WORKERS COMPENSATION OVERVIEW

What Is Workers' Compensation Insurance?

Workers' compensation insurance covers businesses for their statutory and legal obligations for employee expenses that are a direct result of on-the-job injuries and/or illnesses. While plans may differ from state to state, workers' compensation can include weekly payments in place of wages, compensation for economic loss (past and future), reimbursement or payment of medical expenses, and benefits payable to the dependents of workers killed on the job or in the course of employment. Workers' compensation insurance policies generally do not include damages for pain and suffering, or punitive damages for employer negligence.

Workers' compensation laws generally provide no fault benefits to employees—meaning that injured workers can (in most cases) collect workers' compensation benefits regardless of whether they caused their own injury. They also provide the predictability of an exclusive remedy to businesses—injured workers are provided defined benefits as compensation for their injury. State laws establish comprehensive and specific benefits that must be provided to workers who suffer a work-related injury or illness. Usually, businesses obtain workers' compensation protection from one of four sources: private insurance carriers, state insurance funds, self-insurance, or self-insured groups.

When Did Workers' Compensation Insurance Start?

Workers' compensation insurance originated in Germany in 1870 to address the social costs of workers' injuries arising from the industrial revolution. Back then, workers who had been injured or made ill on-the-job had to take legal action against their employers to receive compensation. This made it difficult for workers to obtain timely compensation for workplace injuries and also exposed businesses to potentially devastating lawsuits.

Starting in 1911 in the U.S., individual states began implementing laws domestically, requiring businesses to carry workers' compensation coverage. Wisconsin was first, but other states quickly followed in enacting a "no fault" system intended to help workers receive fair and prompt medical treatment and financial compensation for workplace injuries and illnesses. This compromise system also established limits on the obligations of businesses for workplace exposures, making costs more predictable and affordable.

Do I Need Workers' Compensation Coverage?

Generally speaking, businesses must obtain workers' compensation coverage if they have employees that are not owners of the company. Most states allow sole proprietors and partners to purchase coverage, but it is not required. Check your state's laws for further information on which types of employees need workers' compensation coverage.

Businesses with contract employees should take special care in evaluating their workers' compensation needs. Most states will treat an uninsured contractor or subcontractor as your employee if he or she is injured while doing work for your company.

As of May 2013, Texas and Oklahoma are the only states in which businesses can opt-out of the requirement to provide workers' compensation coverage for their employees, if they comply with other requirements established by the state.

What Happens If I Don't Have Workers' Compensation Coverage?

Failure to meet your workers' compensation coverage requirement can leave your business exposed to both the full costs of workers' compensation claims (through litigation) and additional regulatory penalties levied by the states, which can be severe.

Where Can I Get Workers' Compensation Coverage?

In most jurisdictions, businesses can fulfill their workers' compensation obligations by purchasing a policy from a private insurance company or a state insurance fund. Companies meeting certain legal criteria can assume their own workers' compensation risk and liabilities by self-insuring. An alternative to self-insurance is a self-insured group (SIG), in which companies join a group of other employers, which is responsible for the workers' compensation risk and liabilities for group members.

Four states and two U.S. territories (North Dakota, Ohio, Washington, Wyoming, Puerto Rico, and the Virgin Islands) require businesses to get coverage exclusively through state-operated funds. These are commonly called "monopolistic state funds." A business cannot meet its workers' compensation obligations in these jurisdictions with a policy from an insurance company.

Workers' Compensation Rate and Premium Influencers

• ***The Experience Rating Plan:*** *was designed to encourage businesses to operate safely, and to recognize differences between loss experience and the effectiveness of safety programs of similar businesses. The experience rating plan uses historic payroll and losses (about 36 months of premium and losses) to predict future losses and compares the actual, final audited payroll and losses of a business to those expected for the average risk in a job classification.*

– The Experience Modification Factor is an adjustment to Manual Premium, calculated by an advisory organization (also known as rating bureaus) such as NCCI, based on historic losses and final audited payroll data of a particular insured. It is also called the Experience Modifier or Mod (E-Mod o XMod).

