Workers' Compensation Insurance Rating Bureau of California®

# WCIRB Evaluation of the Cost Impact of Senate Bill No. 863

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Senate Bill No. 863 (SB 863) was passed by the Legislature on August 31, 2012 and signed by the Governor on September 18, 2012. SB 863 increases benefits effective January 1, 2013 and January 1, 2014 and provides for a number of structural changes to the California workers' compensation benefit delivery system.

The WCIRB has reviewed the impact of SB 863 on the costs of losses and loss adjustment expenses (LAE) underlying 2013 advisory pure premium rates. The WCIRB has provided a cost estimate for SB 863 amendments to permanent disability (PD) minimum and maximum weekly benefit levels; the burial allowance; supplemental job displacement benefits; the adjustments to the PD rating corresponding to future earning capacity (FEC); PD impairment "add-ons" for psychiatric impairment, sleep disorder or sexual dysfunction; the three-tiered system of PD weekly benefits based on return-to-work status; liens; reimbursements for spinal implant hardware; fee schedule values for ambulatory surgical centers (ASCs); the process for resolving medical treatment disputes through independent medical review (IMR); and provisions related to services provided outside a valid medical provider network (MPN). The SB 863 amendments which are not quantifiable at this time include provisions related to MPN procedures and processes; independent bill review; IMR as it relates to medical treatment, fee schedules for interpreters, home health services and copy services; conversion of the California Official Medical Fee Schedule (OMFS) to a Resource Based Relative Value Scale (RBRVS) basis; and PD advances. In addition, the WCIRB's cost estimate does not reflect the costs associated with the proposed return-to-work program for the purpose of making supplemental payments to workers whose PD benefits are disproportionately low in comparison to their earnings loss as this program is to be funded by direct assessments to employers and does not directly affect the costs underlying pure premium rates.[1]

In addition to percentage estimates of the impact of SB 863 on underlying costs, the WCIRB has provided estimated dollar impacts. These dollar estimates, while based primarily on data from insured employers, have been extrapolated to the entire market based on the relative sizes of the insured and self-insured markets.

In evaluating the cost implications of SB 863, the WCIRB (a) reviewed the provisions which potentially impact the costs reflected in advisory pure premium rates; (b) consulted with other professionals with expertise in evaluating the impact of the legislation;[2] (c) reviewed relevant research; and (d) performed additional analysis, as appropriate, given the available data and time constraints.

The WCIRB estimates the impact of the SB 863 provisions effective on injuries occurring on or after January 1, 2013 that are quantifiable at this time, including the impact on claim frequency (utilization), is an overall cost reduction of **5.8%, or $1.1 billion**, based on an estimated statewide cost of indemnity and medical losses and loss adjustment expenses (LAE) of $19 billion on injuries occurring in 2013.[3] In addition, the increased PD benefit provisions effective on injuries occurring on or after January 1, 2014, including the impact on claim frequency (utilization), are estimated to increase total system costs by **3.1%, or $0.6 billion**. In total, by the 2014 injury year, the currently quantifiable provisions of the legislation, including the impact on claim frequency (utilization), is estimated to decrease total system costs by **2.7%, or $0.5 billion**, annually.

Policies incepting in 2013 will be fully impacted by the SB 863 amendments effective January 1, 2013 and partly impacted by the SB 863 amendments effective on injuries occurring on or after January 1, 2014.

[1] The program created in Labor Code Section 139.48 is funded by $120 million annually through appropriation from non-General Fund revenues of the Workers' Compensation Administration Revolving Fund.

[2] These professionals include a number of insurer representatives with expertise in claims, legal, and actuarial matters; representatives of the California Department of Insurance; the Commission on Health and Safety and Workers' Compensation; the Department of Industrial Relations (DIR); the California Workers' Compensation Institute; and the University of California at Berkeley.

[3] The WCIRB's estimated system size is based on the estimated cost of indemnity and medical losses and loss adjustment expenses as reflected in the WCIRB's January 1, 2013 Pure Premium Rate Filing, with adjustments for statewide employment growth through 2013 based on UCLA forecasts and an estimated 50% loading for self-insured experience. The $19 billion estimate consists of $4.9 billion in indemnity benefits, $10.4 billion in medical benefits, and $3.7 billion in loss adjustment expenses.

The WCIRB estimates that, on average, SB 863 will reduce the cost of losses and loss adjustment expenses on 2013 policies by 4.4%.

While the information summarized below reflects the WCIRB's current estimate of the cost impact of SB 863, the actual cost impact will depend, in part, on the development and implementation of future regulations required by the legislation, how the Workers' Compensation Appeals Board (WCAB) interprets certain new provisions, the result of potential legal challenges to components of the legislation, and changes in medical treatment and other system practices and patterns. The WCIRB will regularly reassess the cost impact of this legislation as more information and data become available.

The WCIRB's estimated cost impact of SB 863 is summarized in Table 1.

