



# Quick Guide to Workers' Compensation

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*America's small business insurance specialist<sup>®</sup>*

## What Is Workers' Compensation Insurance?

Workers' compensation insurance covers businesses for their statutory and legal obligations for employee expenses that are a direct result of on-the-job injuries and/or illnesses. While plans may differ from state to state, workers' compensation can include weekly payments in place of wages, compensation for economic loss (past and future), reimbursement or payment of medical expenses, and benefits payable to the dependents of workers killed on the job or in the course of employment. Workers' compensation insurance policies generally do not include damages for pain and suffering, or punitive damages for employer negligence.

Workers' compensation laws generally provide no fault benefits to employees—meaning that injured workers can (in most cases) collect workers' compensation benefits regardless of whether they caused their own injury. They also provide the predictability of an exclusive remedy to businesses—injured workers are provided defined benefits as compensation for their injury. State laws establish comprehensive and specific benefits that must be provided to workers who suffer a work-related injury or illness. Usually, businesses obtain workers' compensation protection from one of four sources: private insurance carriers, like EMPLOYERS®, state insurance funds, self-insurance, or self-insured groups.

## When Did Workers' Compensation Insurance Start?

Workers' compensation insurance originated in Germany in 1870 to address the social costs of workers' injuries arising from the industrial revolution. Back then, workers who had been injured or made ill on-the-job had to take legal action against their employers to receive compensation. This made it difficult for workers to obtain timely compensation for workplace injuries and also exposed businesses to potentially devastating lawsuits.

Starting in 1911 in the U.S., individual states began implementing laws domestically, requiring businesses to carry workers' compensation coverage. Wisconsin was first, but other states quickly followed in enacting a "no fault" system intended to help workers receive fair and prompt medical treatment and financial compensation for workplace injuries and illnesses. This compromise system also established limits on the obligations of businesses for workplace exposures, making costs more predictable and affordable.



## **Do I Need Workers' Compensation Coverage?**

Generally speaking, businesses must obtain workers' compensation coverage if they have employees that are not owners of the company. Most states allow sole proprietors and partners to purchase coverage, but it is not required. Check your state's laws for further information on which types of employees need workers' compensation coverage.

Businesses with contract employees should take special care in evaluating their workers' compensation needs. Most states will treat an uninsured contractor or subcontractor as your employee if he or she is injured while doing work for your company.

As of May 2013, Texas and Oklahoma are the only states in which businesses can opt-out of the requirement to provide workers' compensation coverage for their employees, if they comply with other requirements established by the state.

## **What Happens If I Don't Have Workers' Compensation Coverage?**

Failure to meet your workers' compensation coverage requirement can leave your business exposed to both the full costs of workers' compensation claims (through litigation) and additional regulatory penalties levied by the states, which can be severe.

## **Where Can I Get Workers' Compensation Coverage?**

In most jurisdictions, businesses can fulfill their workers' compensation obligations by purchasing a policy from a private insurance company or a state insurance fund. Companies meeting certain legal criteria can assume their own workers' compensation risk and liabilities by self-insuring. An alternative to self-insurance is a self-insured group (SIG), in which companies join a group of other employers, which is responsible for the workers' compensation risk and liabilities for group members.

Four states and two U.S. territories (North Dakota, Ohio, Washington, Wyoming, Puerto Rico, and the Virgin Islands) require businesses to get coverage exclusively through state-operated funds. These are commonly called "monopolistic state funds." A business cannot meet its workers' compensation obligations in these jurisdictions with a policy from an insurance company.



## Workers' Compensation Rate and Premium Influencers

- **The Experience Rating Plan:** was designed to encourage businesses to operate safely, and to recognize differences between loss experience and the effectiveness of safety programs of similar businesses. The experience rating plan uses historic payroll and losses (about 36 months of premium and losses) to predict future losses and compares the actual, final audited payroll and losses of a business to those expected for the average risk in a job classification.
  - The Experience Modification Factor is an adjustment to Manual Premium, calculated by an advisory organization (also known as rating bureaus) such as NCCI, based on historic losses and final audited payroll data of a particular insured. It is also called the Experience Modifier or Mod (E-Mod).
- **The Schedule Rating Factor:** is comprised of judgment rating factors (debits or credits) assigned to distinguish the insured's characteristics from the average insured in its classification, which are not already recognized in the rating or experience rating process. Typical factors include premises condition and work environment, management experience, safety programs and cooperation with insurers and employee hiring practices and training programs.
- **Dividend Plans:** eligible insureds may qualify for a dividend premium savings. Depending on the available plan, dividends may be calculated based on a flat calculation or may vary based on loss ratio.

