

PERSPECTIVE

The Workers' Compensation Insurance Industry Prospective



Abstract

Worker's Compensation industry by its inherent complexity and coupled with the recession is on the cusp. Combined ratio is low, medical costs are heading north, claims are on the rise, and underwriters have a situation on hand to accept or to decline the risk. This paper articulates the factors that are affecting the imbalance within the Worker's Compensation industry, and the industry's response to the challenges through risk management and analytics.

Prelude

Workers' Compensation is a type of insurance where an employee who is injured in the course of employment is compensated in the form of wage and medical benefit, and in case of death, benefits will pass on to the dependent of the person killed in a work-related accident. This was the basic idea when the Workers' Compensation Act was coined in the early 1800s. The intent was to ensure that the workers who are injured in normal course of employment obtain compensation and medical care only for that period till they return to work, and

also to protect employers from legal suits by them. Since then, Workers' Compensation has come a long way, and in today's world it's more complex than when the law was passed.

Today, Workers' Compensation is more stringent and demands a high degree of data by underwriters to evaluate a risk to be underwritten. As a true reflection on how complex Workers' Compensation as a product has become within the U.S., only 9 out of 50 states, have posted a double-digit profit and the return of net worth for

15 states was fewer than 4% in FY 2011. On the other hand, claims arising from Workers' Compensation injuries were 3% in FY 2010, which has come down in 2011, however only by 1%¹.

This paper intends to touch upon the factors affecting the imbalance within the Workers' Compensation industry and what the industry is trying to do to keep up with the challenges through Risk Management and Analytics.

Factors Affecting the Imbalance Within the Workers' Compensation Industry

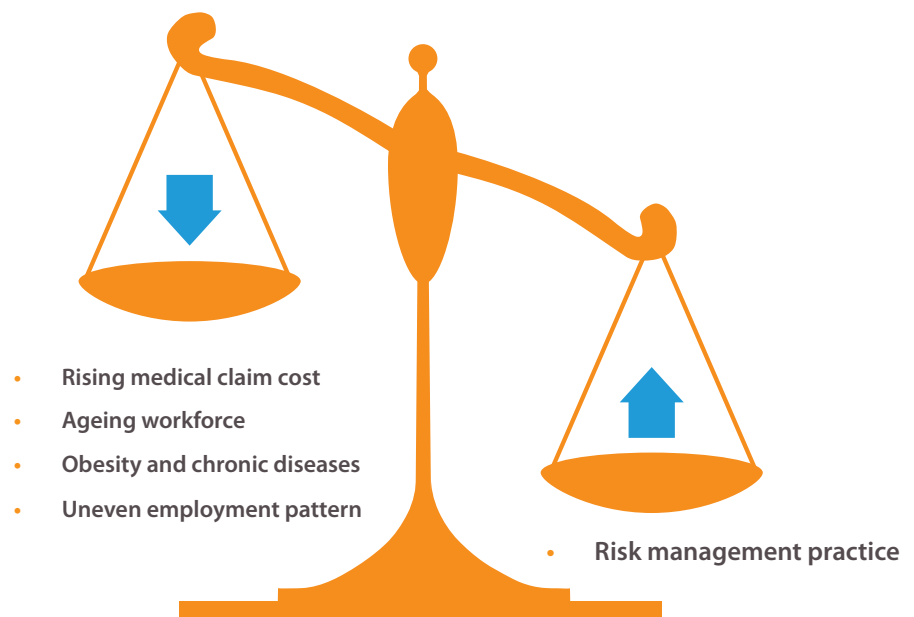
Workers' Compensation rates are greatly impacted by injury rates, inflation, employment, investment, payroll, industry, and medical cost. Total medical cost arising from obesity, chronic disease, and an aging workforce results in 60 cents per

dollar spent on Workers' Compensation. At the same time, employment in service industries, private sector within the U.S., touched a new peak at 93.70 million, however, employment within the

construction industry dropped to 5.56 million (December 2012), from a peak 7.76 million in August 2006. Currently, Workers' Compensation industry is facing challenges from several factors.

Exhibit 1.0

The exhibit highlights the imbalance in the workers compensation industry in terms of challenges faced vs. the risk management practices.