**Table 1: Estimated Cost Impact of SB 863**

| SB 863 Provisions | Direct Impact on Claim Costs ($ millions) | | Indirect Impact on Claim Frequency (Utilization) ($ millions) | | Total Impact on Claim Costs ($ millions) | Total % Impact on Claim Costs |
|---|---|---|---|---|---|---|
| | Loss | LAE | Loss | LAE | | |
| 2013 Benefit Level Changes[4] | $350 | — | $220 | $50 | $620 | +3.3% |
| Elimination of PD Add-ons[5] | ($100) | — | ($60) | ($10) | ($170) | -0.9% |
| Three-Tiered Weekly PD Benefits | ($60) | — | ($30) | ($10) | ($100) | -0.5% |
| Liens | ($190) | ($290) | — | — | ($480) | -2.5% |
| Surgical Implant Hardware | ($110) | — | — | — | ($110) | -0.6% |
| ASC Fees | ($80) | — | — | — | ($80) | -0.4% |
| IMR[6] | ($160) | ($140) | ($70) | ($20) | ($390) | -2.1% |
| Ogilvie Decision | ($70) | ($80) | ($50) | ($10) | ($210) | -1.1% |
| MPN Strengthening | ($130) | — | ($50) | ($10) | ($190) | -1.0% |
| **Total Estimated Impact of 2013 Changes** | **($550)** | **($510)** | **($40)** | **($10)** | **($1,110)** | **-5.8%** |
| **Estimated Impact of 2014 Benefit Changes[7]** | **$340** | — | **$200** | **$50** | **$590** | **+3.1%** |
| **Combined Estimated Annual Impact of SB 863 on 2014 Injuries** | **($210)** | **($510)** | **$160** | **$40** | **($520)** | **-2.7%** |

The basis of the WCIRB's evaluation of the cost impact of the various provisions of SB 863 is summarized below.

## Section I: SB 863 Benefit Provisions for Which WCIRB Can Provide an Estimate

SB 863 amends Labor Code Section 4453 to provide for increases in the minimum and maximum weekly PD benefits for workers with injuries occurring on or after January 1, 2013, with an additional increase to maximum weekly PD benefits for injuries occurring on or after January 1, 2014. Effective January 1,

[4] This includes changes to the weekly PD benefit maximums and minimums, the supplemental job displacement benefit, the burial allowance, the elimination of the future earning capacity (FEC), and the application of a uniform factor adjustment of 1.4 to each impairment.

[5] This includes the elimination of the rating add-ons for psychiatric impairment, sleep disorder and sexual dysfunction, with a 10% offset to account for psychiatric add-ons that arise from a catastrophic injury or violent act.

[6] This includes the estimated impact of IMR on frictional costs, temporary disability duration, and litigation, but does not include any estimate for the impact of IMR on medical treatment.

[7] These 2014 amendments include changes in weekly PD benefit maximums.

2013, SB 863 adds Labor Code Section 4658.7 which provides that a supplemental job displacement benefit of up to $6,000 shall be offered to an injured worker who has not received a qualified return-to-work offer.

SB 863 adds Labor Code Section 4660.1 to provide that the PD impairment produced in accordance with American Medical Association (AMA) Guides will not be modified for FEC as in the 2005 Permanent Disability Rating Schedule (PDRS); instead, a uniform adjustment factor of 1.4 will be applied to the whole person impairment determined pursuant to the AMA Guides. Finally, amendments to Labor Code 4701 increase the burial allowance from $5,000 to $10,000.

The evaluation of the estimated cost impact of the SB 863 statutory benefit level changes on injuries occurring on or after January 1, 2013 is based on information from approximately 200,000 lost-time claims that occurred on policies incepting in 2008 and 2009 and were reported to the WCIRB in accordance with the requirements of the *California Workers' Compensation Uniform Statistical Reporting Plan—1995*. (Certain information on death claims, vocational rehabilitation, and supplemental job displacement benefits is based on survey information.) Injured worker wage information on these claims was adjusted to reflect the level of wages anticipated for 2013 injuries, based on wage level growth estimates using UCLA published wage information.[8]

To evaluate the cost impact of the changes to PD ratings based on Labor Code Section 4660.1, the WCIRB analyzed approximately 20,000 claims available from the Disability Evaluation Unit (DEU) database that had PD ratings computed by the DEU between June 2011 and March 2012. While not all PD claims are rated by the DEU, the DEU database does provide sufficient detail to allow for the evaluation of the effect on the average rating of the elimination of the FEC and the application of the 1.4 adjustment factor. While the DEU database may not be fully representative of all PD ratings, there is no indication of significant bias for the purpose of this evaluation.

Using the DEU database, the estimated change in average rating by percentage of PD rating point was determined and the rating for each claim in the WCIRB database previously discussed was adjusted accordingly. Using this information, the incurred cost of each of the approximately 200,000 lost-time claims at the 2013 cost level was restated after reflecting the changes to (a) weekly PD benefit maximums and minimums, (b) the burial allowance, (c) the supplemental job displacement benefit, and (d) the FEC factor. The restated cost of these claims was then compared with the estimated cost of these claims under the current schedule of benefits. This process was repeated for injuries occurring in 2014 to estimate the cost impact of the SB 863 amendments to the weekly PD benefit maximums effective for injuries occurring in 2014.

With changes in benefit levels, not only is the cost of average weekly benefits changed, but the frequency of claims is also affected. This evaluation includes a provision to reflect the historical impact of changes in temporary total and permanent partial disability benefits on claim frequency. The estimates of the impact of the statutory benefit changes on claim frequency are based on a WCIRB econometric model of the effect of a number of economic, demographic and claims-related variables, including changes in indemnity benefit levels, on the frequency of indemnity claims in California.[9] In essence, the model shows that for every 1% change in average indemnity benefit costs due to changes in statutory benefit levels, there is an approximate 0.2% change in indemnity claim frequency.[10] (The utilization factors are not applied to changes in permanent total or death benefit levels, and no provision is reflected for the potential impact of benefit level changes on claim duration.)

