The California Workers' Compensation Manifesto

A White Paper Analysis

Choice, Not Chance: How To Protect Your Employees, Control Your Costs, And Enjoy the Benefits of Both

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I. Preface

Workers' compensation. Worse yet, *California Workers' Compensation.* A labyrinthine network of quasi-judicial rules and regulations, injured workers and their attorneys, doctors and various medical practitioners, adjusters, insurers, TPA's, QME's, AME's, PhD's, Nurse Case Managers, Vocational Rehabilitation Counselors and Return to Work Specialists, all accompanied by outrageous capital demands. The very thought of it strikes dread into the heart of every businessperson ever caught up in the system. That's probably you or you wouldn't be reading this.

You understand the system about as well as you did your high school geometry class…so what can you do? Plenty. But you'll need a little help. The government can't fix it with "reforms", though they may try. Costly loss control programs promulgated by loss control consulting firms and brokers on a "fee for service" basis are of dubious value. What you need is sound advice. A strategy. A solution.

The problem is, whenever you've bought into the loss control guru thing and paid a hefty fee for your ticket to peace of mind, you were simply handed a laundry list of safety recommendations that could only be implemented through onerous capital expense, *all with absolutely no guarantee it would work*. Here's a good example. Every year employers spend billions of dollars on personal protective equipment, safety glasses, gloves, respirators, etc. That's a good thing, right? Well it is, but then the other shoe drops. As you walk through the workplace one day you notice that only about half of your people are actually using them. As you ponder the significance of this phenomena, perhaps wondering why your loss control guru never addressed that issue, Joe walks up to inform you that he needs to go to the industrial medical clinic because he has a foreign object embedded in his eye. You ask if he was wearing his safety glasses, he tells you he set them down on break and "forgot" to put them back on. So you tell Joe of course he can get treatment but first you have to find another of your workers' to drive him there, wait for him to be treated, and possibly drive him home if he can't return to work.

Let's review. Costly Broker and Loss Control Consultant Services…thousands of dollars. Implementing costly Broker and Loss Control Consultant's recommendations…more thousands of dollars. Cost of Joe's treatment, lost time and indemnity payments, many more thousands of dollars. Oh…and let's not forget the hidden costs. Remember the employee that had to go with him to the clinic? Now you have two workers gone, twice again the lost productivity. Others of course will have to fill that void, meaning overtime payments. And now the kill shot…Joe's new injury is going to have a negative impact on your experience modification factor…you know…the mysterious force your Broker is always blaming for your upwardly spiraling workers' comp premiums and the reason he or she was exhorting you to enlist the help of a loss control guru to get control of? So next year at renewal, you can expect thousands of dollars in rate increases.

If that sounds like a self-perpetuating cycle, it is. You seek help, get the "right" advice, yet the outcome is still uncertain. This is because taking control is something only you can do. Your business operations are unique. You know them best. Nobody watches your money like you do. You need to take back control of the business. Lead, don't follow. You tried to find a way by following the advice of others…now thousands upon thousands of dollars later; it's time to make your own way. You're a leader, right? A successful businessperson with a strong mind and keen insight into your business or industry. Start acting like it. Walk the walk…talk the talk. Learn how to ask the hard questions and make informed decisions on your workers' compensation issues. Stop being held hostage by brokers, insurer's, adjusters, consultants, etc. and take back control of your operations. It's what worked for you in the past and how you got to where you are today. Remember, it's about choice, not chance.

Let me show you how. With a simple, systematic approach to a very complex set of problems. If it's too hard, too boring, too costly, or too time consuming, you won't do it. But you know that. It will take some effort on your part; there are no magic bullets or wonder drugs. No "lose weight while you sleep" action plan. But you will sleep a lot better. Keep reading. By the end of this white paper you will have learned:

- The single most important driver of your workers' compensation insurance costs
- The specific areas and processes you must focus on to gain control
- Who should be doing what, when and where in your workers' compensation program
- Where to get the help you need

II. The Basics

First you need to understand some of the fundamentals of workers' compensation, or more specifically, what the key cost drivers are. OK…here they are.

