The Grand Bargain

Protecting employees and employers with workers' comp insurance

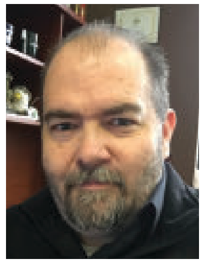
By Tracy Barbour

For most employers in Alaska, workers' compensation insurance is an integral part of operating a business. Workers' compensation is a system of insurance that protects workers and employers from some of the losses caused by on-the-job accidents and job-related illnesses. Before the system was implemented, injured workers would have to sue their employers for negligence to receive compensation. However, proving negligence was a time-consuming and costly endeavor for the injured worker as well as the employer. In response, states began adopting legislation to establish a system of insurance between employees and employers to compensate injured workers while still protecting employers from lawsuits.

The resulting system is based on what is known as the "Grand Bargain," according to Marie Marx, director of the Alaska Workers' Compensation Division. Marx explains: "If a worker is injured, the employer's insurance company or the self-insured employer pays medical and wage replacement benefits due to the worker. In exchange, the injured worker receives prompt, limited benefits and gives up the right to sue the employer. This allows employers to stay in business and continue to provide jobs. Under this limited benefits system, there is no compensation for non-economic damages such as pain, suffering, or loss of consortium. There is also no compensation for punitive damages. It is a no-fault system; an employee does not have to prove an employer was at fault to receive benefits and an employer does not have to admit fault."

The Alaska Workers' Compensation Act governs employee and employer rights and duties and obligations related to a work-related injury. The intent of the act, Marx says, is to ensure quick, efficient, fair, and predictable delivery of benefits to injured workers at a reasonable cost to employers. "If an employee suffers a work-related injury, the act requires an employer to report that injury to the Alaska Workers' Compensation Division and provide medical, indemnity [wage loss], and reemployment [retraining] benefits," she says. "In cases involving fatalities, dependents may be eligible for death benefits. For insured employers, their insurance policy claims administrator takes care of the process for them."

All fifty states have workers' compensation laws, which are unique to each state. And compensation benefits vary significantly from state to state, with the rules being far from uniform. For example, under the Alaska Workers' Compensation Act, all employers with one or more full- or part-time employees are obligated to purchase and maintain workers' compensation insurance policies to cover all employees, Marx says. Sole proprietors, partners, and limited liability members are exempt from having to insure themselves for workers' compensation liability. However, they still must insure employees, including family members, who do not have legal ownership interest in the business. Incidentally, executive officers of a corporation—those with titles such as president, vice president, secretary, and treasurer—are considered employees under the act. They must be insured unless they obtain an executive officer waiver from the Alaska Workers' Compensation Division.



Chris Pobieglo
President of Business Insurance Associates

Image courtesy of Business Insurance Associates

The Alaska Workers' Compensation Act contains exemptions for certain individuals in AS 23.30.230, including part-time babysitters, a cleaning person, contracted entertainers, commercial fishermen, harvest help or other transient help, referees and other sports officials, taxi drivers with specific contractual relationships, real estate agents with specific contractual relationships, and most recently, individuals who fit the definition of a transportation network company driver (Uber and Lyft, for example). "However, exemption under AS 23.30.230 depends upon the particular circumstances surrounding the work relationship," Marx says. "It is important to note there is no such thing as an exempt business under the act. Only individual workers under specific circumstances and business owners may be exempt from the requirement to insure."

Under AS 23.30.045, a project owner and/or contractor is responsible for ensuring employees on a project are covered by workers' compensation insurance, including employees of any subcontractors or contractors it hires. The purpose of AS 23.30.045 is to create "downstream responsibility" to make sure that every employee on a project is covered for workers' compensation liability, Marx says.

Dave Kester,
CPCU, Senior Account Executive with RISQ Consulting

Image courtesy of RISQ Consulting

Therefore, an employer should carefully vet all individuals and businesses with which it does business. "It should ensure those businesses, as well as all the subcontractors those businesses may hire, are properly licensed and insured for general liability and workers' compensation," she says. "This is important because business owners likely will not know if their contractors and subcontractors are misclassifying employee labor."