Exhibit 1 shows the estimates of the cost impact of the SB 863 statutory benefit level changes effective for injuries occurring in 2013, both before and after the adjustment for changing frequency (utilization). Exhibit 2 shows the estimates of the cost impact of the SB 863 benefit level changes for injuries occurring in 2014.

[8] See Part A, Section B, Exhibit 5.1 of the WCIRB's Amended January 1, 2013 Pure Premium Rate Filing.

[9] Brooks, Ward, *California Workers Compensation Benefit Utilization – A Study of Changes in Frequency and Severity in Response to Changes in Statutory Workers Compensation Benefit Levels*, Proceedings of the Casualty Actuarial Society, Volume LXXXVI, 1999, pp. 80 – 262.

[10] The medical loss factor is adjusted to reflect the assumption that some of the newly generated indemnity claims may not incur additional medical costs since they were medical-only claims in the past.

Changes in statutory indemnity benefit levels do not necessarily impact the cost of LAE. However, to the extent the number of indemnity claims is impacted by the benefit level changes, LAE cost will also be affected. The WCIRB's estimate of the cost impact of the SB 863 changes to the statutory benefit levels, as reflected in Table 1, assume that the change in LAE costs is proportional to the indicated change in claim frequency.

In total, including the impact of the changes in benefit levels on claim frequency (utilization), the WCIRB estimates that the SB 863 changes to statutory benefit levels will increase the total statewide cost of losses and loss adjustment expenses by 3.3%, or $620 million, for 2013 injuries and by 3.1%, or $590 million, for 2014 injuries.

## Section II: SB 863 Provisions for Which WCIRB Can Provide a Judgmental Estimate

### A. Elimination of Permanent Disability Add-ons

SB 863 amendments to Labor Code Section 4660.1 provide that there shall be no increases in impairment ratings for sleep disorder, sexual dysfunction or psychiatric impairment arising out of a compensable physical injury. However, psychiatric add-ons to permanent disability impairments would continue to apply to catastrophic injuries or if the injury was the result of a violent act.

The previously discussed DEU database of PD ratings allows for identification of add-ons for psychiatric injury, sleep disorder and sexual dysfunction. The DEU database of ratings does not, however, allow for the identification of claims with psychiatric add-ons associated with catastrophic injuries or injuries arising from violent acts. The WCIRB has approximated the percentage of permanent disability add-ons that will not be eliminated for catastrophic injuries or injuries resulting from a violent act based on the underlying injury characteristics of reported permanent disability claims from WCIRB unit statistical data. Exhibit 3 shows the WCIRB's estimated savings from the elimination of the permanent disability add-ons — including the estimated impact of the exception pertaining to psychiatric add-ons rising from catastrophic injuries or injuries resulting from violent acts. As shown in Table 1, the WCIRB estimates that these SB 863 provisions, including the commensurate impact on claim frequency, will reduce total system costs on 2013 injuries by 0.9%, or $170 million, based on a total statewide estimate of the cost of losses and loss adjustment expenses of $19 billion.

Note that this estimate assumes no adjustment to reflect the impact of any legal challenge to this restriction on PD add-ons which may occur. Additionally, no estimate has been reflected for any potential impact on medical costs of specifying in the Labor Code the intent to not limit the ability of the injured worker to obtain medical treatment for psychiatric impairment, sleep disorder or sexual dysfunction arising out of an industrial injury.

### B. Elimination of Three-Tiered Weekly Permanent Disability Benefits

Amendments to Labor Code Section 4658 in effect repeal the provision for a 15% increase or decrease in weekly PD benefits depending on whether the employer provides a qualified offer to return to work to an injured worker. The WCIRB collects information on the proportion of weekly PD benefits paid at each of the three tiers through its annual PD claim survey. The WCIRB's survey information indicates that approximately 7.5% of the weeks of PD benefits on accident year 2006 through 2009 claims were paid at the lower benefit level that reflected the 15% reduction and approximately 30.6% of the weeks were paid at the higher benefit level that reflected the 15% increase. As a result, the WCIRB estimates that eliminating these tiered PD benefit adjustments and paying weekly PD benefits at the standard rate would reduce PD benefits by approximately 3%.

Exhibit 4 shows the cost impact of eliminating the three-tiered system of PD benefits based on the status of a qualified return-to-work offer. The WCIRB estimates that this provision, including the commensurate impact on claim frequency, as shown in Table 1, will reduce total system costs on 2013 injuries by 0.5%, or $100 million, based on a total statewide estimate of the cost of losses and loss adjustment expenses of $19 billion.

C. Liens

SB 863 includes a number of provisions related to liens, including those in Labor Code Sections 4603.2, 4603.3, 4603.4, 4603.6, 4622, 4903, 4903.1, 4903.6, 4903.8, 4904 and 4905. Labor Code Section 4903.05 is added to the Labor Code and provides that every lien claimant is required to file its lien with the WCAB using an approved form and be charged a filing fee of $150. In addition, the amendments to Labor Code Section 4903.5 provide that no liens may be filed more than three years from the date of service for liens filed before July 1, 2013 or 18 months from the date of service for liens filed on or after July 1, 2013.

