The Impact of COVID-19 on Workers' Compensation

June 2020

As if U.S. businesses didn't have enough to worry about already, they now face a potential looming crisis as respects to rising workers' compensation costs.

The COVID-19 pandemic has had a profound impact on U.S. workers as evidenced by record unemployment levels and a rapid shift to stay at or work from home. As states begin to reopen, it is tempting to think that the worst may be over. Unfortunately, significant uncertainty remains around the long-term effects for organizations, including potential for a second cycle of infections and when/if employees can return to work safely. As a result, the virus will continue to challenge employers and insurers with regard to workers' compensation.

Workers' compensation typically presents a significant liability for employers, and COVID-19 will exacerbate the risk. It is important to understand the potential challenges and develop appropriate mitigation strategies to address them. Lockton can apply important actuarial insights to help employers understand how these actions may impact current period accruals, projected loss estimates, collateral requirements and premium. Careful attention to seemingly small details can often lead to critical savings during a period of intense budget pressure.

Compensability of COVID-19 claims

Traditionally, coverage for communicable diseases has been rare under workers' compensation policies. The burden has always been on the employee to prove that the illness was acquired in the scope of employment or that they were at greater risk of the disease than the general public. However, as states grapple with the best way to mitigate the economic fallout of the pandemic, some have turned to the workers' compensation system for support.

Over the last few months, several states have rolled out "presumptive compensability" regulations that assume workers with a COVID-19 diagnosis were infected at work unless the employer can prove otherwise. Some states have applied the presumption only to certain industries, such as healthcare workers and first responders, while others have applied the new rules much more broadly. In states that have not yet made a change, employers still face a material risk that pending legislation on the issue could retroactively increase their workers' compensation costs.

A current listing of these changes can be found in the COVID-19 State Report on Lockton's website.

The challenges: How will COVID-19 impact loss costs?

Employers with large deductible programs face additional complications, as deductibles for disease claims will likely apply on a per employee basis. Given the extremely contagious nature of the coronavirus, one infected employee could easily lead to a situation where the virus spreads rapidly through the workforce. As each infected employee would be subject to a separate deductible, there is a material risk that retained losses could far surpass initial expectations.

Traditional actuarial methods for estimating workers' compensation losses assume historical losses are a reasonable proxy for future experience. The coronavirus, however, is new and presents unique estimation challenges. Given that it is not in any historical experience, employers and carriers could struggle to quantify the potential impact on retained workers' compensation losses. In response, Lockton has developed a model to help companies understand and quantify any potential exposure.

Although there are still many unknowns, it is clear that the virus affects different groups of people in drastically different ways. Lockton's COVID-19 model leverages employee demographic data, such as distribution by age and state, to create a projection tailored to an employer's workforce. Further qualitative adjustments can be made for consideration of factors such as mitigation measures and coronavirus outlook.

Using the example in this chart, based on the company's profile and assuming that 10% of employees would be infected, with 50% being symptomatic, retained loss would hover around $195K. The model acknowledges the uncertainty that exists and allows employers to scenario test the potential impact on their program.

SENSITIVITY OF LIMITED LOSS ESTIMATE

		Infection rate		
		5%	10%	20%
% Symptomatic	30%	$58,455	$116,910	$233,820
	40%	$77,940	$155,880	$311,760
	50%	$97,425	$194,850	$389,666
	60%	$116,910	$233,820	$467,639
	70%	$136,395	$272,790	$545,579

Employer's liability: New considerations

Employer's liability (EL) is an often overlooked part of the workers' compensation program designed to protect the employer from negligence lawsuits filed by employees. New presumptive compensability rules enacted for COVID-19 create some unique issues as respects employer's liability, spurring a need for a closer look at EL losses during the actuarial process.

- With COVID-19 infection already tied to the employer, the plaintiff bar may try to evade WC state-mandated benefit caps by alleging violation of recommended safety requirements.
- Spouses, children and other family members living with an infected employee who contract the virus may also bring an action against the employer.
- EL claims are civil in nature, and employers are not protected by the state benefit caps afforded under traditional WC.

