

# WORK COMP INSIGHTS

## Is Paying Small Work Comp Claims Out of Pocket Ever a Good Idea?

Medical-only claims are an important factor in the experience modification rating process. In many states, these claims, also known as injury or IJ code type 6 losses, are reduced by 70 percent for the mod calculation. This reduction is known as the experience rating adjustment (ERA).

The ERA was implemented in many states in the late 1990s as a way to encourage employers to report all losses, not just those involving lost-time claims. At that time, it was common for companies to pay, rather than report, their small claims in order to avoid having those claims count against the experience modification factor, or the mod. The National Council on Compensation Insurance (NCCI) and other stakeholders were interested in collecting all possible data for statistical and actuarial purposes, so the ERA was introduced.

More than 15 years later, a reduction of medical-only losses now applies in 38 states, but there is still a fair amount of talk about employers self-paying small workers' compensation claims—even in ERA states. This raises the question: Is paying small medical-only claims out of pocket ever a good idea? Examining a few hypothetical scenarios will allow employers to try to answer the question analytically.

### Key Factors to Keep in Mind

Before examining the scenarios to determine whether self-payment saves or costs the employer, keep the following in mind:

- Self-payment of small claims is not legal in all states, and may be subject to fines or penalties. Specific rules are determined by state workers' compensation statutes.

For example, the Missouri Department of Insurance specifically suggests that employers take advantage of the state's Employers Paid Medical Program to reduce the cost of their workers' compensation average. It's important to know the rules in your state.

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**The question at the heart of this debate is whether paying small medical-only claims out of pocket is ever a good idea. The short answer, in most scenarios, is no.**

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- Self-payment of claims also has implications at the federal level if injured employees are eligible for Medicare.
- Employer access to state or "reasonable and customary" fee

schedules is an important consideration in the cost of self-paid claims.

- Employers paying small claims out of pocket may risk liability if those claims develop into something more costly.

### Scenario 1: ERA States

To analyze a scenario where the use of ERA is approved, imagine Mike's Machine Shop, a relatively small business operating in Missouri and Indiana (both ERA states). Here's some background information on Mike's Machine Shop:

- Effective date of mod is 1/1/2014

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- Approximately \$1.7 million to \$1.8 million in payroll each year in codes 3632 and 8810, generating a minimum mod of 0.73
- Three itemized losses, all type 5: \$8,000, \$12,000 and \$45,000
- The assumption that the shop had only one \$1,000 med-only claim per month in 2012, for a total of \$12,000 in type 6 losses

| ERA States – Year 1   |                                      |   |                                |
|---|--------------------------------------|---|--------------------------------|
| <i>For type 6 losses in a state where ERA is approved</i>   | No Losses Less Than \$1,000 Reported | One \$1,000 Loss per Month Reported in 2012 | Potential Savings of Reporting |
| <b>Mod Effective 1/1/2014</b>   |                                      |   |                                |
| Mod factor  | 0.95                                 | 0.98  | -0.03                          |
| Estimated premium due (Mod x 50,000 manual premium)   | 47,500.00                            | 49,000.00                                   | ★ -1,500.00                    |
| ★ The \$1,500 cost in premium impact of 2012 reported losses will also apply to the 2015 and 2016 mods. |                                      |   |                                |
| Self-paid claims cost (one \$1,000 loss per month)  | 12,000.00                            | 0.00  | 12,000.00                      |
| <b>Year 1 total cost of risk</b>  | <b>59,500.00</b>                     | <b>49,000.00</b>                            | <b>10,500.00</b>               |

In 2014, Mike will save three points on his mod and \$1,500 on his premium if he doesn't report those small claims. And, because those claims are not affecting his mod for two more years, he will save about \$1,500 in 2015 and 2016, too. The bad news is that the self-paid claims costs add considerably—in this case, \$12,000—to Mike's Year 1 total cost of risk.

In Year 2 of this scenario, imagine that Mike has instituted some safety improvements and the shop had just one small claim per quarter in 2013, for a total of \$4,000 in type 6 losses. Also imagine that payroll and

other itemized losses have stayed exactly the same, as well as rating values.

If Mike is not reporting small losses, his mod and premium are the same as in 2014 (0.95 and \$47,500). If he is reporting the small claims, then the new claims in 2013 drive his mod to 0.99—one more point than the 2014 mod. Cumulatively, the 2012 and 2013 small reported claims are responsible for four points, or approximately \$2,000 in premiums.