- *Your Experience Modification Factor* *(x-mod to you from here on out)*
  The purpose and theory of experience rating is much more complex and detailed than you care to know, trust me. Simply put, it's your company's report card. It's designed to determine whether or not your company's losses are better or worse than expected compared to similar occupations or industries. If worse than expected, you get a higher score (think golf), or high mod (greater than 1.0). This also called a "debit mod", which it is because it means you pay more for your workers' compensation coverage. On the other hand, if you do better than expected, you get rewarded with a lower score, a low mod, (less than 1.0), also called a "credit mod" and pay less for your workers' compensation coverage. It's also used to predict your future probable losses. Auto insurers do the same based on your driving record. If you have a lot of tickets and accidents, chances are you'll continue to do so…you pay a higher rate. If you have none, chances are you won't in the future either…you pay less. Simple enough, right?

  Not really. It can only be achieved through a very complex formula that takes into account the size of the company, the probability of unexpected losses for that occupation or industry, and even more complex differences between *loss frequency* (the actual number of losses) and *loss severity* (the actual cost of each loss). But when all is said and done, ***the x-mod determines your final workers' compensation cost.*** The premium you pay will equal the base premium (the average published rates for your state) times your x-mod. For example, if the basic rate is $10 for every $100 of payroll and your x-mod is 1.30, do the math, 1.30 x 10= $13.00. That's right. You can expect to pay $13.00 for what most of your competitors pay $10 for. Conversely, if your x-mod is .70, you can expect to pay $7.00 for what most of your competitors pay $10 for. *For each $100.00 of payroll.*

  It should be fairly obvious to even the most uninitiated which makes the most business sense in these scenarios.

  Now, one last thought. Most companies (like your competitors) operate on the assumption that an x-mod of 1.0 is "good". That's a "C" on your report card. You can give your company a huge strategic advantage by simply *seizing control of your x-mod, striving to decrease your losses, beat the averages, and lower your workers' comp costs.* Whether your mod is being driven by loss frequency, severity, or misallocation of payroll, you can learn how to identify the problem.

  And it's healthy for your employees too.

- ***Loss Prevention v. Loss Control***

Here are two terms that get used and confused a lot. Contrary to conventional thinking, they are NOT the same thing. Here's the difference.

Loss Prevention involves just that, preventing losses from occurring in the first place. The most extreme method is avoidance. John Madden refuses to fly and avoids dying in an air crash. But what's life without a few risks? So for most of us avoidance won't work. There are other ways. Brushing your teeth three times a day is good loss prevention. Changing your oil every 3000 miles is good loss prevention. It's proactive and seeks to avoid potential problems before they arise. It requires some planning and forethought, and some capital expense, but it's well worth the cost. An oil change costs about twenty dollars. An engine overhaul costs a couple thousand.

Loss Control involves controlling or mitigating the losses that *do* occur. Politicians call it damage control…same concept. Getting the proper medical treatment as quickly as possible for an injured worker is good loss control. A solid return to work program for injured workers is good loss control. Although important, it's essentially a reactionary approach. It requires a lot of time and attention and capital expense, certainly much more than preventing the loss altogether in the first place.

Oh…and your employees are getting hurt too.

Now, if I asked you to brush your teeth three times a day religiously or show up for a root canal three years from now, which would you choose?

- ***Loss Frequency v. Loss Severity***

This concept was touched upon earlier. *Frequency* = your number of actual losses. *Severity* = the relative cost of each loss. So, which is the more reliable indicator of your probable future losses? Put another way, if you were an underwriter or actuary looking at a company with $200,000 in past losses, what would cause the most concern, a company with twenty $10,000 losses or a company with two $100,000 losses?

Loss frequency trumps loss severity. This is because each loss is a new opportunity for a severe loss. The more losses you have, the riskier you become in the eyes of your insurer. Loss severity is more difficult to control than loss frequency. But if you reduce your loss frequency, you reduce your chances of having a severe loss, because each loss is an opportunity for a severe loss. A company with numerous minor losses greatly increases its chances of having a severe loss.