¹Source: iii.org – Mega-Trends Influencing the Workers Compensation Insurance Industry

• **Rising medical claim cost**

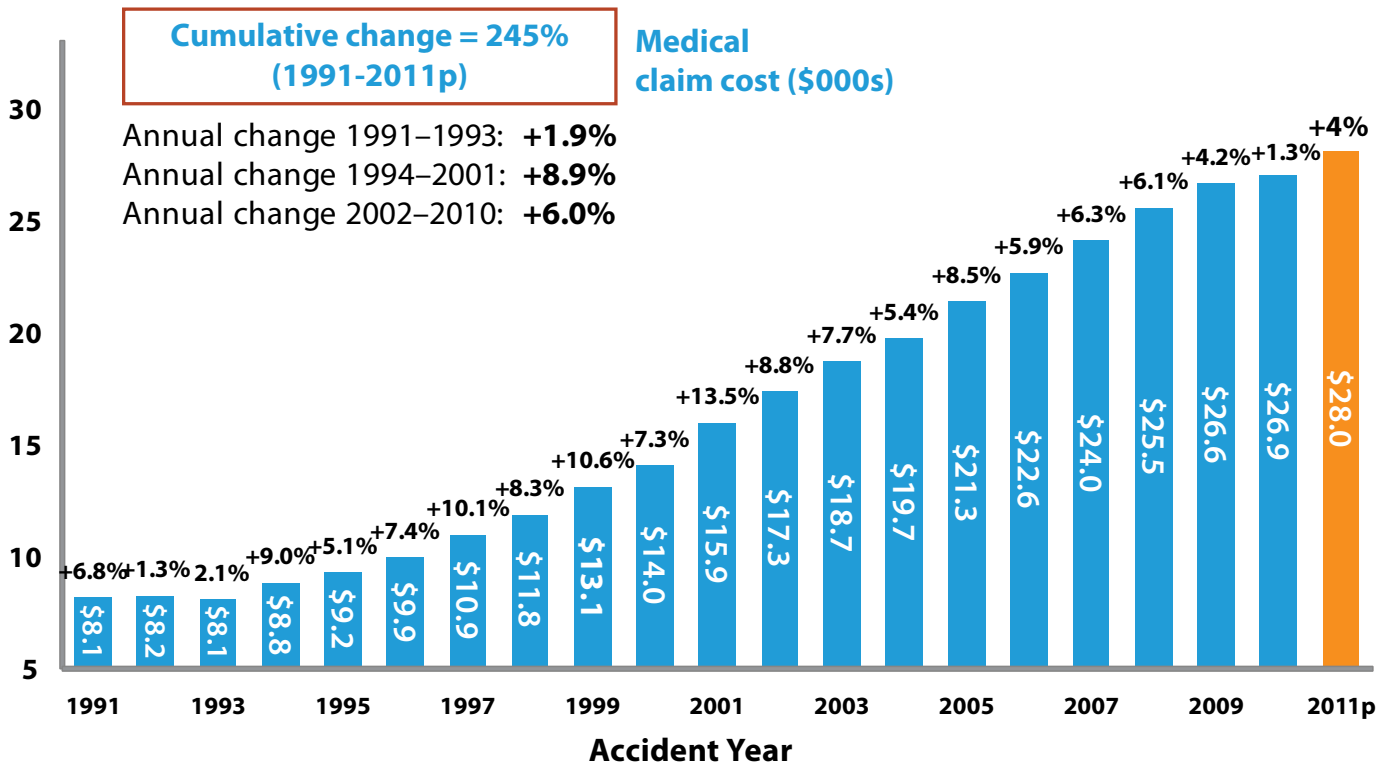
Over the past few years, it has been observed per visit procedures and overall cost is on the rise. Workers' Compensation industry researchers such as National Council on Compensation Insurance (NCCI) and Worker's Compensation Research Institute (WCRI) have specified that, for every dollar spent, 60% of the cost be

attributed to the medical cost over the past 10 years; the cumulative change has gone up by 245%. There are various factors which have contributed to the rise in medical cost over a period of time, like litigation cost over employer and depletion of earlier Worker's Compensation reforms. While there are continual efforts to reduce

the medical cost, by leveraging third party administrator model or pharmacy benefit management companies and usage of analytics like predictive modeling, it is clearly emerging that 'informed decision making capabilities' are much required within the Workers' Compensation industry.

Worker's Compensation Medical Severity Moderate Increase in 2011

Average Medical Cost per Lost-Time Claim



2011p: Preliminary based on data valued as of 12/31/2011.
 1991-2010: Based on data through 12/31/2010, developed to ultimate.
 Based on the states where NCCI provides ratemaking services; Excludes high deductible policies.