## How Are Workers' Compensation Insurance Premiums Calculated?

The cost of workers' compensation insurance is determined based on a business' risk classification rate and its individual payroll. The ultimate cost to an employer may be impacted by credits, dividends and/or individual experience modification factors. Although base rates (the risk classification rates) vary from state to state by type of business, the basic processes used to calculate ultimate premium is similar.

Here's a simple example of a workers' compensation premium calculation:

$(\text{Annual Payroll}/100) \times \text{Risk Classification Rate} \times \text{Experience Modification Factor} = \text{Estimated Annual Premium}$

- Businesses are assigned a classification based on their business operation(s). There are approximately 600 classifications in most states. To come up with the annual cost of a policy, the company determines the following:
  - **Manual Rate:** each classification has a rate, which in most instances is multiplied by each hundred dollars of payroll assigned to the classification to compute the manual premium.
  - **Standard Premium:** to calculate the Standard Premium, the manual premium is modified (multiplied) by an experience modification factor (for eligible businesses). The Standard Premium may be modified by a Schedule Rating Factor (see above for description), a premium discount, and several other fees and state assessments to determine the estimated annual premium (EAP).
  - **Final Premium:** the Final Premium is determined at the end of the policy term, and a final audit at the expiration of the policy term is completed based on actual, not estimated, payroll by job classification. Minimum qualifying premiums are set by state.

## **What Can Be Done to Control Workers' Compensation Policy Costs?**

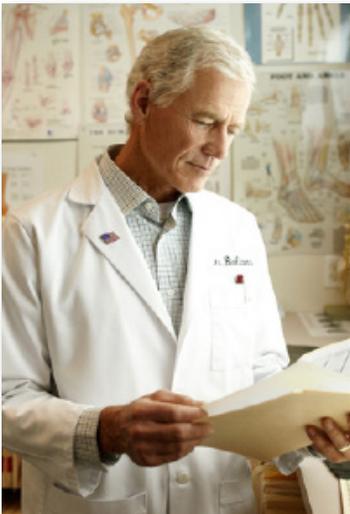
The upfront cost of a workers' compensation policy is certainly an important factor when selecting an insurance provider. But when it comes to insurance, a workers' compensation carrier's focus on safety, fraud detection and prevention, managed care and claim management provides added value that better protects businesses for the future. The following factors may impact the cost and outcome of workers' compensation claims and the overall cost of workers' compensation insurance:

- **Early Reporting:** Timely reporting of any workplace-related accident or injury assists not only in the investigation of the cause, but also the development of safety measures to avoid similar occurrences.
- **Having a Pre-Arranged Medical Care Facility:** Having a pre-arranged medical facility can benefit your organization by helping you get your injured worker the care he or she needs and possibly back to work (when medically possible) faster. You can also request that this facility perform post-accident drug testing on all injured employees.
- **Creating an Alternate Duty Work Description and Program:** Businesses that provide an alternate duty work program for their injured employees can help reduce their time away from work and may lower workers' compensation costs. In addition, this can help minimize the possibility for fraud and attorney involvement. Businesses should strive to provide alternate duty until full recovery by their injured employees, which reduces cost and time away from the employees' regular work.
- **Implementing a Successful and Cost-Effective Safety and Health Program:** Experience shows that with informed planning and proactive hazard analysis and controls, and committed safety training and enforcement, workplace accidents and injuries can be reduced. By implementing an effective injury prevention program, businesses can increase productivity, reduce claim costs and ultimately reduce their experience modification factor.
- **Having Ongoing Pre-Injury Employee Education:** Pre-injury information educates employees on how to prevent or respond to a work-related injury. Educating employees can improve their job satisfaction, and may reduce attorney involvement when a claim occurs. Education should be offered during new employee orientation and annually thereafter (group health enrollment sessions are a good time to present workers' compensation safety program elements to employees).
- **Keeping in Contact with Injured Workers:** Businesses who ensure that injured workers receive appropriate treatment and maintain compassionate contact during the recovery period (by sending cards/flowers, visiting and/or contacting the injured worker by phone) may improve worker satisfaction and reduce the chance of legal involvement in claims.
- **Separating Workspaces:** Premium costs can also be reduced by providing a separate workspace for clerical employees (away from production areas) and maintaining detailed, segregated payrolls by employee.

## What are the Basics of a Good Safety Program?

The following are some key elements that every formal safety program should have.