Special attention must be paid to the policy limit of the employer's liability coverage as well as to the correct distinction between WC and EL claims. Although EL claims were traditionally immaterial to the overall analysis, a potential influx this year could create the need to develop them separately from traditional WC claims given the distinct nature of the EL losses.

Workforce changes affect loss projections, premiums and collateral requirements

As states began imposing lockdown for nonessential businesses, many employers were forced to adjust the makeup of their workforce in order to comply and keep their businesses afloat. For some, this meant reducing hours or cutting staff, paying employees to remain idle, or asking the employee base to work remotely. Conversely, essential businesses may have experienced a spike in demand that required hiring or increasing hours per employee.

As noted earlier, traditional actuarial methods assume historical experience is predictive of future loss. Shifts in operations, like those precipitated by COVID-19, create distortions in standard loss estimates. The direction and extent of those distortions are not uniform across all companies, and outcomes vary with the actions taken in response to the pandemic.

Below are some of the most common operational shifts triggered by the pandemic as well as the probable impact on a company's workers' compensation risk.

- Many companies scaled their workforce up or down. While some essential industries increased hiring to handle elevated demand, other companies had to reduce their workforces. Shifts in payroll create an inherent change in the opportunity for workplace injuries. The first step to estimate exposure to loss or variation from historical patterns is to accurately account for payroll adjustments.
- Some companies pivoted the focus of their operations and output in response to the pandemic, leading to altered risk profiles.. For example, companies that quickly expanded to meet increased demand were often left with a less experienced workforce more prone to workplace injury. In contrast, in companies reducing operations, front-line jobs were often the first to go. This asymetric drawdown of operations resulted in a dramtically reduced opportunity for loss.
- Moving to a remote workforce has also changed many companies' risk profiles. Having employees work from home potentially reduces the number of opportunities for workplace injury, leading to lower claim frequency. However, for some types of employees, this could be overshadowed by an increase in ergonomic claims as employees scrambled to set up makeshift workspaces. Click here to see how your organization can proactively manage these exposures.

These changes in the underlying risk can have wide-ranging impact on budgeting, balance sheet accruals, collateral requirements and premium.

Impacts on claim patterns

The coronavirus not only created a completely new class of claims, it has also fundamentally changed the way many existing claims are handled. Operating under the theory that the "best claim is a closed claim," the WC industry has long emphasized the importance of prompt reporting, treatment and claim resolution. The pandemic has made this more challenging by signficantly slowing treatment, which has the potential to drive loss costs higher.

- Exponentially increased demand for medical resources, coupled with social distancing requirements and general fears about visiting any medical facility, is creating delays in treatment.
- Many WC commissions temporarily closed, leading to delays in hearings and settlements.
- Shifting operations make it harder for employers to accommodate light duty work. Consequently, some injured employees that could have returned to work in a limited capacity may continue to miss work and receive indemnity payments.

