COVID-19, Disrupting Workers' Compensation

Part 2: Payroll and Rating for Guaranteed Cost

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As employers navigate the challenges associated with the COVID-19 pandemic, workers' compensation rating strategies can be leveraged to drive short-term reductions in premium expenses.

Sharply reduced payrolls, COVID-19 claims and lower yields are likely to exert considerable upward pressure on workers compensation rates. This pressure can be amplified or alleviated based upon industry sector, payroll reclassifications and changes in underlying operations. The impact is more pronounced for clients with a guaranteed cost structure (first-dollar), and these programs will be the focus of this discussion.

When would a reclassification be most advantageous?

Guaranteed cost policies are rated based upon the classification codes that apply to the state and job duties of each employee. Responding to stay at home orders, many employers have transitioned large portions of their workforce to a remote-only environment and /or changed their duties. Why does this matter? As an example, there are 37 states with a job code for Clerical Telecommuter (8871). In those states, the rates for this code are, on average, 34% less than the typical code for Clerical, (8810)[1] . In fact, 15 states provide for rate reductions of 50% or more for the Clerical Telecommuter code. One notable exception, however, is New York where rates are 46% higher for Clerical Telecommuters. In response, New York created a new code for Telecommuter Reassigned (8873) that carries the same rate as Clerical.

Although some states will not allow employers to reclassify clerical workers to the telecommuter code, there are still opportunities with other employees. A great example includes sales professionals who have gone from being on the road to working from home. Such remote sales professionals may either be moved to the code for Clerical (8810) or Clerical Telecommuter (8871), both of which carry lower rates than the code for Salespersons (8742). Yet another opportunity for savings relates to employees being paid but not working (idle time). Historically, idle time was captured within ratable payroll and charged at the full rate for that code. The National Council for Compensation Insurance (NCCI) has proposed a rule change that provides a separate code for idle time associated with COVID-19 (0012). If approved, this payroll will not be included within the rating, and no premium will be charged.

As noted, seemingly minor changes in classifications can have a material impact on premium, and at a time when every dollar counts, it is important to capture such changes for premium audits and upcoming renewals.

[1] Average difference includes states that do not distinguish between Clerical and Clerical Telecommuter. Excluding these states from the average would increase the difference to 42%.

Can a reclassification sometimes increase costs?

As employee duties shift to meet new operational needs, there is a chance that the associated payroll will be reclassified to a higher-rated code. Typically, these stem from two factors:

1. Individual employees shifting their responsibilities within the scope of the employers' original operations. For example, employers in the janitorial space have asked some of their managers to move from office roles to be in the field, in order to meet demand.
2. Changes to the employers' operations may precipitate broader changes. Some restaurants have added delivery operations, requiring the addition of a delivery code to their program. Manufacturers have shifted their operations to produce goods that are in high-demand, and this too can result in different codes or increased concentration within existing codes.

The workers' compensation payroll codes are very specific in many areas, and brokers have access to data that can help employers understand how employees will be classified under an evolving operational framework. Once potential new codes are identified, a broker can help anticipate the impact to cost under, providing greater budget certainty.

When can job codes be reclassified?

Most states have not provided clear guidance around when new codes should be applied. Two notable exceptions, however, pertain to how idle time should be classified and California's requirement that the Clerical code (8810) be used for remote employees.

Unless states issue broader guidance, the application of the rules will be subject to the discretion of the insurance carrier and the auditor reviewing the payroll. The traditional approach has been to include all payroll associated with an individual employee within the highest rated code applicable to their job functions. Such an approach, however, can lead to an inaccurate perception and pricing of the risk if employees' roles and duties have changed during the policy term.

As auditors review the data presented to them, the following factors are likely to have a material impact on any potential reclassification:

1. **Duration** – The argument is stronger for a reclassification if there is a long-term deviation for the original job duties.
2. **Type of Change** – The difference between a clerical employee's operations at home and in the office may be minimal, making it more difficult to explain why there is a difference in the underlying risk.
3. **Company Operations** – Some industries have master classifications that apply to all employees associated to the business with limited exceptions. For example, clerical employees for a doctor's office may fall under the Physician and Clerical code (8832) in a particular state, regardless of their remote working status.
4. **State Mandates** – As mentioned above, some states have issued formal guidance that insurance companies must follow when classifying payroll. It is anticipated that this will continue to evolve over time.