Because Mike's self-paid claims costs are considerably lower in Year 2 (\$4,000), the Year 2 total cost of risk differs only by \$2,000 between reporting and not reporting losses. Still, Mike has a financial advantage to report claims, especially when considered over the cumulative two-year total cost of risk.

| ERA States – Year 2   |                                      |   |                                |
|---|--------------------------------------|---|--------------------------------|
| <i>For type 6 losses in a state where ERA is approved</i>   | No Losses Less Than \$1,000 Reported | One \$1,000 Loss per Quarter Reported in 2013 | Potential Savings of Reporting |
| <b>Mod Effective 1/1/2015</b>   |                                      |   |                                |
| Mod factor  | 0.95                                 | 0.99  | -0.04                          |
| Estimated premium due (Mod x 50,000 manual premium)   | 47,500.00                            | 49,500.00                                     | ★ -2,000.00                    |
| ★ The \$2,000 cost in premium impact includes \$1,500 for the 2012 losses and \$500 for the 2013 losses. The \$500 cost for 2013 reported losses will also apply to the 2016 and 2017 mods. |                                      |   |                                |
| Self-paid claims cost (one \$1,000 loss per quarter)  | 4,000.00                             | 0.00  | 4,000.00                       |
| <b>Year 2 total cost of risk</b>  | <b>51,500.00</b>                     | <b>49,500.00</b>                              | <b>2,000.00</b>                |
| <b>Cumulative two-year total cost of risk</b>   | <b>111,000.00</b>                    | <b>98,500.00</b>                              | <b>12,500.00</b>               |

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## Scenario 2: Non-ERA States

If Mike were operating in a state that has not approved the ERA reduction, then the impact on the mod of small medical-only claims is certainly more significant, and it's easier to see how the scales could tip in favor of not reporting. However, in this scenario, using all the same assumptions as before, the overall cumulative cost savings still favors reporting of claims.

| Non-ERA States – Year 1   |                                      |   |                                |
|---|--------------------------------------|---|--------------------------------|
| <i>For type 6 losses in a state where ERA NOT approved</i>  | No Losses Less Than \$1,000 Reported | One \$1,000 Loss per Month Reported in 2012 | Potential Savings of Reporting |
| <b>Mod Effective 1/1/2014</b>   |                                      |   |                                |
| Mod factor  | 0.95                                 | 1.04  | -0.09                          |
| Estimated premium due (Mod x 50,000 manual premium)   | 47,500.00                            | 52,000.00                                   | ★ -4,500.00                    |
| ★ The \$4,500 cost in premium impact of 2012 reported losses will also apply to the 2015 and 2016 mods. |                                      |   |                                |
| Self-paid claims cost (one \$1,000 loss per month)  | 12,000.00                            | 0.00  | 12,000.00                      |
| <b>Year 1 total cost of risk</b>  | <b>59,500.00</b>                     | <b>52,000.00</b>                            | <b>7,500.00</b>                |

In states that have not implemented the ERA reduction, the total cost impact of paying workers' compensation claims out of pocket requires especially close analysis.

| Non-ERA States – Year 2                                    |                                      |   |                                |
|--|--------------------------------------|---|--------------------------------|
| <i>For type 6 losses in a state where ERA NOT approved</i> | No Losses Less Than \$1,000 Reported | One \$1,000 Loss per Quarter Reported in 2013 | Potential Savings of Reporting |
| <b>Mod Effective 1/1/2015</b>                              |                                      |   |                                |
| Mod factor   | 0.95                                 | 1.06  | -0.11                          |

|   |                   |                   |                  |
|---|-------------------|-------------------|------------------|
| Estimated premium due (Mod x 50,000 manual premium)   | 47,500.00         | 53,000.00         | ★ -5,500.00      |
| ★ The \$5,500 cost in premium impact includes \$4,500 for the 2012 losses and \$1,000 for the 2013 losses. The \$1,000 cost for 2013 reported losses will also apply to the 2016 and 2017 mods. |                   |                   |                  |
| Self-paid claims cost (one \$1,000 loss per quarter)  | 4,000.00          | 0.00              | 4,000.00         |
| <b>Year 2 total cost of risk</b>  | <b>51,500.00</b>  | <b>53,000.00</b>  | <b>-1,500.00</b> |
| <b>Cumulative two-year total cost of risk</b>   | <b>111,000.00</b> | <b>105,000.00</b> | <b>6,000.00</b>  |

## Analyze Your Choices

There are a myriad of reasons that ultimate costs could vary other than these two scenarios. However, in most scenarios, paying small claims out of pocket demands a detailed analysis that accounts for all associated costs, such as any fines and applicable medical fee schedules. In all cases, knowing your state rules is imperative. Refer to your state's Department of Insurance or to the NCCI's Unit Statistical Reporting Guidebook for more information.

Claiming all losses results in better data—not just for the bureaus or insurance carriers, but also for you as an employer. And better data leads to more meaningful analysis opportunities.

Work with your broker at BCG Advisors, Inc. to analyze and act on your mod data. Getting the complete picture reveals all trends and will help you drive the most appropriate operational initiatives towards improvement.