Sometimes organizations characterize their business relationships contrary to the views of the Department of Labor, Internal Revenue Service, or workers' comp insurance carriers. But they need to base their perception on official standards, says Christopher Pobieglo, CIC, CRIS, president of Business Insurance Associates. "Just because you 1099 another party doesn't automatically make them an independent contractor and absolve you from the responsibility that comes with an employer-employee relationship—notably workers' compensation coverage," he says. "Establishing a contractor-independent contractor relationship, which could absolve some of the employer responsibilities like workers' comp, requires a litmus test, and a 1099 might be a piece of that but by no means constitutes the totality of it. There are a number of factors to be considered, and company policies on this should be crafted and implemented under the guidance of an attorney and a risk management professional/insurance broker."

Understanding Workers' Comp Costs

Alaska has the unfortunate distinction of carrying some of the highest medical costs in the nation, and those costs are major drivers of workers' compensation premium rates. In Alaska, medical benefits contribute 72.9 percent of total benefit costs, compared to 58.6 percent nationwide, says Dave Kester, CPCU, referencing figures from National Council on Compensation Insurance (NCCI), the rate-setting organization for Alaska and about forty other states. "That makes the cost of doing business that much higher than in the Lower 48," says Kester, a senior account executive with RISQ Consulting. "And because medical costs are impacting healthcare, that's a double whammy. It just continues to add to the high cost, plus Alaska is an expensive place to do business."

He adds: "In a state that's experiencing a couple of years of recession now, that's just more pressure on employers and businesses in the state. Whatever can be done to bring medical costs more in line with the rest of the nation would be very beneficial not just to workers' compensation but also to the costs of employers."

Kristin Muir
CIC, AINS, of HUB International Northwest

Image courtesy of HUB International Northwest

There are many factors that determine how much a company pays for its workers' compensation insurance premium. The gross premium is calculated based on gross payroll, class codes, and the rates for each of the class codes. "This gross premium is then adjusted by a few potential variables such as the experience modification rating and carrier credit/debits, such as premium size discounts, surcharges, safety program credits, and drug testing credits, to come up with a net premium," Pobieglo says.

Among these factors, the experience modification—often called the EMOD or mod—is an important part of determining a company's workers' comp premium. And calculating the EMOD rating is a complex actuarial process that involves a number of variables and elements. But in layman's terms, it's determined by comparing claims data and payroll data against other employers with similar business operations to develop expected losses factored against payroll, Pobieglo says. Essentially, the formula incorporates factors that account for company size, unexpected large losses, and the incidence of loss frequency and loss severity to achieve a balance between fairness and accountability. When calculating the EMOD, the experience rating for a three-year window of time is used—excluding the prior year—so that years two through four apply.

"A neutral EMOD is 1.00," Pobieglo says. "Anything below that is a credit, and everything above that is a debit. A $10,000 claim will hurt a company running $100,000 in payroll annually, more than it would a company running $1 million in payroll annually, so in that sense you see more volatility in the EMODs on smaller businesses, but any increase or decrease is also proportionately weighted."

"The bottom line is that a bad EMOD rating and bad claims history can drive you right out of business by making the overhead on your products and services uncompetitive for the market," he says. "Of course there are typically other underlying factors that cause businesses to fail aside from just the EMOD, but a bad EMOD rating can be indicative of a company not appropriately managing risk, which doesn't speak well for the long-term viability."

To be eligible for an experience modification, a business needs to have a premium of $5,000 or greater for two years, according to Kristin Muir, vice president of commercial lines with HUB International Northwest. If it doesn't, it will have to wait a third year before a mod factor is developed. The larger the company, the more potential for a lower experience mod, says Anchorage-based Muir, CIC, AINS.

With the three-year premium information that NCCI uses to calculate the EMOD, the oldest year falls off with each incoming year and the more current year is added. "The mod is negatively affected if there are losses during that time and positively affected if there are no losses," Muir says. "Medical-only claims are discounted by 70 percent, and full payouts are used for indemnity losses."

Essentially if the insured has a few medical-only claims, it may not have much of an impact on the mod. This can be a significant advantage, given Alaska's high medical costs.

So which one has the bigger impact on workers' compensation premiums, the frequency of losses or the severity of each loss? That's a tough question, and the answer is: it depends, Muir says. "If all of the small, frequent losses are medical-only, they will be discounted and not have much of an impact on the experience mod. Most of the time, the larger losses are indemnity losses, and the full value would have a negative effect on the mod. Carriers that see small, frequent losses may think the company needs a better loss control program and either will not write it or choose to add a schedule debit, whereas a large infrequent loss may just be bad luck and the debit mod will roll off in three years."