The lesson here is that loss prevention is quite possibly one of the most effective yet most overlooked parts of the workers' comp program in most companies. Why? Because it can only be quantified in the most general sense. This is something that drives Risk Managers and Safety Officers crazy. All the CFO or accounting types can see is that a certain amount of resources were diverted to loss prevention efforts and whether or not a return on the investment was realized, e.g., a 10% reduction in workers' compensation costs. In a quintessential example of linear thinking, if the perception is that the cost was not worth the gain, the program quickly comes under scrutiny. What cannot be quantified by Risk or Safety personnel is exactly how many losses were prevented and exactly what the outcome may have been without a loss prevention program. In most cases, the organization can never truly know how many or how crippling theses losses may have been for them. They would do well to remember what Ben Franklin famously observed, an ounce of prevention is worth a pound of cure.

- *Loss Control*

Consider loss prevention your first-line defense. Loss Control is the second. But how do you control losses? Accidents happen, right? It's part of the cost of doing business.

It's about taking control. Choice, not chance. You've taken the right steps to prevent losses and its working. Losses are down. Profits are on the rise. Life is good. Then…somebody gets hurt. What to do? Lots; and most should be established procedure for your company. There are actually several facets to effective loss control so pay close attention.

I. *Medical Control*

First and foremost, get the injured worker the proper medical treatment as quickly as possible. *Proper* is the operative word here. That means you've done a little homework about the available clinics in your area and visited them. You've talked to the Doctor or clinic manager. You've learned how they approach industrial injuries, i.e., do they call the employer and inquire about available modified work, or do they simply temporarily disable the worker? That's important. Why? Because there's a big difference between a *medical only* (no lost time) claim and an *indemnity* (lost time) claim. But more about that later.

Is the clinic clean and comfortable? Would *you* go there for treatment? Can you establish a working rapport with the staff that facilitates a free and uncomplicated exchange of information? You don't want to send your injured workers to a substandard facility; it screams "I don't care about you". You also want a doctor who talks to *you and the injured worker* about all the options, modified duty, alternative work, etc.

Once you've chosen a clinic that you feel comfortable with there's one more thing you need to do, choose a hospital. There's always the chance you could have a 911 that the clinic can't handle. All hospitals are NOT created equal so find the best in your area. There's a ton of online resources to help you do that, just Google "hospital ratings" and see what comes up. American ambulances operate on a "scoop and run" basis, meaning they whisk the ill or injured party off to the *nearest* qualified facility unless told otherwise. "Nearest" does not equal "best". LA County General may be the nearest but would you rather be taken there or Cedars Sinai? You or one of your staff needs to direct traffic, tell emergency responders what hospital to take your injured worker to.

Finally, visit each facility at least twice a year. Hospitals and clinics are like any other business, they often change hands. Making sure the quality of care is consistent is up to you.

Remember this, a little aid and comfort from the start goes a long way in easing your injured workers' anxiety and could mean the difference between a long, drawn out litigated claim and a satisfied, unrepresented worker that eagerly returns to work after receiving a high standard of quality care. Establishing medical control of your injured workers treatment should be a critical part of your loss control program. Otherwise, you risk having his or her attorney do it.

II. *Indemnity v. Medical Only Claims*

Perhaps you remember a little earlier when I mentioned that this was important? Here's why.

Experience Rating Adjustment. That's part of the overall experience rating formula that is used to calculate your x-mod. All you really need to know is that medical only claims are ***reduced by approximately 70% before they are incorporated into the x-mod formula.*** Indemnity claims go in fully loaded. This is because a lost time claim is generally a more severe and costly loss. Again, it's easy to see clearly which makes the most business sense.