Any changes in classification should be pre-approved by both the underwriter and the auditor before endorsements are issued. Remember, the auditor is the one who has control over the class codes used on the policy *after it has expired!*

Lockton is closely monitoring these regulatory actions and aggregating data to improve advice to clients. It is worth checking frequently to determine how state mandates may have evolved.

Will my experience modification factor (EMR) be impacted by COVID-19 claims?

An EMR increases or decreases premium based upon how losses perform in comparison to peers. This can be material as an EMR of 0.50 would effectively reduce rates by half. Conversely, an EMR of 2.0 would effectively cause rates to be doubled. NCCI, CA, DE, MI, NJ, and PA have issued guidance that COVID-19 claims should be removed from EMR calculations. It is critical to ensure that the carrier or TPA has properly classified such losses before they are submitted to the NCCI.

Has the audit process changed?

Payroll audits have become more challenging with stay at home orders, and many carriers are accommodating the need for virtual audits. Many carriers are also offering flexibility with the time period in which insureds are required to comply with the audit. However, this flexibility is voluntary in most states, and carriers have the option of including an Audit Non-Compliance Charge (ANC) of up to three times the estimated premium on the policy. It is important to respond to auditors' requests in a timely manner and schedule the audit within a mutually agreeable timeframe.

How can employers optimize their position in preparation for renewals and audits?

Strong record keeping, strategic presentation of information and communication with the broker and auditor are crucial to leveraging the best possible results. Best practices include the following:

1. **Record Keeping** – Keep a thorough and accurate record of when and how the business changed. Track when employees' duties changed, when work from home started and ended for various subsets of the employee population based on job title and location.
2. **Formalize Job Changes** – Auditors typically classify payroll based on the job title included in payroll reports. Formally updating the internal title structure to reflect changes in job duties will simplify the presentation of payroll results for both premium audits and renewal projections. It will be important to structure this so it's in line with the class code description to further support the case.

3. **Learn the Codes –** Understand which codes can be applied to payroll as well as the potential impact. Most payroll systems can include a field for WC codes and should be updated to reflect the code most representative of the job duties that exist within the workforce after a change in operations. Additionally, it is important to determine if the payroll system can include different titles and codes for the same individual to account for temporary deviations in duties. Otherwise, these deviations should be tracked manually.
4. Consider Payroll Incentives – Increased pay is commonly being used as an incentive for employees to continue working during the pandemic. This is often included in ratable payroll and will increase costs. Ensure this is contemplated and quantified in audit budgets and renewal estimates.
5. Proactive Carrier Communication – In most instances, changes to the codes are best negotiated during the current policy term to ensure that the underwriter and the auditor are aligned with the proposed changes. Audit questions are escalated to the underwriter, and proactive communication will clarify and resolve differences before the audit occurs.
6. Tell the Story – It is critical to share as much detail as possible about the business, including the timeline of events, how the business has changed and how roles have evolved. This should trigger a dialogue about various subjects, including the immediate rating impact on the workers' compensation program and negotiation strategies. In addition to optimizing the granular details of the rating process, it is important for the broker to be able to provide an underwriter a high level overview: If the business is in a high-exposure industry that has not had any COVID-19 claims, what has it done differently to protect its employees? If it has experienced issues, what has been learned that will limit its exposure in the future? How quickly is the business expected to recover? How long before employees return to the office or their normal positions? How quickly will payroll ramp up and which states / locations were most impacted? All of this will be critical to influencing the outcome of the upcoming renewal.

Summary

The COVID-19 pandemic is far from over, and its impact on businesses will continue. Combined with broader macroeconomic forces, the market for Workers Compensation is likely to shift from "stable" to "hardening", placing a premium on creative thinking and strategy. As employers struggle to find efficiencies and reduce costs the importance of accurately classifying employees is critical. Short-term changes in operations can lead to reduced premiums both at audit and renewal. Employers must keep detailed and accurate records regarding how the business is changing, review these changes with their broker and develop a strategy to present information in a manner that drives competitive results.

Part 3 of this Series will discuss payroll, rating and collateral for loss responsive programs.

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