Like Muir, Pobieglo says the experience modification loss computation is weighted toward frequency. It's a better indicator of loss

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control practices and the safety culture of an organization than severity, he explains. Any company can be at risk of having a severe claim; even those that implement the best safety practices and aggressively manage risk can have a one-off event that results in extraordinary medical and indemnity costs. "Having five workers comp claims of $5,000 will have a more detrimental effect on your experience rating then having a single claim of $25, 000," he says.

Kester agrees, saying that a trend of frequent losses—even small ones—can be damaging for an employer in the long run. "There's a risk management saying that frequency tends to bring about severity," he says "So the more losses you have, the more probability you will have a severe loss."

With the many complexities surrounding workers' compensation, companies are often left with misconceptions about workers' comp insurance. For instance, some business owners feel that all companies in their industry pay the same premium rate regardless of their insurance company. But that's not true, Kester says. "Every insurance company adds on an expense ratio to the base rate," he says. "It's kind of their 'mark-up'. As a broker, we get quotes from different insurance companies because they do differ."

Also, many employers think if they have a workers' comp claim, their premium will go up and they will end up paying for the claim themselves based on the increased premium, Muir says. "In reality, if a client has a large workers' compensation claim and the premium ends up being increased through an increase of the experience modification, the additional amount of premium that they pay is pennies on the dollar compared to what the carrier pays out to the injured employee," she says.

Trends and Changes

The good news is that workers' compensation medical costs are trending down in Alaska. In 2014, the overall medical average cost per case in Alaska was $62,000, compared to $28,000 countrywide, Marx says. In 2015, the overall medical average cost per case went down to $49,000, with the national average remaining at $28,000.

And there's more positive news: Workers' comp costs have gone down since December 1, 2015, when the Alaska Division of Workers' Compensation implemented a new medical fee schedule that completely changed how providers are reimbursed for their treatments and services.

In addition, NCCI has proposed a decrease in Alaska's overall average workers' comp loss cost level. If approved by the Alaska Division of Insurance, benefit costs and loss adjustment expenses could decrease 7.9 percent overall than those underlying the January 1, 2017, approved loss cost level, Marx says. This would be a significant development because the voluntary market loss costs are the "building blocks" to final manual rates that insurers calculate.

Marx says she is optimistic that workers' comp costs will continue to trend downward in Alaska. "However, there are many drivers to the overall loss cost level, in addition to changes to medical fee schedules themselves," she says. "The trends and loss cost levels are re-evaluated with each filing, so the future trends are not yet determined."

As another major trend, insurance auditors are requiring their insured employers to provide very detailed information not only about employee payroll and duties but also about the employer's contractors, subcontractors, and vendors. However, Marx says, "An employer's insurance company is well within its rights to conduct these audits and require the information because, under the Alaska Workers' Compensation Act, the employer's insurer may end up paying for the work-related injury of an uninsured contractor or subcontractor's employee."

Reducing Costs

Companies can use a variety of strategies, including loss control and safety programs, to lower their workers' compensation insurance costs. Loss control usually translates into lower losses. And the lower the losses, the lower the experience modification. This translates into a lower premium. "You can sometimes negotiate schedule credits on a policy if the carrier is aware the insured has an active loss control program," Muir says.

Beyond using loss control, employers can also employ safety meetings, drug testing, and claims monitoring as cost-reduction strategies. They should also pay attention to their final audit. "Auditors sometimes misclassify employees or don't catch the excess payroll on overtime," she says.

Keeping clerical staff in a separate area from other operations can sometimes help and always get certificates from subcontractors, Muir says. Exercising good hiring practices right from the start is also a benefit. She explains, "Don't put the wrong employee in a job that is not appropriate for them and be sure you provide the appropriate training for the job."

Wellness programs can also have an impact on workers' comp costs because the personal health of an injured employee can affect the outcome of a claim. Likewise, drug and alcohol abuse, diabetes, obesity, and smoking can all affect the outcome of an employee's claim. ☼

Tracy Barbour is a former Alaskan.