There is relatively limited information available on the cost impact of liens. A 2011 report published by the Commission on Health and Safety and Workers' Compensation (CHSWC) indicated that the number of medical lien filings has increased sharply since 2005.[11] The report suggested that approximately $1.5 billion per year is claimed in lien disputes, and the average cost of defending and settling a lien is approximately $1,000.

The WCIRB has recently issued a special claim survey gathering lien information from insurers on a random sample of 1,000 permanent disability claims from 2007 and 2002 through 2004.[12] Exhibit 5.1 shows the computation of the estimated impact of the new lien filing fee on costs while Exhibit 5.2 shows the cost impact of the new provisions related to the time limitations for filing a lien.[13] The key assumptions underlying the WCIRB estimates developed in Exhibits 5.1 and 5.2 are summarized as follows:

1. The total number of liens for 2013 injuries, based on Division of Workers' Compensation (DWC) data and WCIRB frequency change forecasts, is estimated at 640,000.
2. Based on the distribution of lien settlements by size from the WCIRB lien survey, it was assumed that 30% of the liens would be eliminated by the filing fee. (This corresponds to an average lien settlement demand of approximately $1,000 and an average lien settlement amount of approximately $300, which is twice the $150 filing fee.)
3. Based on WCIRB lien survey data on individual liens by size, the average size of the liens with settlements below $300 that are projected to be eliminated by the lien filing fee is estimated to be $150.
4. The average savings in administrative cost per lien on the liens projected to be eliminated by the $150 filing fee is estimated at $400.[14]
5. The percentage of liens related to medical and medical-legal issues that were filed more than two years[15] from the date of service and were above the $1,000 lien demand threshold that was estimated to reflect liens eliminated by the new lien filing fee was estimated at 11% based on WCIRB survey data on lien demands and CHSWC data on the timing of lien filings.
6. The average lien claim based on WCIRB lien survey information for the liens that would be eliminated by the statute of limitations was assumed to be $7,500, with an assumed 30% settlement rate and $3,000 in legal and administrative costs.[16]

Based on the assumptions summarized above, as shown in Table 1, the WCIRB estimates that the SB 863 lien provisions will reduce total system costs by 2.5%, or $480 million, based on a total statewide estimate of the cost of losses and loss adjustment expenses of $19 billion.

[11] *Liens Report*, CHSWC, January 2011.

[12] These included a sample of 2002 through 2004 permanent disability claims that had recently reopened.

[13] Preliminary WCIRB estimates were based largely on the assumptions reflected in the Bickmore Risk Services' August 23, 2012 preliminary evaluation of the proposed legislation for the Department of Industrial Relations, which pre-dated the availability of the WCIRB lien survey data. Overall cost estimates based on the two sets of assumptions are very close.

[14] Estimates of the cost of loss adjustment expenses per lien have ranged from $1,000 in the 2011 CHSWC lien study to $1,500 based on CWCI's preliminary results from its 2012 lien survey (as discussed at the July 30, 2012 WCIRB Claims Working Group meeting). The WCIRB estimate is based on WCIRB lien survey information, which suggests $150 in legal costs per lien for smaller liens plus an approximate $250 provision for insurer administrative costs.

[15] The analysis reflected a two-year timeframe rather than the 18 months in SB 863 in that it was assumed that some liens that would otherwise be filed after 18 months will be filed earlier due to the establishment of the 18-month statute of limitations.

[16] WCIRB lien survey data suggests that the average cost of lien legal fees for these larger medical-related liens is approximately $1,400 with an assumed additional $1,600 in other claims administrative costs.

D. Surgical Implant Hardware

SB 863 repeals Labor Code Section 5318, which provides for separate reimbursement for implantable medical devices, hardware and instrumentation. Earlier this year, the California Workers' Compensation Institute (CWCI) preliminarily estimated that the savings from eliminating the multiple reimbursements for spinal implant hardware in California workers' compensation injuries was approximately $67 million.[17] Based on the WCIRB's estimate of total insured medical costs paid in 2010[18] adjusted to reflect the total statewide system, this would equate to approximately 1% of total paid medical costs. As a result, the WCIRB estimates that the repeal of the separate reimbursement for surgical implant hardware would reduce medical costs by 1% and total system costs by approximately 0.6%, or $110 million, based on a total statewide estimate of the cost of losses and loss adjustment expenses of $19 billion.

Additionally, SB 863 adds Labor Code Section 5307.1(m), which provides that on or before July 1, 2013, the Administrative Director shall adopt a regulation specifying an additional reimbursement for certain diagnostic-related groups pertaining to spinal surgery to ensure that aggregate reimbursement is sufficient to cover costs, including implantable hardware.[19] While this has the potential to affect the savings resulting from the repeal of Labor Code Section 5318, the WCIRB has not reflected any cost impact from Labor Code Section 5307.1(m) pending review of any regulations that may be adopted by the Administrative Director.

E. Ambulatory Surgical Center (ASC) Fees

SB 863 amendments to Labor Code Section 5307.1(c) provide that the maximum facility fee for services performed in ASCs should not exceed 80% of the Medicare fee for the same service in a hospital outpatient department. Currently, maximum ASC facility fees are set at 120% of the Medicare rate for hospitals. As result, these amendments would result in a one-third reduction in ASC facility fee payments if it is assumed that the change in the maximum fee schedule allowance would translate directly to ASC facility fee costs.

