

California Workers' Compensation Update – Senate Bill No. 863

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Summary

- Background
- SB 863 Summary
- WCIRB Cost Evaluation of SB 863
- 1/1/2013 WCIRB Amended Pure Premium Rate Filing



Background

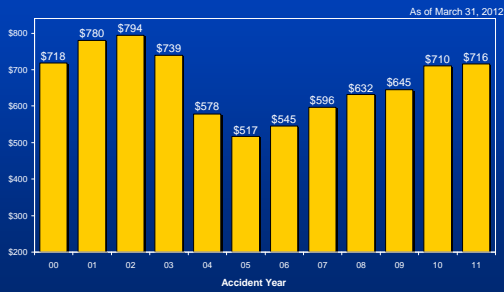
- Rapidly Escalating Costs Prior to Reforms of 2002 through 2004
- 3-Year Series of Reforms in 2002 through 2004
 - Evidence-Based Utilization Standards
 - Unlimited Employer Control of Medical Within Networks
 - Limits of Physical Therapy and Chiropractic Visits
 - New Permanent Disability Schedule Based on AMA Guides
 - 2-Year Cap on Temporary Disability
 - Apportionment of Permanent Disability Benefits
- WCIRB Retrospective Estimate of Savings: 66%, or \$14 Billion Annually in Statewide Costs
- Industry Average Charged Rates Declined by Two-Thirds from 2003 to 2009



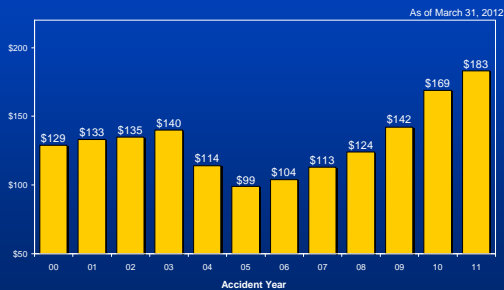
Background (Continued)

- Erosion of Reform Impacts Since 2005
 - Indemnity cost per claim up 40% since 2005
 - Medical cost per indemnity claim up 50% since 2005
 - ALAE cost per indemnity claim up almost 100% since 2005
 - Claim frequency rising (cumulative injuries)
 - Rising lien costs
 - Slowing of claim process
- Industry Average Charged Rates up 17% Since 2009
 - Costs Rising More Quickly
 - Deterioration in Combined Ratios

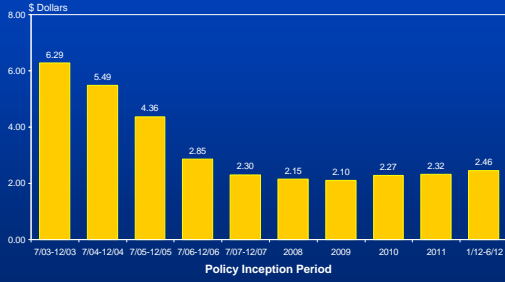
Estimated Ultimate Medical Benefits on Indemnity Claims Per Full-Time Employee



Estimated Ultimate ALAE Per Full-Time Employee



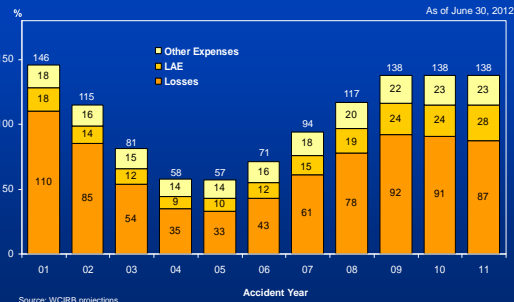
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Industry Average Charged Rate per \$100 of Payroll



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Projected Accident Year Combined Loss and Expense Ratios



Source: WCRB projections

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Background (Continued)

- Consensus that 2002–2004 Reforms Cut PD Benefits Back Too Far
- Several Attempts to Significantly Increase PD Benefits Vetoed
- 2011: Governor Indicated Would Consider Balanced Solution
- 2012: Labor and Employer Representatives Attempt to Negotiate Compromise Bill
 - Reduce frictional costs
 - Increase PD benefits
 - Reduce employer costs

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WCIRB Cost Evaluation of SB 863

Summary of WCIRB Estimates for 2014 & Later Accident Years

| SB 863 Provisions | Impact on Statewide Claim Costs (\$ millions) | % Impact on Claim Costs |
|---|---|-------------------------|
| Total Estimated Impact of 2013 Changes | (\$1,110) | -5.8% |
| Impact of 2014 PD Benefit Maximum Changes | \$590 | +3.1% |
| Combined Estimated Impact of 2013 & 2014 Changes on 2014 Injuries | (\$520) | -2.7% |