III. *Return to Work, Modified duty and Alternative Work Programs*

See the above. Now, what do you think I tell my clients when they say they simply can't find *any* modified duty for injured workers that can return to work with a few simple work restrictions? I don't care if you have them bake cakes all day, if they are able to return to work with restrictions, *you should seize that opportunity and avoid an indemnity claim when a medical only claim is a viable option.*

Another excuse I often hear for not offering modified or light duty is that it's "bad for morale". The other workers will want to avoid work by faking an injury so they can bake cakes all day too, right? Let me ask you this, would you rather stay home, collect indemnity benefits and watch TV all day because your employer can't or won't accommodate your work restrictions, or would you rather come to work and count paper clips for eight hours as your accommodation? And which scenario do you think might motivate you to recover more quickly so you could resume your usual and customary job duties?

The same goes for return to work and alternative work scenarios. *Whenever the opportunity to return an injured worker to the workplace presents itself, take it.* Oh sure, there are problem children that you're probably glad to see gone and don't want back, but that may not always be what's best for you. There's also the chance the employee will refuse. But as long as the work does not violate his/her work restrictions and pays at least 80% of the prior wages or salary, they either have to accept or forfeit their indemnity benefits.

Claims Control

Well, despite your best efforts, there are claims. That's what insurance is for, right? Just turn it over to them and let them handle it now, right?

Wrong. As I mentioned earlier, nobody watches your money like you do. You may *think* that it's insurance company dollars now funding your loss because you transferred the risk to them when you purchased the policy. And you would be wrong. Very wrong. That's pure illusion.

Consider this actual illustration from one of my clients' recent mod analysis:

If we take a *really* modest $500.00 loss and amortize that over the three year period that it affects the x-mod on a premium to loss ratio basis, we see that the $500.00 loss results in a three year premium cost of…**1,416.00!** That's a staggering **283.2%** premium to loss ratio. Do the same with a far more likely garden variety $5,000.00 loss and the premium cost comes in at **$14,809.00** or a **296.2**% premium to loss ratio. And so on and so forth. Granted these are estimates and vary from occupation and industry, but they are based on real premium data from the WCIRB (California's rating bureau, the Workers' Compensation Insurance Rating Bureau). Do you still think "it's the insurance company's money"?

So what can you do? Well, since you're probably not a claims or insurance expert, not much. But you know who should be stepping up to the plate in this situation? Your Broker. That's right. You're relying upon his or her advice for your insurance needs, you have a right to expect competent counsel. Remember when I said you need to learn to ask the hard questions to make informed decisions on your workers' compensation issues? This is who you start with. And expect answers. If you don't get them, you may want to re-evaluate your relationship with that Broker.

Depending on the size of your organization, a claims review should be conducted at least annually. If you have a lot of claims, semi-annually or quarterly. But what's a claim review? Basically, you and your Broker (or someone at the Brokerage knowledgeable in the claims handling process) ask to review some or all of your claims to see how they are being handled. Without getting too technical, there is a certain protocol or "Best Practices" model to be followed in claims handling and *you want to see that it's being followed.* In other words, that your claims being handled according to established industry practices.

Now here's a useful tip to keep in mind. The insurer or TPA does *not like this at all.* They do not want you poking around the files. Why? I'll leave that to your imagination. Typically they will use delay tactics such as they need a minimum of 30 days to prepare, the adjuster's on vacation, or the Account Executive that you never even knew you had is suddenly deeply interested in your account and needs to be involved but has a myriad of scheduling conflicts. Just keep up the pressure.

The other thing they will try to do "in the interest of time" (theirs, not yours) is to limit you to your "large loss only" files, typically those with reserves over 25K. Those are the most important, right? The high dollar ones?

NOT. Remember the premium to loss ratio example? A $500.00 claim develops into dollar devouring beast that at the end of three years consumes $1416.00 in premium and grows by a 283.2% premium to loss ratio. But that's also subject to the Law of Diminishing Returns. A $50,000.00 loss results in just a $57,822.00 premium cost over three years, or a relatively tame 115.6% premium to loss ratio.

Frequency trumps severity**.** So, should you be more interested in seeing **ten $5,000.00 losses** that could potentially cost you **$148,090.00** in future three year premium costs or **one $50,000.00** loss that may result in **$57,822.00** in three year premium costs? What makes the most business sense to you?