- **Management Commitment:** Management should create a culture that discourages unsafe conditions and behaviors. Management's commitment is the first step to successful injury prevention.
- **Responsibility and Accountability:** Responsibilities and expectations must be developed for top management, supervisory, and hourly employees. All employees must be held accountable for meeting the expectations of your safety program.
- **Safety Work Rules and Procedures:** Safety rules and procedures should be developed and communicated to supervisors and employees so they will know their responsibilities. Rules must be enforced, and management and supervisors must be accountable for this enforcement. Employees should be held accountable for these rules.
- **New Employee Orientation:** A new employee orientation program must be developed to provide new-hires with information about the work environment and their job safety responsibilities. This is the first training that a new employee will receive that demonstrates management's commitment to injury prevention.
- **Employee Involvement:** Employees should be involved in establishing safety rules and procedures. It is vital to program success that employees participate on the company's safety committee.
- **Training and Safety Committees:** Training is key for building and maintaining employee knowledge and awareness of injury prevention efforts. The employer must inform and train employees in a language they understand. Safety committees allow employees to be actively involved in this.
- **Accident Investigation:** An accident investigation procedure should be developed to determine the cause of an accident. Emphasis should be placed on identifying and eliminating root causes to prevent future occurrences.
- **Documentation:** All training activities and inspection reports must be documented. Records must be maintained in accordance with OSHA guidelines.



## Workers' Compensation Glossary

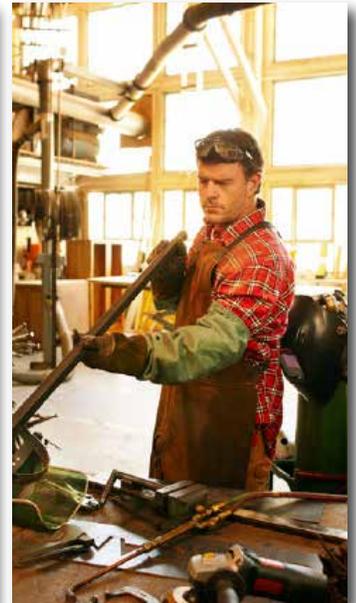
There are many different acronyms used in workers' compensation insurance policies and laws. Here are definitions for some of the most common:

- **Average Daily Wage (ADW):** The ADW is a calculation of an injured employee's average daily earnings and is sometimes used to determine entitlement to wage loss benefits following an injury, particularly where the Average Weekly Wage (AWW) would not be an accurate representation of the employee's earnings.
- **Average Weekly Wage (AWW):** The AWW is another method that may be utilized in calculating entitlement to wage loss benefits. The average earnings, by week, for a fixed period of time are calculated and wage loss benefits are computed according to that amount.
- **Independent Medical Examination (IME):** In some situations, an employer or insurance company may want to have an injured employee seen by a particular physician in order to obtain an objective evaluation of the employee's health. An employee may initially be seen by a company physician, or a physician of their own choosing; however, if a concern or dispute arises over the extent of the employee's injuries (or whether the employee has any injury at all), the employer and insurer will likely be entitled to require the employee to appear for an IME with a physician of their choosing.
- **Permanent Partial Disability (PPD):** PPD benefits are payable, in most jurisdictions, to an employee who has sustained a permanent, but not complete, disability. Many state statutes have pre-set values for a host of different PPD injuries involving specific body parts or conditions.
- **Permanent Total Disability (PTD):** PTD benefits are available if an injured employee is permanently and totally disabled from work.
- **Physical Therapy (PT):** Many injured employees are entitled to receive physical therapy as a form of medical treatment to recover from injuries. On forms, or in medical records, you may see a reference to "PT." That is short for "physical therapy."
- **Social Security Disability Insurance (SSDI):** SSDI benefits are payable to disabled individuals through the Social Security Administration. Many state workers' compensation statutes have specific provisions that dictate whether an injured employee may receive both workers' compensation benefits and SSDI benefits at the same time. Generally, if both benefits are appropriate for the same individual, a complex calculation will be performed to "offset" the benefits so that the individual does not receive more money than they are entitled to from both programs.



## Workers' Compensation Glossary (Continued)

- **Statewide Average Weekly Wage (SAWW):** *The statewide average weekly wage is a computation of average wages paid to workers in a jurisdiction for a set period of time and is generally used to calculate the minimum, and maximum, amounts of workers' compensation benefits that an injured employee will be entitled to receive.*
- **Temporary Partial Disability (TPD):** *TPD benefits are payable when an injured employee is able to work despite their injury, but at a reduced rate. The benefits are available only for a limited period of time, in recognition of the fact that the employee will recover fully in the future and will be able to resume full employment without a wage diminution or decrease.*
- **Temporary Total Disability (TTD):** *TTD benefits are available to employees whose injuries leave them totally unable to work for a period of time. The benefits are no longer payable when the "temporary" disability clears and the employee is able to resume working. In some states, if the employee is able to return to work at partial hours or at a wage decrease while their disability clears, they may be entitled to payment of TPD benefits after receiving TTD benefits.*
- **Vocational Rehabilitation (VR):** *Vocational rehabilitation generally includes a variety of services that are offered to injured employees to help them return to work following a work injury. Vocational rehabilitation may involve transferable skills assessments, educational courses, job search assistance, and many other vocational aids. Vocational rehabilitation is sometimes also referred to as "occupational rehabilitation."*



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