long-vacant Division Manager position with an industry expert that oversees In-House claims administration, prevention, and safety efforts, as well as managing the TPA contract.

With the current TPA (Intercare), strong management has led to a partnership in which City Departments are reporting positive customer service feedback and new workflows and strategies are being developed to address the 2009 City Auditor recommendations, the 2016 State audit shortcomings, and to contain costs.

2016 State Audit: Clarifications

At the December 14, 2017 PSFSS meeting, staff became aware that there was some confusion about the 2016 State audit. Some of this may be due to the way information was presented to Committee members in the past. The Administration hopes the following will provide clarification.

Scope of the 2016 Audit: The 2016 State Audit covered claims administered by the In-House team only. The State Auditor's reviewed claims with dates of injury from 2013 through 2015.

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Claim files that the TPA administered were not subject to the 2016 State audit. The TPA at the time (Athens) was audited by the State in 2015 and passed that audit.

Pilot Project Impact on the 2016 Audit: The Committee asked if the Pilot Project's Hybrid Model had caused or contributed to the audit failure. As noted above, the TPA was not a part of the audit. The In-House team failed the audit.

The Administration believes the causes for the 2016 Audit failure were the following: Lack of management expertise in workers' compensation; lack of appropriate internal procedures and controls; lack of effective training; and staffing challenges. Many of these issues had originally been identified by the City Auditor in the 2009 audit of the workers' compensation program.

Preparation for December 2018 State Audit

At the December 14, 2017 meeting of the PSFSS Committee, the Committee and staff discussed what resources were needed to ensure the In-House Program passes the 2018 State re-audit.

Staff continues to evaluate the needs of the In-House Program, including providing ongoing training and correcting issues identified in the 2016 State audit, as well as improving internal controls. Should additional resources be needed to optimize readiness for the audit, the Human Resources Department will make a request through the 2018-2019 budget process.

COORDINATION

This memo has been coordinated with the City Attorney's Office and the City Manager's Budget Office.

/s/

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