

Controlling the Costs of Workers' Compensation

With the exception of terrorism, perhaps the most troubling risk for employers in the United States is workers' compensation. Over the past three years, its costs have increased an average of 50 percent and currently account for \$.67 of every dollar spent on casualty insurance. This increase does not reflect any corresponding increase in workplace hazards or change in the types of reported injuries or diseases. In fact, spurred by the U.S. Occupational Safety & Health Administration, employers have successfully reduced the frequency of workplace injuries by almost 40 percent since 1990. Despite these safety gains, workers' compensation costs have continued to rise far faster than the medical inflation rate.

By Stanton Long

In some states, the crisis is so severe that the workers' compensation system can no longer fulfill its fundamental mission. Starting in 1911, workers' compensation laws were introduced as a covenant between employees and employers. Employees gave up their constitutional right to sue their employers for on-the-job injuries and occupational diseases in exchange for fast and efficient wage-loss replacement, reasonable and necessary medical care, and, when complete medical cure was not possible, disability awards to compensate for lost future earnings. Without this covenant, the entire U.S. economy would be mired in endless litigation, high expense, and impaired productivity.

In light of these noble purposes, consider what is currently happening in California. Employers in the state will pay \$30 billion for workers' compensation coverage in 2004, up from \$9 billion in 1995. California accounts for 14 percent of the U.S. economy but 26 percent of the country's workers' compensation premiums. Although reports of all workplace injuries and diseases have declined, California reports claims with permanent partial disability awards at the rate of 1,221 per 100,000 employees, compared with the national average of 434 per 100,000. Workers' compensation payments to chiropractors are 148 percent higher in California than in the median state. And although the workers' compensation system is supposed to reduce litigation, 30 percent of California's open and closed indemnity claims from 1992 to 1999 ended in litigation – compared with just 14 percent nationally.

While it might be tempting to suppose that California employees would be delighted with this benefit bonanza, the very opposite is true. A recent study by the Workers Compensation Research Institute reveals that California employees are less satisfied with their workers' compensation system than employees in states such as Pennsylvania and Massachusetts, where the costs are far lower. As expensive as it is, California's system is not very popular with employees.

The workers' compensation crisis is not limited to California. Texas, for example, already has the nation's highest average total cost per claim. In New York, Tennessee, and Florida, costs are mounting at an accelerated pace.

The rise in workers' compensation costs is a national problem driven by local politics. Since coverage is regulated closely by state law, there are, in effect, 51 separate systems in the United States (plus additional systems in Puerto Rico and the Virgin Islands, as well as one for federal employees). Virtually all employers are required to participate in these systems, and they have little control over the benefits offered. Unlike health insurance, workers' compensation coverage, benefits, and dispute resolution procedures are all fixed by statute.

The Cost Drivers

Inappropriate claims are a major component of the workers' compensation problem. As many as 25 percent of all filings may have some element of impropriety. There are many possible causes, including misunderstandings, honest mistakes, cost shifting from nonoccupational health care, employee resentment, unscrupulous service providers, and outright fraud. The National Insurance Crime Bureau estimates that workers' compensation fraud alone costs insurers \$5 billion each year. This, in turn, is billed back to employers in the form of at least \$6.5 billion of premium.



Workers' compensation laws create irrational incentives. The longer an employee is out of work, the more likely he or she is to get a cash award. Sometimes, claimants with injuries that should keep them out of the workplace for two or three days are tempted to stretch their absence to two or three weeks or more. Many don't even regard such "secondary gain" behavior as fraudulent. Every workers' compensation jurisdiction has a waiting period – typically three or seven days – before a claimant is entitled to wage-replacement benefits. By extending an absence, an employee becomes entitled to indemnification

for lost wages, often on a retroactive basis to day one of the claim. For many lower-paid workers, the “tax free” wage replacement represents an acceptable lifestyle.

The growing role of health care providers in the shaping of public policy has contributed to the stretching of absences. Workers’ compensation was initially a two-sided compact between employers and employees, but it has now become a triangle with providers as the third side. Certainly in California, the emergence of this triangle has had an adverse impact. The key problem has not been the amount charged per visit but the number of visits per claim. When medical services are overutilized, employers must foot the bill, but employees suffer, too. The longer they stay out of work, the more likely they are to perceive themselves as disabled and the harder it becomes for them to re-establish the discipline of being in the workplace eight hours a day. Employees pay in another sense, too: higher workers’ compensation costs ultimately mean lower wages.