However, many ASC fees are reimbursed under contract at levels different from those contemplated in the current fee schedule. The WCIRB's review of a sample of medical transactions suggests that a significant portion of ASC fees are being reimbursed at amounts well below the current fee schedule. Savings of approximately 20%, rather than one-third, is indicated if it is assumed that the fee schedule change will have no impact on these contracted rates and these procedures will, in the future, be reimbursed at the lesser of the current contract rate and the new fee schedule value. However, some contract rates may be impacted by the new schedule and lower reimbursements may occur. The WCIRB has assumed savings of approximately 25% in ASC facility fees due to SB 863, which is the approximate average of the indicated savings assuming all fees are reduced by the change in schedule value and the indicated savings if it is assumed that the lower contracted values would be unaffected.

The CHSWC, based on information provided by the RAND Corporation, estimated that ASC facility fee payments in 2010 were $187 million.[20] A reduction in ASC facility fees of 25% would generate savings of approximately $50 million in 2010. This equates to approximately 0.8% of total medical costs based on the WCIRB's estimate of total insured medical costs paid in 2010[21] adjusted to reflect the total statewide system. As a result, the WCIRB estimates the reduction in ASC facility fees would reduce medical costs by 0.8% and total system costs by approximately 0.4%, or $80 million, based on a total statewide estimate of the cost of losses and loss adjustment expenses of $19 billion.

F. Independent Medical Review

SB 863 adds Labor Code Sections 139.5, 4610.5, and 4610.6 and amends 4061, 4062, 4062.2, 4610.1, and 4903 to provide for a newly-created process of independent medical review (IMR). In particular, the

[17] *Preliminary Estimate of California Workers Compensation System-Wide Costs for Surgical Instrumentation Pass-Through Payments for Back Surgeries*, CWCI, June 2012.

[18] *2010 California Workers' Compensation Losses and Expenses,* WCIRB, June 2011.

[19] The regulation would be repealed January 1, 2014 unless extended by the Administrative Director.

[20] *CHSWC Staff Estimates for Labor and Employer Discussions,* CHSWC, November 2009.

[21] *2010 California Workers' Compensation Losses and Expenses,* WCIRB, June 2011.

impact of these SB 863 provisions on indemnity and medical benefits is difficult to evaluate inasmuch as their ultimate impact is dependent upon the regulatory structure used in its implementation, any judicial interpretations of the new review process, and the practices and procedures used by the parties involved.

The SB 863 provisions related to IMR potentially impact a number of system cost components. The assessment of the cost impact of IMR on each of these components is discussed below:

1. Liens. The total number of liens for 2013 injuries, based on DWC data and WCIRB frequency change forecasts, is estimated at 640,000, prior to any adjustment for the impact of other SB 863 provisions. CHSWC data suggests that 62% of the liens are for medical and 11.3% relate to utilization review disputes. Judgmentally assuming that one-third of these liens were to be eliminated by other SB 863 provisions suggests that 30,000 liens related to utilization review disputes would remain in the system.[22] Assuming that the administrative and legal cost related to these issues is $3,000 based on WCIRB lien survey data[23] and those costs would be replaced with a $500 IMR report, estimated savings in loss adjustment expenses are $75 million (30,000 liens x ($3,000 - $500).

2. Qualified Medical Evaluations. CHSWC data indicates that there were 116,000 Qualified Medical Evaluator (QME) reports in 2010, with 18% or 21,000 related to medical treatment issues. WCIRB data indicates that the average cost of a medical-legal report in 2009 is $1,662.[24] Assuming an annual trend of 5%, the WCIRB estimates that the average cost of a medical-legal report for 2013 injuries would be approximately $2,000. As a result, assuming each of these QME reports will be replaced by an IMR report at a cost of $500 each would produce savings of approximately $32 million (21,000 QME reports x ($2,000 - $500)).

3. Expedited Hearings. CHSWC data suggests that there are approximately 12,000 expedited hearings, of which approximately 75% or 9,000 are related to medical necessity. Based on an informal survey of insurer claims departments, it is suggested that the legal and administrative costs related an expedited hearing is approximately $1,500. As a result, eliminating the costs related to these expedited hearings would suggest savings of approximately $14 million (9,000 expedited hearings x $1,500).[25]

4. Medical Treatment Costs. Medical treatment costs per indemnity claim have risen by approximately 45% since 2005.[26] Also, based on CHSWC data on liens and QME reports and WCIRB data on medical treatment lien demands, it is estimated that there are approximately 65,000 utilization review disputes — with approximately $400 million in dispute. However, at this time it is not clear how often utilization reviews are overturned under the current system and how often it will be overturned under SB 863's IMR system. Nor is it clear how often IMRs will be utilized and how the system might eventually affect treatment patterns. Given these uncertainties, the impact of SB 863's IMR system on medical treatment is not clear at this time. The WCIRB plans to actively monitor treatment costs subsequent to implementation of SB 863 and, to the extent appropriate, modify its pure premium rate projections based on emerging medical treatment cost information.

5. Temporary Disability Duration. WCIRB and CWCI data shows that temporary disability duration has increased by approximately 20% since the reforms of 2002 through 2004 were fully implemented in 2005.[27] Also, information from the Workers' Compensation Research Institute

[22] These assumptions are reflected in the August 23, 2012 Bickmore Risk Services report to the DIR evaluating potential reform savings.