WCIRB Cost Evaluation of SB 863

Summary of SB 863 Benefit Changes

- Benefit Changes Effective on 1/1/2013 Injuries
 - Increase in minimum and maximum weekly PD benefits
 - Increase in burial allowance from \$5,000 to \$10,000
 - Change in supplemental job displacement to maximum of \$6,000
 - Elimination of multi-tiered weekly PD benefits
- Changes in PD Ratings Effective on 1/1/2013 Injuries
 - Elimination of FEC factors
 - Application of 1.4 factor to impairment rating
 - Elimination of PD "add-ons" for psychiatric impairment, sleep disorder or sexual dysfunction
- Changes in Weekly PD Benefit Maximums Effective on 1/1/2014 Injuries

WCIRB Cost Evaluation of SB 863

Evaluation of Changes in Statutory Benefits

- Based on WCIRB Standard Legislative Evaluation Model
 - Reviewed by Actuarial Committee in 2010
 - Based on 200,000 2008 and 2009 indemnity claims
 - Supplemented by survey data on death and vocational rehabilitation costs and Disability Evaluation Unit (DEU) data on PD Ratings
 - Wages adjusted to 2013 levels based on UCLA data
 - Individual claims restated at new benefit levels
- Loss Adjustment Expenses Assumed Not to Change Proportionately with Losses
- Standard Frequency Adjustment (Utilization): 10% Average Indemnity Benefit Change = 2% Indemnity Frequency Change (Medical Loss Impact Tempered)
- Estimated 2013 Impact: +3.3%, or \$620M in Statewide Costs
- Estimated 2014 Impact: +3.1%, or \$590M in Statewide Costs

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Evaluation of Changes in Lien Procedures

- SB 863 Provides for \$150 Filing Fee and Statute of Limitations
 - No liens to be filed more than 3 years from date of service (18 months for liens filed after 7/1/2013)
- Evaluation Based on Assumptions Using CHSWC 2011 Liens Study and WCIRB 2012 Special Lien Survey
 - Number of liens estimated based on DWC data
 - 30% liens eliminated by filing fee corresponds to smallest liens (below \$1,000 demand) (based on WCIRB survey data)
 - Moderate speed-up in filings due to statute of limitations
 - 11% of liens eliminated by statute of limitations
 - Liens eliminated by statute of limitations assumed to (i) average \$7,500 in lien demand, (ii) have 30% average settlement rate, and (iii) incur \$3,000 in average legal and administrative costs
 - Estimated Savings: 2.5%, or \$480 Million in Statewide Costs

WCIRB Cost Evaluation of SB 863

Evaluation of New Independent Medical Review (IMR) Process – Impact on Frictional Costs

- SB 863 Provides for IMR Process to Resolve Medical Disputes
- Evaluation of Impact on Frictional Costs Based on Assumptions Derived from CHSWC and WCIRB Data
 - Lien costs related to utilization review would be replaced by lower cost IMR report
 - Higher cost qualified medical evaluator (QME) reports on medical treatment disputes replaced by lower cost IMR reports
 - Elimination of ALAE costs on expedited hearings related to utilization review
- Estimated Frictional Cost Savings: 0.6%, or \$120 Million in Statewide Costs

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Evaluation of New IMR Process – Impact on Medical Treatment Costs

- 65,000 Utilization Review (UR) Disputes in 2010 (Based on CHSWC Information) with Approximately \$400 Million in Dispute
- No Consensus on IMR Impact from Medical Treatment Disputes
- Other Systems
 - California Group Health
 - less than 2,000 IMRs per year (less than 1 per 10,000 enrollees)
 - Decision upheld approximately 55% over last several years
 - Medical necessity determinations based on hierarchy of factors
 - Diagnoses vary from WC (17% orthopedics)
 - Texas Workers' Compensation
 - Relatively similar in structure
 - IMRs relatively rare but more common than in CA Group Health
 - Relatively high rate of UR decisions upheld

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Evaluation of New IMR Process – Impact on Medical Treatment Costs (Continued)

- Key Questions
 - How often are UR decisions overturned under current system?
 - How often will UR decisions be overturned with IMR?
 - How frequently will IMR be utilized?
 - How will IMR affect treatment patterns?
- Potential Studies
 - Analysis of effect of current utilization review decisions
 - Re-assessment of sample of expedited hearings under IMR
 - Monitoring of IMR results
- Impact on Medical Treatment Costs Uncertain at This Time
- No Estimated Cost Impact Reflected at This Time