Employer Responses

Employers of virtually all sizes are feeling the effects of rising workers’ compensation costs, but the strains may be greatest on companies that need to buy full coverage. Very large employers have long retained some portion of their workers’ compensation risk through high deductibles and other mechanisms. Today, with premium prices rising, some mid-sized companies are also contemplating the retention of risk through self-insurance, captives, and other means. These arrangements may be prudent for rock-solid companies that can afford to give up some of the benefits of insurance pooling, but companies should proceed with caution. It makes little sense for a business to risk its operating capital – and possibly its survival – on its workers’ compensation results.

While the majority of workers' compensation claims are legitimately work-related, there are strategies employers can use to minimize the cost and duration of these claims. There are also strategies to reduce the incidence of inappropriate claims that migrate, intentionally or not, into the workers' compensation system.

Before embarking on any kind of action, a company needs to know how well its workers' compensation program is functioning. Even if there are relatively few claims, for example, the overall program cost will still be high if the company is not managing individual claims effectively. Pinpointing specific problems must be the first step in any cost-reduction initiative.

What is the claims denial rate? At the outset of a program to focus more seriously on claims – and questionable claims in particular – a denial rate of 20 percent is not unreasonable. The denial rate will be higher in some industries than in others. The more critical factor is the stability or fluctuation in this rate. If it varies substantially from one month to another, what is the cause? Is there a new claims adjuster who is being too easy or too harsh? Has there been high turnover at the claims administrator? Wide fluctuations indicate a problem that needs to be fixed.

What is the sustained-denial rate? Another important measure is the sustained-denial rate – the percentage of claims denied that stay denied. If many denials are being overturned, the claims adjusters may be making poor decisions, or the company's legal representatives may be less than adequate.

How quickly are claims adjusted? Certain actions need to happen within a specific time frame. If the employer or its adjuster is not gathering information within 24 to 48 hours of a claim, a company needs to make effective changes in procedures immediately.

While the questions above are specific to the company itself, it is equally important to develop comparative data relative to other companies in the same industry. Rigorous analytics, coupled with detailed databases, can provide a company with reliable and credible comparisons to its industry at large. Whether a state's workers' compensation system is efficient or wasteful, an employer can still set its sights on being best in class.

Another kind of benchmarking tool may be equally valuable. Before spending money to lower workers' compensation costs, senior executives need an objective cost/benefit analysis. Cost avoidance is hard to prove, and senior leaders are generally uncomfortable with guesswork here. Marsh is developing a tool that will inform a company just how much it stands to gain in dollar terms by making a particular change in its workers' compensation program. Senior executives will have a sound basis for deciding where their spending is likely to generate the greatest return.

Pre-loss Initiatives

The least expensive claim is the one that never occurs. Some 32 percent of all workplace injuries occur to employees who are new to the job. Injury prevention begins with the hiring process.

Employers know that the Americans with Disabilities Act forbids discrimination in the hiring process against any qualified individual with a disability, either physical or mental. But some employers are not aware that between hiring and placing an applicant in a position, they still have an opportunity to determine whether the person is capable of doing the job. An applicant who cannot perform the essential functions of the job, even with reasonable accommodation, need not be placed in it.

Objective post-offer, pre-hire screening is a two-step process. First, the demands of the job must be accurately assessed – for example, lifting a specified weight, bending, twisting, walking, and seeing. Then the employee's own physical capabilities must be carefully evaluated. The employer who truly understands both the demands of the job and the physical capabilities of the employee can make a perfect match. Advanced technology for this kind of screening is now available.

In addition to reducing injuries, claims and costs, this matching process has other benefits, as well. Employees are generally pleased to be placed in positions where they can, indeed, meet the demands of their jobs. Such matching is likely to make the work environment more productive and the company more profitable. Screening also gives the employer a baseline for the employee's capabilities at the time of hiring. Employers are responsible only for injuries that arise out of employment and in the course of employment. With screening, they can avoid being held responsible for the effects of the aging process or for injuries sustained before an employee came aboard.



