# COVID-19: Disrupting Workers' Compensation

*Part 1: Executive Summary*

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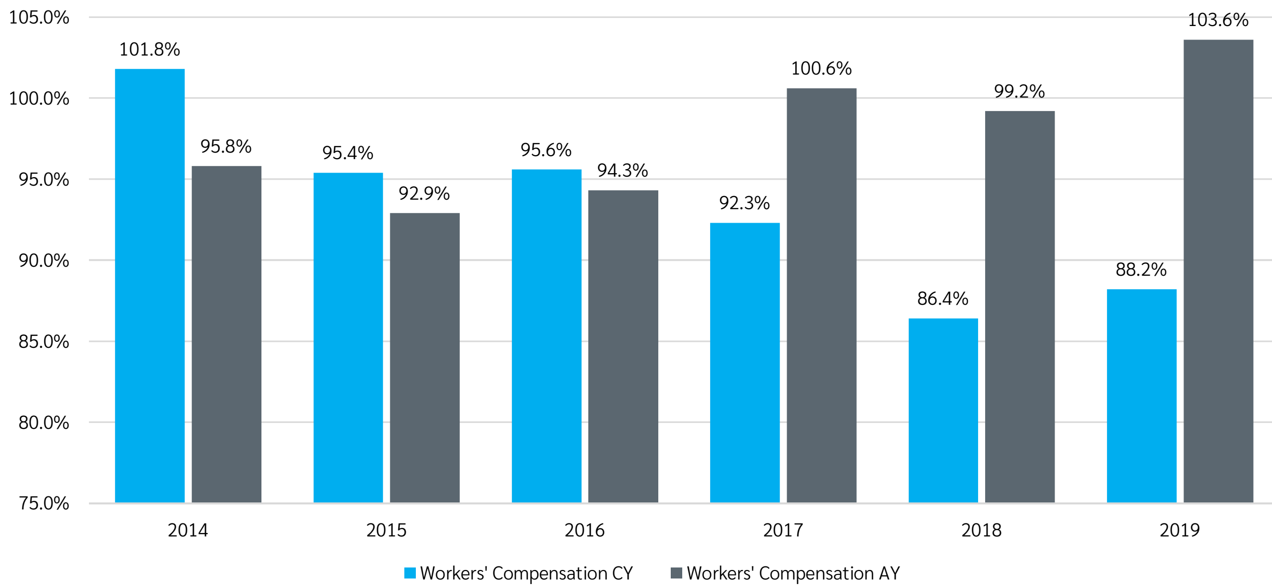
Workers' compensation insurance has been in a “soft” market cycle for many years, but this trend was plateauing even before COVID-19. While the industry has highlighted calendar year combined ratios in the high 80’s and low 90’s, these figures were supported by significant reserve releases from prior years. Removing the impact of these releases and focusing just on the accident year highlights a significant deterioration in results. More tellingly, carriers have now largely exhausted their reserve redundancies.




The workers’ compensation system is now under additional pressure from both COVID-19 and the economic downturn-- at a time when employers are searching for ways to reduce costs. It is important to analyze the factors influencing workers’ compensation to understand the potential impact to your business and how to optimize your position. Changes in your operations, aggregate payroll and worker classifications will all significantly influence the pricing of your Workers Compensation program both now and in the years to come.

# *Factors Influencing Loss Experience:*

The most pressing issue relates to the overall impact of any direct losses from COVID-19 and the associated expenses required to manage the claims. To address this question, we must first determine if COVID-19 claims are likely to be covered (compensable) under the applicable workers’ compensation scheme. For most employers, the answer is not clear. Rules differ by state with many jurisdictions excluding “ordinary diseases of life”. In states that allow for coverage to apply, two key factors are often considered to determine if a disease is compensable;

1. Whether it was contracted in the course of employment and
2. If it was contracted due to conditions unique to that employment. A common example would be a nurse that contracted a bloodborne disease through a needle that was infected by a patient with that disease.

For workers in the healthcare space, establishing causation would be very straightforward. In other industries, factors such as travel, job requirements, and exposure to vendors and suppliers would have to be considered.