WCIRB Cost Evaluation of SB 863

Evaluation of New IMR Process – Impact on Temporary Disability (TD) Costs

- General Consensus that IMR Should Accelerate Claims Process and Reduce TD Duration
- 2013 TD Benefits Estimated at 19% of Total Benefits (\$2.9B)
- TD Duration Has Increased by Approximately 20% Since 2005 (Approximately Two Months on PD Claims)
 - Unclear how much is due to medical treatment delays and how much is due to economy, PD issues and other issues
 - California TD duration and rate of growth in duration are considerably higher than Texas and 16-state median (WCRI)
- Assumed 4% Reduction in TD Duration (Additional 1% Reduction Assumed Due to MPN Strengthening)
- Estimated Savings: 1.1%, or \$210 Million in Statewide Costs

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Evaluation of New IMR Process – Impact on Litigation

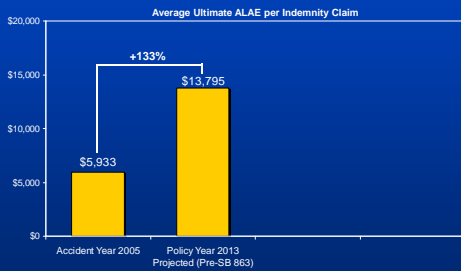
- General Consensus that IMR Should Reduce Litigation over Medical Necessity Issues
- 2013 ALAE Costs Estimated at \$2.5 Billion
- ALAE Per Claim Has Almost Doubled Since 2005 (WCIRB)
 - Unclear how much is due to medical treatment disputes and how much is due to PD issues, liens or other issues
 - California average benefit delivery expenses per claim more than 50% higher than Texas and 16-state median (WCRI)
 - Litigation over medical necessity in Texas unusual
- SB 863 Reforms Related to Liens, IMR and Quilvie Projected to Reduce ALAE Costs by \$380 Million, or 15% of Total ALAE
- Additional Reduction in ALAE Estimated at 2.4% (Based on TD Duration Assumption): 0.3%, or \$60 Million in Statewide Costs

Total SB 863 IMR Savings: 2.1%, or \$390M in Statewide Costs

WCIRB Amended 1/1/13 Pure Premium Rate Filing

- 1/1/13 Filing Initially Submitted August 21, 2012
- Average Indicated Pure Premium (PP) Rate: \$2.68 per \$100 Payroll or 12.6% above Industry Average Filed PP Rate (\$2.38)
- Potentially Subject to Amendment
 - Review of June 30, 2012 experience
 - Analysis of potential legislative changes if adopted (SB 863)
- Updated Indication Based on June 30 Experience and Estimated Impact of SB 863: \$2.61 per \$100 of Payroll
- WCIRB Recommended Pure Premium Rate Level: Average Industry Filed Pure Premium Rate of \$2.38 per \$100
 - High level of uncertainty with SB 863 impacts
 - Future SB 863 components may reduce cost
 - WCIRB to actively monitor SB 863 costs and amend future pure premium rates as appropriate

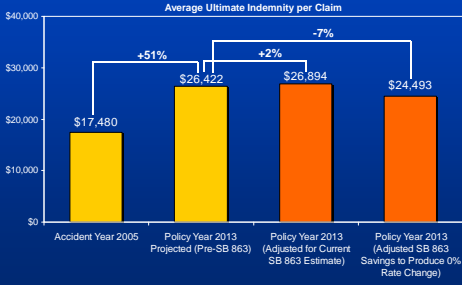
Deterioration from 2002-2004 Reforms Loss Adjustment Expenses



Deterioration from 2002-2004 Reforms Loss Adjustment Expense Cost Drivers

- Liens
 - SB 863 imposes lien filing fee and statute of limitations which should significantly reduce liens filed
 - IMR process should eliminate lien costs related to utilization review
- Ogilvie and Almaraz/Guzman Decisions
 - SB 863 effectively eliminates Ogilvie
 - Does not address Almaraz/Guzman
- Medical Cost Containment Expenses
 - SB 863 creates IMR process which should reduce frictional costs related to medical treatment disputes
- Increases in Cumulative Injury Claims and Claims with Multiple Body Parts
 - Not addressed by SB 863

Deterioration from 2002-2004 Reforms Indemnity – After SB 863 Adjustments



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