Post-loss Initiatives

Claimants who extend their absences often have more than one motivation. In addition to the possibility of a cash award, they may feel disaffection from the workplace and antipathy to their supervisor. Frequently, their supervisor is ineffective or overbearing.

Most companies have some kind of early-return-to-work (ERTW) program designed to prevent the unnecessary extension of employee absences. These programs are typically managed by a member of the HR staff, a case manager, a nurse, or some other person who is external to the actual work unit. This is not an ideal arrangement. Companies that have the lowest cost of workers' compensation risk give ERTW responsibilities directly to the employee's operational manager or supervisor. This is the person who has the greatest influence on the workplace environment and on the individual employee.

Most injured employees seek positive communication and want an opportunity to come back to the work environment when medically able – whether in their regular position or in a transitional one. When supervisors treat injured employees with dignity and respect at the time of injury and throughout the recovery process, the duration of lost work time shrinks and workers' compensation costs come down. The right behavior by the supervisor can prevent the relationship with the employee from turning adversarial. The right behavior can also have a positive impact on the treating physician. Doctors are more inclined to support an employee's return to work when they know that the workplace environment is supportive.

A company's senior executives must be involved in the ERTW program, as well. They need to make it clear that they are not asking operational managers to assume this new responsibility but telling them to do so. They also need to provide adequate training. Operational managers need to understand the rules of the workers' compensation system and its costs, and they need to gain insight into their new role in managing employees' return to work. A very high percentage of operational managers can master the necessary skills and successfully fulfill their new responsibilities.

An ERTW program does not take the place of a safety program, which is still essential, but it is likely to produce far more rapid behavioral changes than a safety program can achieve.

Dramatic Cost Reduction

A Marsh client in the transportation industry had workers' compensation costs that were well above industry norms. The company instituted an ERTW program that gave supervisors primary responsibility for managing their employees' return to work. Within 18 months of implementation, the following milestones had been reached:

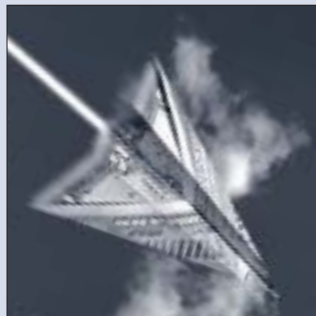
Incurred costs – down 50 percent

Total paid – down 40 percent

Lost work days – down 60 percent

Frequency of claims – down 25 percent (an unexpected byproduct of the changed relationship between supervisors and employees)

In the first year, the program delivered savings of approximately 20 times its cost. In an industry where profit margins are notoriously tight, the company's senior executives attributed a 1 percent increase in profitability to the ERTW program.



Legislative Reform

In the 93 years since workers compensation laws were first passed in the United States, systems have, from time to time, gotten out of balance. Currently, the situation in California is so grave that we believe the system actually needs to be replaced rather than reformed. There are a number of specific areas where change is crucial:

- Definitions of compensable injuries and occupational diseases must be written more tightly.
- A higher degree of proof should be required for conditions, such as stress, that are susceptible to legal manipulation, patient exaggeration, mistakes in causation, abuse, or fraud.
- Controls are needed on the number of medical visits per claim, particularly to physical therapists and chiropractors.



We believe that employers should demand a seat at the table, along with labor, to address the workers' compensation crisis. Senior business leaders can speak directly to their legislators, and they can become active in affiliated business associations. They need to impress on state government that excess workers' compensation costs are a serious drag on competitiveness. If the crisis deepens, they themselves may feel compelled to site new or existing operations elsewhere. By the same token, prospective new employers will surely choose locations where they can operate at a more reasonable cost.

In our view, however, political engagement can never substitute for cost-reduction initiatives. Regardless of the situation in a given state, companies should continue working to reduce their own workers' compensation costs. Benchmarking, post-offer screening, and ERTW programs are three of the most effective strategies they can employ.

In deciding how to respond to the workers' compensation crisis, we recommend that employers keep in mind the following fact: At the current average rate of growth, the employer's total costs for workers' compensation will exceed the employer's costs for social security in only six years!

Stanton Long is chairman of Marsh's Workers' Compensation Practice. He works with clients to design and implement unique strategies that manage risk, minimize administrative costs, and enhance their health and safety profile.