• **Ageing workforce**

Largely within the U.S., we have seen a change in the population mix. There are now over 7.4 million senior workers. This is double the number in 1998 (as reported by U.S. Bureau of Labor Statistics, U.S. Department of Labor, and Insurance Information Institute). Over the next decade, it will probably double again. As a result, the older workforce tends to lose more days from work due to injury or

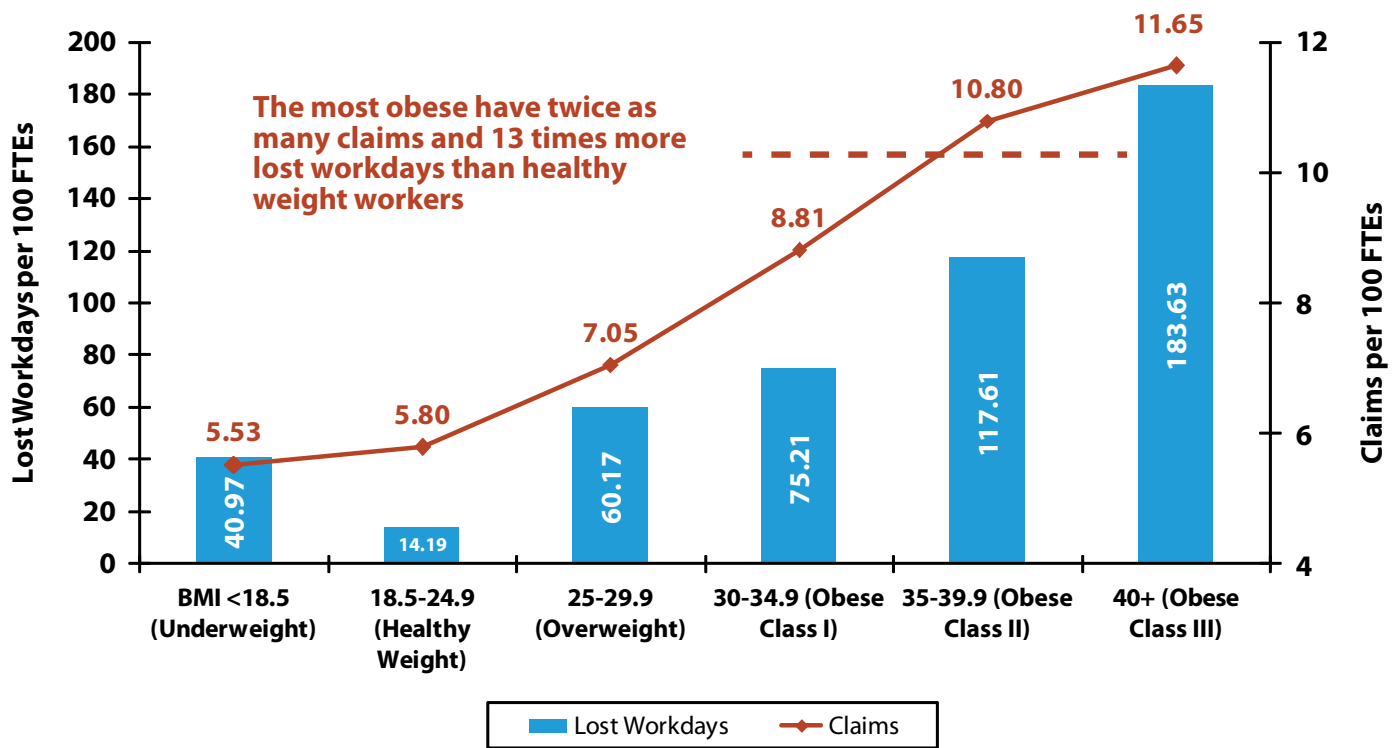
illness. In addition, the older workforce is more susceptible to age-related injuries at their workplace. The fatality rate for workers aged 65 and older was five times as compared to workers in the age group of 25-34. Thus, resulting in a higher degree of rising claims cost².

• **Obesity and chronic diseases**

In one of the statistics published by Insurance Information Institute (iii.org), in 1994, in no state was the percentage of

adults who were obese, as high as 20%. By 2010, all 50 states had adult obesity rates of 20% or more. In 12 states, 30% of the adults were obese. As a result, the most obese workers file twice as many Workers' Compensation claims as compared to a healthy worker. The same is reflected as per the data published by iii.org.

The Most Obese Workers File Twice as Many WC Claims as Healthy-Weight Workers



Source: Ostbye, T., et al, "Obesity and Workers Compensation," Archives of Internal Medicine, April 23, 2007.

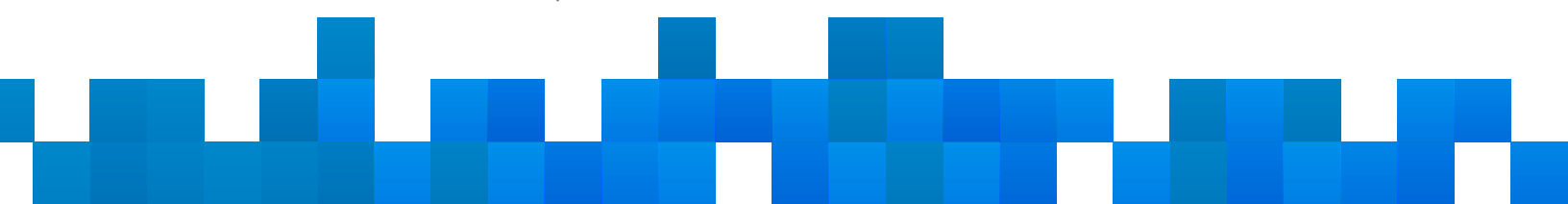
• **Uneven employment pattern**

In the case of employees who sustain injuries during the normal course of work, it is understood that they will stay out of work for an extended period. While we would agree that employee retention is a

