



# AMERICAN ACADEMY *of* ACTUARIES

---

February 12, 2010

Christine Baker, Executive Officer  
Commission on Health and Safety and Workers' Compensation  
1515 Clay Street  
Suite 901  
Oakland, CA 94612

Re: February 25, 2010 Roundtable Discussion on Integration of Care

Dear Ms. Baker:

The American Academy of Actuaries'<sup>1</sup> Workers' Compensation Subcommittee has taken an interest in your Commission's investigation of relationships between workers' compensation (WC) and group health care. Your work to date raises important questions that do not have simple or obvious answers.

With this letter, we hope to contribute to your research by offering a general overview of some key issues and specific comments regarding the proposal offered by Frank Neuhauser, et al. ("Comparing the costs of delivering medical benefits under group health and workers' compensation—Could integration pay for covering the working uninsured?", October 2009) that the Commission is currently reviewing.

In addition to the comments that follow, there are a number of additional technical issues with the assumptions made in the Neuhauser paper's quantification of potential savings through integration of WC medical benefits into the health care system. For example, expense ratios for WC-insured customers are assumed to be the same as those for self-insureds. We have not addressed these more technical issues here, but we are available to provide this more in-depth review if the Commission so desires.

In this letter, we provide a framework for evaluating possible reforms such as this one. Three key areas must be addressed:

1. Differences in delivery cost
2. Timing of coverage – in order to compare systems, calendar-year health care must be reconciled with policy-period coverage under WC.
3. Legal Status – WC insurers and self-insurers have legal obligations to their injured workers. For savings to become possible, legislation to change the

---

<sup>1</sup> The American Academy of Actuaries ("Academy") is a 16,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

scope and purpose of WC would need to be implemented in concert with the change in health coverage.

### **Differences in Delivery Cost**

Opportunities do exist for improving the efficiency of WC delivery systems, and the group health model may offer features of value to that enterprise. While each state's WC system works somewhat differently, periodic reform efforts have identified and addressed areas for improvement, such as the use of national standards for reporting.

The Neuhauser paper makes the fundamental assumption that any quantitative differences in medical expenses between WC and health insurance are inefficiencies of WC compared to health insurance coverage. That is not the case, for at least the reasons that follow.

- Expense loadings included in WC rates are subject to a variety of (mostly downward) adjustments, including carrier deviations but most notably the premium discount provision. As a result, expenses embodied in manual rates will exceed actual expenses. Accordingly, any expense comparison must include adjustment for pricing features, such as premium discount.
- Return to work – Employers and insurers are keenly interested in getting injured workers back to full or partial duty as soon as possible. Managing this process is a necessary cost of the WC system not found in group health. Alternatively, if medical benefits for work injuries and illnesses were transferred to the health care system, and the process of return to work was not actively managed, the cost of providing indemnity benefits in WC would likely increase.
- Making job sites safer through loss control and risk management – Insurers provide loss control services to smaller employers. Larger employers and self-insured risks often have their own safety and loss control departments. This would be a continuing expense in an integrated system.
- Legal and other medical case adjustment costs – Disputes arise out of the claim management process, including issues of causation and permanent disability ratings. These costs would continue to be incurred in an integrated system.

The author assumes that, in an integrated model, there would be a proportional decrease in administrative costs in the WC system due to the elimination of medical coverage. This assumption is not valid, since administrative costs associated with WC policy issuance, claim handling, and other similar areas would continue undiminished in the WC system, effectively raising the WC expense ratio.

### **Timing of Coverage**

A second major issue that arises in our reading of the Neuhauser paper is the comparison of costs supporting a fully funded system (like workers' compensation) with a pay-as-you-go system like group health care. While this difference is pointed out in the paper, in our view, it is not adequately discussed and qualified there. Since these two systems are

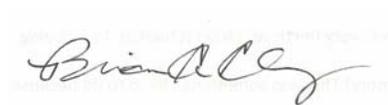
providing coverage for different periods, and financing those coverages in different ways, it is imperative to reflect the true ultimate cost differences inherent in those systems in any comparisons between them. It is improper to declare differences between costs recognized in any specific time frame in a fully funded system and a pay-as-you-go alternative as “savings” for the latter.

### **Legal Status**

- A determination needs to be made regarding whether an injury is work-related. This determination triggers employer responsibility for wage loss indemnification, medical cost payment, and other covered WC benefits. This is a tricky issue and must be investigated thoroughly for some claims, requiring extensive medical reporting.
- Wage replacement and determination of the percentage reduction in earnings power because of a work-related injury is a significant portion of the workers’ compensation cost. Many of the administrative costs are not eliminated under an integrated medical system but rather are attributed to indemnity.
- Bifurcation of the loss adjustment activities for indemnity coverage from the medical components could result in counterproductive conflicts between the entities managing the separate parts.
- Workers’ compensation is a system whereby the employer is relieved of legal costs for job-related injuries in return for providing compensation to employees injured in furtherance of the employer’s work. It is critical to ascertain whether any injury is work-related or not; otherwise, employees are compensated by more than one type of insurance to the detriment of other lines of coverage.

We hope that you will find our observations helpful to your discussion at the Feb. 25 meeting. If you have any questions, please feel free to contact Lauren Pachman, the Academy’s casualty policy analyst, at [pachman@actuary.org](mailto:pachman@actuary.org). Thank you for this opportunity to comment on the Commission’s work.

Sincerely,



Brian Clancy, FCAS, MAAA  
Chair, Workers’ Compensation Subcommittee  
American Academy of Actuaries