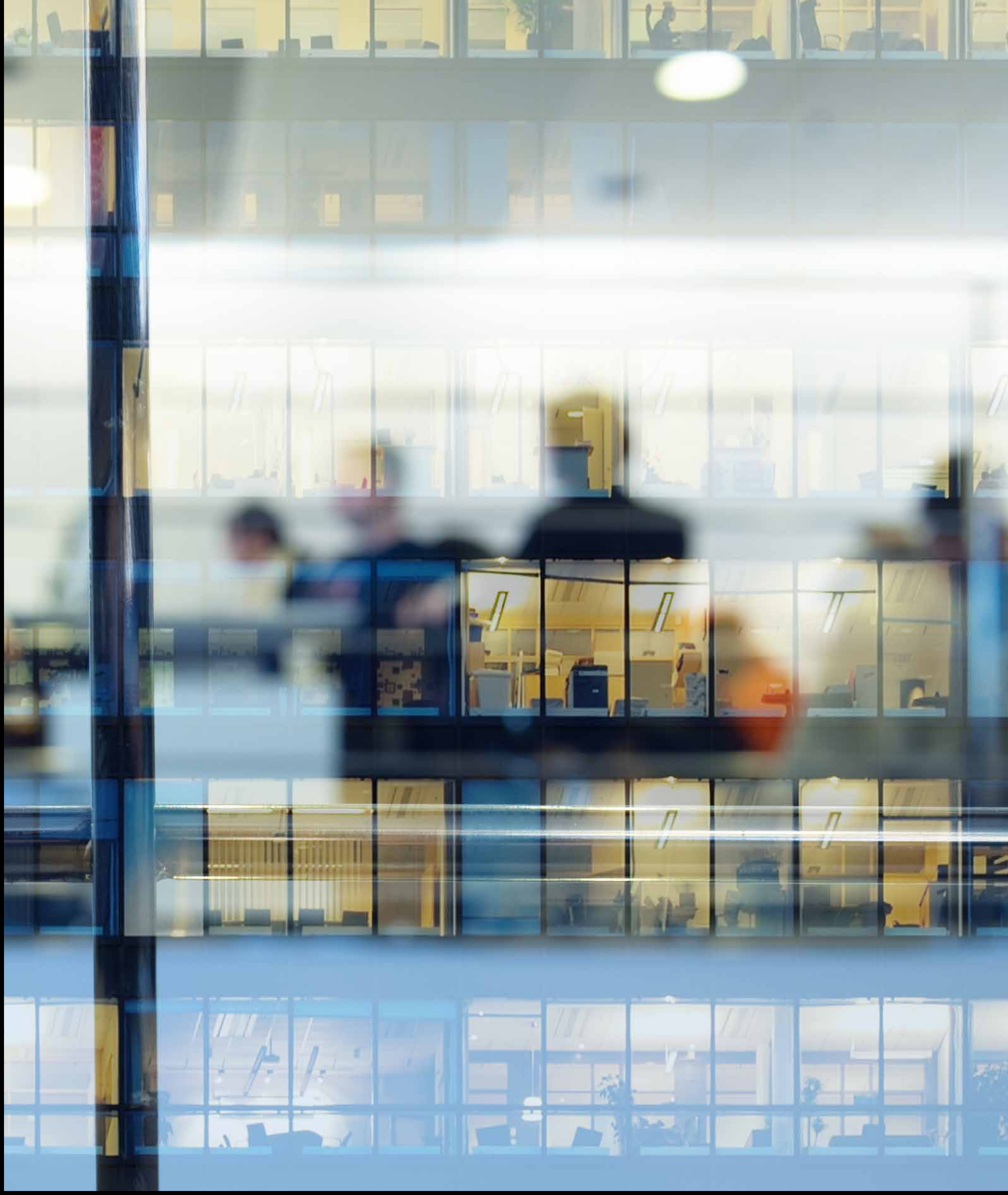
These conditions, however, may also create an opportunity for employers and TPAs. Most noteably, significant economic uncertainty paired with mounting backlogs in the courts may incentivize some claimants to settle more quickly and avoid litigation.

Given the uncertainty, many actuaries may default to conservative assumptions focusing more on the factors prolonging claim durations and increasing costs. This has potentially significant ramifications in terms of increased collateral and accruals. Employers need a strong partner to understand how they are responding to these challenges operationally, analyze their data and trends, and tell their story to all interested parties.

Economic impact on collateral

COVID-19's many impacts on workers' compensation have introduced additional considerations when it comes to collateral negotiations, and as the economy continues to struggle, carriers are taking a closer look at the underlying credit risk of their insureds. Increased conservatism can manifest itself in reduced paid loss credits, industry surcharges and higher loss estimates, all of which lead to higher collateral requirements.

Lockton can help minimize any adverse impact by ensuring the carrier has an accurate loss estimate, highlighting favorable development trends and working with clients to address questions about the financials.



The right advisor can help companies analyze unique company characteristics, quantify potential changes in total cost of risk, and provide effective advocacy through both qualitative and quantitative communication. Click here for more information from Lockton's Coronavirus Advisory Practice, or connect with a Lockton support team by visiting this link.

UNCOMMONLY INDEPENDENT