• ***The Schedule Rating Factor:*** *is comprised of judgment rating factors (debits or credits) assigned to distinguish the insured's characteristics from the average insured in its classification, which are not already recognized in the rating or experience rating process. Typical factors include premises condition and work environment, management experience, safety programs and cooperation with insurers and employee hiring practices and training programs.*

• ***Dividend Plans:*** *eligible insureds may qualify for a dividend premium savings. Depending on the available plan, dividends may be calculated based on a flat calculation or may vary based on loss ratio.*

How Are Workers' Compensation Insurance Premiums Calculated?

The cost of workers' compensation insurance is determined based on a business' risk classification rate audits individual payroll. The ultimate cost to an employer may be impacted by credits, dividends and/or individual experience modification factors. Although base rates (the risk classification rates) vary from state to state by type of business, the basic processes used to calculate ultimate premium is similar. Here's a simple example of a workers' compensation premium calculation: (Annual Payroll/100) x Risk Classification Rate x Experience Modification Factor = Estimated Annual Premium• Businesses are assigned a classification based on their business operation(s). There are approximately 600 classifications in most states. To come up with the annual cost of a policy, the company determines the following:

*– **Manual Rate:** each classification has a rate, which in most instances is multiplied by each hundred dollars of payroll assigned to the classification to compute the manual premium.*

*– **Standard Premium:** to calculate the Standard Premium, the manual premium is modified (multiplied) by an experience modification factor (for eligible businesses). The Standard Premium may be modified by a Schedule Rating Factor (see above for description), a premium discount, and several other fees and state assessments to determine the estimated annual premium (EAP).*

*– **Final Premium:** the Final Premium is determined at the end of the policy term, and a final audit at the expiration of the policy term is completed based on actual, not estimated, payroll by job classification. Minimum qualifying premiums are set by state.*

Workers' Compensation Glossary

There are many different acronyms used in workers' compensation insurance policies and laws. Here are definitions for some of the most common:

- ***Average Daily Wage (ADW):** The ADW is a calculation of an injured employee's average daily earnings and is sometimes used to determine entitlement to wage loss benefits following an injury, particularly where the Average Weekly Wage (AWW) would not be an accurate representation of the employee's earnings.*

- ***Average Weekly Wage (AWW):** The AWW is another method that may be utilized in calculating entitlement to wage loss benefits. The average earnings, by week, for a fixed period of time are calculated and wage loss benefits are computed according to that amount.*

- ***Independent Medical Examination (IME):** In some situations, an employer or insurance company may want to have an injured employee seen by a particular physician in order to obtain an objective evaluation of the employee's health. An employee may initially be seen by a company physician, or a physician of their own choosing; however, if a concern or dispute arises over the extent of the employee's injuries (or whether the employee has any injury at all), the employer and insurer will likely be entitled to require the employee to appear for an IME with a physician of their choosing.*

- ***Permanent Partial Disability (PPD):** PPD benefits are payable, in most jurisdictions, to an employee who has sustained a permanent, but not complete, disability. Many* *state statutes have pre-set values for a host of different PPD injuries involving specific body parts or conditions.*

- ***Permanent Total Disability (PTD):*** *PTD benefits are available if an injured employee is permanently and totally disabled from work.*
- ***Physical Therapy (PT):*** *Many injured employees are entitled to receive physical therapy as a form of medical treatment to recover from injuries. On forms, or in medical records, you may see a reference to "PT." That is short for "physical therapy."*
- ***Social Security Disability Insurance (SSDI):*** *SSDI benefits are payable to disabled individuals through the Social Security Administration. Many state workers' compensation statutes have specific provisions that dictate whether an injured employee may receive both workers' compensation benefits and SSDI benefits at the same time. Generally, if both benefits are appropriate for the same individual, a complex calculation will be performed to "offset" the benefits so that the individual does not receive more money than they are entitled to from both programs.*