critical factor irrespective of the industry, it is imperative that cost goes down once a trained employee returns to work. However, due to economic slowdown, it is a challenge to deploy an injured worker

when on the other hand there are lay-offs. Therefore, an injured worker has little incentive (motivation / monetary) to get well, which as a result increases the cost of claims on an ongoing basis.

²Source: US Bureau of Labor Statistics, US Department of Labor



What Should be the Three Most Critical Aspects to Bring Down Cost of Servicing Within Worker's Compensation Industry?

During the last few decades we have seen how technology has changed the way different industry segments operate, be it banking customers operating online or booking tickets and shopping online. This has reduced the cost of servicing for both consumers as well as service providers.

Within the Workers' Compensation industry, such changes have not shaped up. The last this industry was in green was in the year 2006. With the given backdrop, it is imperative that the Workers' Compensation industry has to ensure that the cost of servicing comes down.

In my opinion, the three most critical aspects that the Workers' Compensation insurance industry is looking upon to ensure that the combined ratio aligns to the expectations are:

- **Robust risk management**
- **Analytics – to garner more visibility**
- **Reducing operating cost**



Effective risk management is a primary need. Risk management determines the probability of the risk occurring, and ensures that such occurrence are minimized for the overall organization. Risk managers evaluate such factors by creating a risk program along with the line managers, to ensure that the occurrence is minimized of such losses arising out of illness or injury. Employee safety and

awareness programs are created to ensure that the employees are aware of the occupational hazard and caution is maintained. From an overall organization standpoint, risk planning, assessment, and monitoring is critical to risk management processes for controlling Worker's Compensation.

The second most critical factor for effective decision-making is availability of data

and usage of analytical tools, to achieve precision in pricing and effective risk selection. Detecting fraudulent claims within Workers' Compensation becomes a serious concern for the claims team to monitor and take corrective action. Some of the fraudulent cases observed in the past are:

- **Occurrence of claim just before a strike or lockout to avoid loss of pay**
- **Accident / injury reported on Friday evening or Monday morning**
- **Most of the time, the injury may not have come from a work-related activity, but from a weekend activity**



Such instances are not rare and occur more frequently than expected. Over a period, it has been realized that such instances can be curbed, if adequate data and visibility had been made available to the claims managers. In today's world, techniques like predictive modeling are widely used to enhance the visibility of available data. As a result, high impact claims are identified at an early stage. Apart from identifying the claims early, predictive modeling also reduces the likelihood of the worker returning to work after sustaining specific injuries.

Finally, reducing operating expenses and monitoring cost per claim, and cost of servicing per policy, demands the highest attention. While there are external factors which are driving the cost up, like physician fee, medical cost, or cost arising from the treatment of a long injury, it is still important to keep the cost below the threshold level for those which are under the control of an insurance company. While we have seen that, the combined ratio of 117% in 2011, which in 2012 has gone up³. Having mentioned that, Workers' Compensation insurance companies are opting to outsource non-core / non-critical processes, both from hiring of workers to offshoring processes like policy administration, and claims management to complex predictive modeling.

³Source: www.insurancejournal.com/news/national/2012/06/14/251574.htm



The Way Forward

While we understand that the Workers' Compensation industry will have a gestation time to achieve desired results on a long-term basis, there are levers to boost the efficiencies for informed decision-making and reduce operating cost, which are available with the service providers. By leveraging technology interventions and process efficiencies, service providers can help reduce cost up to 20-30%.

In addition, underwriters can arrive at informed decision-making like predictive modeling by collaborating with service providers and leveraging their tools, methodologies, and frameworks. This can help underwriters make decisions to underwrite a risk or decline based on the available data, and claims teams can predict fraudulent losses proactively.

About the Author



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Vivek has been involved in P&C Insurance companies for over 15 years and has worked for both retail and commercial lines of business. He has handled complex underwriting for marine, fire and allied perils, machinery breakdown, and engineering and has closely worked with underwriters at London Underwriting Center (LUC) and Lloyds of London. Vivek was instrumental in creating applications deployed for motor, home owners, and personal accident in retail LoBs. He also has direct exposure in risk management, involving in risk assessment for large factories and corporates.

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