Another purpose of a review is to evaluate the claim reserving. What's that? Simply put, it's a best guess at the probable dollar outcome of a claim so the insurer can set that amount aside to pay the future obligations. Under or over reserving can both distort the financial picture of an organization and if there's enough of it, bad things happen. It's an inexact science at best but an extremely important one. And guess who it's left to? The line adjuster. These are most likely the least experienced claim personnel on staff. They're still learning and growing. Think of them as doctors completing their residency. If you had a heart attack, would you prefer a newly minted doctor in residency or an experienced cardiovascular surgeon directing your treatment?

So you need to review the reserves for appropriateness and negotiate them if necessary. Why? Because size matters. Back to the premium to loss ratio example, a $5,000.00 loss results in premium cost of **$14,809.00** or a **296.2**% premium to loss ratio. So what happens if an adjuster, being cautious as he or she is taught to think, over reserves a $5,000.00 claim for $7,500.00 as a "precautionary measure" in adjuster speak? Yikes!

And that happens more often than you may think. The insurer will tell you that all reserves must be approved by "a supervisor" for correctness before they can be posted, but this is a largely ceremonial duty. Do you think some overworked middle manager really cares if the claim is over reserved by $2,500.00? These people talk real money. Hundreds of thousands of dollars in payments and settlement money flow through their hands. As I said earlier, nobody watches your money like you do.

I don’t know how many times I’ve been in a file review where this scenario has popped up repeatedly. When an adjuster gets a lost time claim, he or she has to evaluate it and post preliminary reserves. Not knowing how serious the claim will get, they will typically approach it conservatively and post a vocational rehabilitation reserve to the tune of about $5,000.00 “as a precaution”. What’s that? It’s a reserve to retrain an injured worker in another vocation should they be unable to return to their usual and customary occupation. Cake decorating and dog grooming are quite popular. But it’s rarely necessary.

So we get into the review, pick up the first file and the adjuster dutifully reports that because of the insurer’s adroit claims management team, the injured worker has been declared permanent and stationary (no further treatment necessary) and has returned to work without restriction; but there is a small permanent disability finding of say, 5% that needs to be settled before the file can be closed. All is well, you needn’t worry. As he or she is talking I peruse the reserves and what do you think jumps out? *That same $5,000.00 VR reserve is still posted.* By now you’ve learned what a $5,000.00 claim (or reserve) means to you in premium payout…**$14,809.00**. And by now you should also have learned why it’s so important to have a point man reviewing your files regularly.

Now one last word in the insurer’s defense. They don’t do this intentionally. They honestly don’t realize its happening. They’re highly complex, compartmentalized organizations. Ask a claims person if they understand just how over reserving may effect an insured’s premiums, he or she will shake their heads and tell you underwriting and the WCIRB sets the rates, they just set the reserves. Ask an underwriter if he or she understands how the claims people arrive at the figures for the reserves that they report to the WCIRB and use to price your account, they will shake their heads and tell you that’s the claims guy’s expertise, not theirs.

This is why you need a systematic, proactive approach to claims management. It really is your money, not theirs. Nobody watches it like you do.

Summary

So there you have it. Workers' compensation demystified. You must gain control of your x-mod. To do this, you use a basic military strategy that has been used in some form in nearly every war because it works. A two-pronged attack known as a "pincer movement". You attack the outer flanks of your adversary simultaneously in a pinching movement that closes off and surrounds it, forcing your enemy to fight on two fronts. And as the pincer closes, you also prevent reinforcements (injured workers and their attorneys, doctors and various medical practitioners, adjusters, insurers, TPA's, QME's, AME's, PhD's, Nurse Case Managers, Vocational Rehabilitation Counselors and Return to Work Specialists) from joining the enemy's main force from the rear. In this case, your loss prevention and loss control functions are the enemy's flanks. Control them; you control your x-mod. Divide and conquer. It's easy.

But you still need help, don't you? Uh huh…I thought so. You've got a compass and a course charted but you've never sailed a boat. OK, maybe I can help.

Through my partnership with IEN, I can help you address your experience modification factor analysis, effective loss prevention, loss control, and offer claims consulting services. Please contact me if this is of interest to you.