The industry is also at risk of possible government intervention as state politicians continue to look to workers' compensation policies as a potential vehicle for additional financial relief, especially for front line workers. In response to the crisis, 17 states have either enacted or announced that they are considering the presumption that COVID-19 cases are compensable for essential employees. California is evaluating a conclusive presumption for the state, and the WCIRB's mid-range estimate of the COVID-19 claims to essential employees in the state is "$11.2 billion, or 61% of the annual estimated cost of the total workers' compensation system prior to the pandemic." Losses of this magnitude will lead to material changes in carrier pricing, program structure, and underwriting appetite/strategies. Such actions are also likely to draw legal challenges.

The breadth and extent of compensable WC claims will ultimately have an impact on loss rates and the overall market.

Disruption in the healthcare industry is also delaying resolution of claims and leading to increased costs. There are delays in scheduling doctor's appointments caused by limited hours and restrictions on the number of appointments per day. Elective surgeries are suspended at many hospitals. Physical therapy appointments are being limited or cancelled, inhibiting recovery and leading to more expensive interventions. Delays in care disrupt the normal course of a claim, impede recovery and increase the length of time it takes for an employee to be released to full duty.

Once released, there may not be an available job, given the downturn in the economy and increased unemployment. This is further exacerbated by obstacles to the implementation of modified light duty, which has been a successful tool to help mitigate ballooning indemnity costs. These factors will increase the overall cost of medical care and increase the period of indemnity, ultimately increasing the anticipated average severity of individual claims.

## *Payroll and Rating Implications:*

In the short-term, employers will seek opportunities to reduce expenses and improve cash flow through changes to their programs. In addition, they are paying premium on exposures that now look very different. Some insurance companies are allowing mid-term changes to policies based on reduced payroll caused by the suspension of operations while others are limiting their flexibility to only comply with the requirements mandated by state regulators. Key factors influencing the final payroll calculation will also include the reclassification of workers due to changes in operations, payroll for employees that are not working and aggregate reductions in payroll due to layoffs and furloughs.

Changes in operations will often lead to changes in worker classification. 40 states have a separate job code for telecommuters that carries a lower rate than most other available codes. With many employees working remotely, it is prudent for employers to track this information in their payroll reports to ensure they have the tools to argue for more favorable rates at the time of audit. Conversely, some employees may be taking on new responsibilities that would lead to a higher rate. It is critical for employers to be aware of these changes and work with their broker to determine which classification codes may be applicable and the potential impact to premium. First-dollar, guaranteed cost programs may experience material changes in cost due to changes in worker classifications.

Some employers have also made the decision to continue paying employees-- even though they are not working. As such, these employees are not at risk of being injured in the course of their employment. Many states have elected to exclude this payroll from rating (no premium charge) using a new class code, 0012. By tracking this in payroll reports, employers can seek a reduction in total cost when the policy is audited.

Finally, given the loss of over 22 million jobs in just 3 weeks, total premium for workers' compensation will be down sharply simply due to the reduction in payroll. Some carriers are open to reviewing the potential impact of such reductions mid-term, but most are waiting until the policies are audited to return any premium. The overall impact, however, can be estimated if the employer shares updated payroll figures with their broker. Although each carrier will behave differently, clients with a more dramatic downturn in payroll may have a stronger argument for a mid-term adjustment

## *Future State of the Market:*

Carrier profitability is expected to be materially constrained by historically low investment yields, increased frequency and rising loss severity. Given the dynamic and uncertain nature of the COVID-19 pandemic, the trajectory of the market is more easily forecasted than the ultimate severity. The magnitude of direct COVID-19 claims, disruptions to the healthcare system, extent of government intervention and ultimate impact to the value of losses will not be known until the pandemic is controlled. Similarly, the duration of stay at home orders, the length of the recession and pace of recovery will also influence the overall impact to written premium and profits. As such, we anticipate significant upward pressure on WC rates as well as changes to carrier appetites for targeted classes of business. We will be closely monitoring these interrelated factors to determine the extent of the impact on the market.

The next part in the series will provide more detail on the payroll and rating implications for employers.

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