[23] WCIRB lien survey data suggests that the average cost of lien legal fees for these larger medical-related liens is approximately $1,400 with an assumed additional $1,600 in other claims administrative costs.

[24] See Exhibit TR-S11 of Agenda Item AC12-08-01 of the August 2, 2012 WCIRB Actuarial Committee meeting.

[25] Since the cost of the IMR reports related to these disputes was already reflected in the evaluation of the impact of SB 863's IMR provisions on QME reports, no additional offset for the cost of IMR was reflected.

[26] See the Executive Summary of the WCIRB's January 1, 2013 Pure Premium Rate Filing submitted on August 21, 2012.

[27] See Exhibits LD-P7.1 and LD-P7.2 of Agenda Item AC12-08-01 of the August 2, 2012 WCIRB Actuarial Committee meeting.

(WCRI)[28] suggests that temporary disability duration in California is considerably higher than in most other states. It is not possible to isolate the impact of medical treatment delays from the impact of the economy, prior legislative changes impacting temporary disability duration, and issues related to permanent disability on increasing temporary disability duration. However, inasmuch as delays related to medical treatment are generally believed to be a significant component in the 20% deterioration in temporary disability duration since 2005 and it is generally believed that SB 863's IMR process should reduce delays related to medical treatment, the WCIRB believes some cost level adjustment is appropriate. The WCIRB believes it is reasonable to judgmentally assume that one-fifth of the recent deterioration in temporary disability duration will be eliminated by SB 863's IMR provisions. This results in a reduction of temporary disability benefits of 4% and a total cost reduction, including the estimated impact of changes in indemnity benefit levels on claim frequency utilization, of 1.1%, or $210 million, assuming a total system size estimate of $19 billion.

6. Litigation. Paid allocated loss adjustment expenses (ALAE) have increased by approximately 96% since 2005.[29] Also, WCRI information suggests that temporary benefit delivery expenses in California are significantly higher than in other states.[30] It is not possible to isolate the impact of medical treatment issues on litigation or ALAE from the impact of lien, permanent disability and other issues. However, inasmuch as disputes over medical treatment issues are generally believed to be a significant component in the deterioration of ALAE per claim since 2005 and it is generally believed that SB 863's IMR process should reduce litigation related to medical treatment, the WCIRB believes some cost level adjustment is appropriate.

   Other SB 863 reforms reflected in this evaluation are estimated to reduce ALAE costs by 15%, or approximately $400 million. The WCIRB believes it is reasonable to judgmentally assume that the estimated reduction in ALAE as a result of SB 863's IMR provisions is approximately proportional to the estimated 2.4% reduction in indemnity benefits as a result of the projected reduction in temporary disability duration discussed above. This assumption results in estimated total cost reduction of 0.3%, or $60 million, assuming a total system size estimate of $19 billion.

Based on the assumptions summarized above, as shown in Table 1, the WCIRB estimates that the currently quantifiable SB 863 provisions relating to the IMR process will reduce total system costs by 2.1%, or $390 million, based on a total statewide estimate of the cost of losses and loss adjustment expenses of $19 billion.

G. Elimination of the Impact of the Ogilvie Decision on PD Rating Adjustments

The 2009 WCAB decision in Ogilvie v. City and County of San Francisco allowed for the PD rating to be adjusted based on a finding that the FEC component of the PD rating did not appropriately describe the loss of FEC. As discussed in Section I above, under SB 863, FEC will not be used as a basis to determine the PD rating on injuries occurring on or after January 1, 2013 and, as a result, these ratings will not be subject to amendments based on the Ogilvie decision.

In 2009, the WCIRB projected the combined impact of the Ogilvie and Almaraz v. Environmental Recovery Services/Guzman v. Milpitas Unified School District WCAB decisions on cost levels to be an increase of 5.8%.[31] PD benefits, excluding the impact of changes in claim frequency, were estimated to increase by approximately 20% as a result of these WCAB decisions. The WCIRB has since reviewed a wide range of information on costs emerging subsequent to the WCAB decisions. This information shows costs emerging at a level generally consistent with the initial estimates reflected in the WCIRB's earlier

[28] *How California Compares Prior to SB 863: CompScope Benchmarks for California, 13th Edition*, Workers' Compensation Research Institute, October 2012.

[29] See the Executive Summary of the WCIRB's January 1, 2013 Pure Premium Rate Filing submitted on August 21, 2012.

[30] *How California Compares Prior to SB 863: CompScope Benchmarks for California, 13th Edition*, Workers' Compensation Research Institute, October 2012.

[31] See Part A, Section B, Appendix C of the WCIRB's July 1, 2009 Pure Premium Rate Filing for a complete discussion of the WCIRB's estimate of the cost impact of the Ogilvie and Almaraz/Guzman decisions on costs.

pure premium rate filings.[32] In particular, a WCIRB analysis of claim settlement data from the DWC suggested that total claim settlements increased by approximately 12% following the decisions, which corresponds to an approximate 25% increase in PD benefits.[33] The WCIRB has also reviewed information on ratings from the DEU which suggest that the increase in PD benefits due primarily to the Almaraz/Guzman decision could range from 8% to 17%.[34]

Given this information, the WCIRB believes that the initially estimated impact of Ogilvie and Almaraz/Guzman decisions on PD costs of an increase of 20% appears reasonable. However, the WCIRB is not aware of any information segregating the impact of Ogilvie from that of Almaraz/Guzman. The WCIRB's Claims Working Group has indicated that Ogilvie adjustments to PD are significantly rarer than Almaraz/Guzman adjustments, although they do impact claim settlements — particularly in Northern California.[35] The WCIRB judgmentally estimates that one-fifth of the increase in PD benefits collectively attributed to Ogilvie and Almaraz/Guzman is attributable solely to Ogilvie and, as a result, PD benefits on 2013 injuries is estimated to be reduced by 4% (one-fifth of 20%) by the effective elimination of the Ogilvie adjustments.

In the 2009 evaluation of the impact of the Ogilvie and Almaraz/Guzman decisions, the WCIRB estimated that ALAE would increase by 9% due to the WCAB decisions.[36] Although the impact of the WCAB decisions on ALAE costs cannot be isolated from other factors impacting ALAE (e.g., liens), ALAE costs did escalate following the WCAB decisions at a level relatively consistent with the estimate.[37] As noted earlier, Ogilvie adjustments to PD are significantly rarer than adjustments based on the Almaraz/Guzman decision. Nevertheless, Ogilvie cases do involve significant frictional costs. As a result, the WCIRB judgmentally estimates that one-third of the 9% increase in ALAE estimated to reflect the combined impact of Ogilvie and Almaraz/Guzman is attributable solely to Ogilvie and, as a result, ALAE on 2013 injuries is estimated to be reduced by 3% by the effective elimination of the Ogilvie adjustments. This would reduce statewide LAE by approximately $80 million based on a total system cost estimate of $19 billion.

As shown in Table 1, the WCIRB estimates that the elimination of the Ogilvie adjustments to PD will reduce total system costs by 1.1%, or $210 million, based on a total statewide estimate of the cost of losses and LAE of $19 billion.

H. Provisions Related to Medical Services Provided by a Valid MPN

SB 863 amends Labor Code Section 4605 to provide that reports prepared by a consulting or attending physician chosen by the injured worker and outside the MPN shall not be the sole basis of compensation. These amendments appear to address the Valdez[38] decision, which relates to the admissibility of reports completed outside a MPN. In addition, Labor Code Section 4603.2 provides that the employer is not liable for treatment or the consequences of treatment obtained outside a valid MPN. The WCIRB believes that, in particular, the SB 863 amendments to Labor Code Section 4603.2 should significantly strengthen the impact of the MPNs.

[32] See Agenda Item AC09-03-07 of the August 2, 2012 WCIRB Actuarial Committee meeting for a more complete discussion of this information.

[33] See Agenda Item AC09-03-07 of the August 3, 2011 WCIRB Actuarial Committee meeting.

[34] See Agenda Item AC09-03-07 of the August 2, 2012 WCIRB Actuarial Committee meeting.

[35] See Agenda Item AC09-03-07 of the August 2, 2012 WCIRB Actuarial Committee meeting.

[36] See Part A, Section B, Appendix C of the WCIRB's July 1, 2009 Pure Premium Rate Filing for a complete discussion of the WCIRB's estimate of the cost impact of the Ogilvie and Almaraz/Guzman decisions on costs.

[37] See Agenda Item AC09-03-07 of the August 2, 2012 WCIRB Actuarial Committee meeting for a more complete discussion of this information.

[38] Valdez v. WCAB (Demo Warehouse). The WCAB, in an en banc decision issued on April 20, 2011, held that if the injured worker obtains unauthorized treatment outside a validly established and properly noticed MPN, the reports from any non-MPN doctors are inadmissible in court. The California 2nd District Court of Appeals, in a published decision issued on May 29, 2012, overturned the decision of the WCAB, holding that the Labor Code does not prohibit the admission of medical reports from non-MPN doctors.

It is difficult to precisely estimate the cost impact of these provisions related to services provided outside a MPN. However, recent CWCI analyses have shown that costs are impacted by the use of MPNs.[39] The WCIRB's projected cost impact of the SB 863 provisions related to MPN strengthening on medical costs, temporary disability benefits and PD benefits is based on the assumptions reflected in the Bickmore Risk Services' August 23, 2012 report to the DIR on potential reform savings. The key assumptions underlying the estimates are as follows:

1. Based on WCIRB and CWCI data, it is estimated that 76% of PD claims are within network and 70% of claims are litigated.
2. One-fifth (20%) of in-network litigated PD claims will obtain medical services outside the networks.
3. Based on CWCI data, approximately 75% of medical payments and 76% of temporary disability payments are assumed to occur on PD claims.
4. Based on CWCI data on cost differences within and outside networks, medical costs procured outside of network are estimated to be approximately 10% higher than in-network costs, temporary disability costs are estimated to be approximately 14% higher, and PD costs are estimated to be approximately 23% higher.
5. Based on WCIRB data, 68% of medical costs are unpaid at 24 months and assumed to be affected by the changes related to MPNs.

Based on these assumptions, a savings of approximately $60 million in medical costs, $30 million in temporary disability costs and $40 million in PD costs is estimated prior to the impact of the temporary disability and permanent disability benefit reductions on claim frequency utilization. In total, based on these assumptions, the WCIRB estimates that SB 863 provisions related to strengthening MPNs, including the impact of the reduction in temporary disability and permanent disability benefits on claim frequency, will reduce total system costs by 1.0%, or $190 million.

## Section III: SB 863 Provisions for Which No WCIRB Estimate is Provided

SB 863 included a number of provisions for which the WCIRB is not able to provide an estimated cost impact. These include the following:

1. New Return-to-Work Program. SB 863 adds Labor Code Section 139.48, which authorizes the Administrative Director to develop a return-to-work program funded at $120 million annually from the non-General Funds of the Worker's Compensation Administrative Revolving Fund for the purpose of making supplemental benefit payments to workers whose PD benefits are disproportionately low in comparison to their earnings loss. Labor Code Section 139.48 also provides that determinations of the Administrative Director shall be subject to review at the trial level at the Workers' Compensation Appeals Board (WCAB) upon the same grounds as petitions for reconsideration. While this provision, once adopted through regulation, will have a significant impact on employer costs as reflected in direct employer assessments, it does not directly affect the costs underlying pure premium rates. As a result, the WCIRB has not included any cost assessment of this provision in this evaluation. While it is possible that administration of this new program may have an impact on LAE costs, any estimate of this cost impact is premature until such time as the programs enabling regulations have been promulgated.
2. Medical Provider Networks. SB 863 amends Labor Code Sections 4061, 4062, 4062.3, 4616, 4616.1, 4616.2, 4616.3 and 5502 to address MPNs. These provisions are intended to improve communication and quality assurance and streamline the entire MPN process in California. The WCIRB is not aware of any statistical basis upon which to predicate an estimate of the cost impact of these changes.
3. Independent Bill Review. SB 863 adds Labor Code Section 4603.6 to create a new process for independent bill review when there is a bill payment dispute. Specifically, Labor Codes 4603.6 provides that if there is a dispute on the amount of payment and that dispute was not resolved by

[39] *Analysis of Medical and Indemnity Benefit Payments, Medical Treatment and Pharmaceutical Cost Trends in the California Workers' Compensation System*, CWCI, July 2012. See the Minutes for Item AC12-06-03 of the August 2, 2012 WCIRB Actuarial Committee meeting.

the employer's second review, the provider may request an independent bill review within thirty days of the second review. If the provider fails to request an independent bill review within thirty days, the bill will be deemed satisfied. There are a number of outstanding issues related to the independent bill review to be resolved through regulation. At this time, the WCIRB is not aware of any statistical basis upon which to predicate an estimate of the cost impact of these changes.

4. IMR. As discussed in Section II, Paragraph F, the WCIRB was able to estimate an impact of the SB 863 provisions related to IMR on frictional costs, temporary disability duration and litigation. However, given uncertainties as to how the IMR program will be implemented and utilized and how it may affect medical treatment patterns, the WCIRB was unable to quantify the impact of IMR on medical treatment costs at this time. The WCIRB will actively monitor treatment costs subsequent to implementation of SB 863 and, to the extent appropriate, modify its pure premium rate projections based on emerging medical treatment cost information.

5. New Medical Fee Schedules. SB 863 adds Labor Code Section 5307.8 to authorize the Administrative Director to adopt a fee schedule for home health services by July 1, 2013 and adds Labor Code Section 5307.9 to authorize the Administrative Director to adopt a fee schedule for copy services by December 31, 2013. The SB 863 amendments to Labor Code Section 5307.7 and Labor Code Sections 4600(g) and 5811 pertain to fee schedules for vocational services and interpreters, respectively. It is premature to assess the cost impact of new fee schedules until such time as the fee schedules are adopted. Once the new schedules are adopted, the WCIRB will assess their cost impacts and, to the extent appropriate, reflect those cost impacts in proposed pure premium rates.

6. Conversion of OMFS to RBRVS Basis. SB 863 amends Labor Code Section 5307.1 to provide that the Administrative Director shall adopt a fee schedule based on the RBRVS for physician services, with the maximum reasonable fees paid set at a level not to exceed 120% of Medicare. The amendments provide for a four-year transition period beginning in 2014. It is premature to assess the cost impact of fee schedule revisions until such time as the specific revisions have been promulgated. Once the revised schedule values are adopted, the WCIRB will assess their cost impacts and, to the extent appropriate, reflect those cost impacts in proposed pure premium rates.

7. Advances to Permanent Disability. SB 863 revisions to Labor Code Section 4650(b) provide that the advances to PD are not required if the employer has made a qualified offer of return-to-work. Typically, the WCIRB does not reflect changes affecting only the time value of money in pure premium ratemaking. However, inasmuch as the typical PD advance is believed to be well less than one year and current interest rates are low, the WCIRB believes this provision will not have a significant impact on total system costs.

**Exhibit 1.1**
Updated October 12, 2012

**Estimated Cost Impact On Accident Year 2013 - SB 863**
Changes in Statutory Benefit Levels[1]

| Type of Injury | Distribution of Incurred Losses | Impact Prior to Utilization Adjustments | Impact Subsequent to Utilization Adjustments |
|---|---|---|---|
| Death | 0.0063 | 2.5% | 2.5% |
| Permanent Total | 0.0108 | 0.0% | 0.0% |
| Major 70-99.75 | 0.0077 | 10.5% | 12.3% |
| Major 25-69.75 | 0.1669 | 10.2% | 11.9% |
| Serious | 0.1917 | 9.4% | 11.0% |
| Minor 15-24.75 | 0.0265 | 5.2% | 6.9% |
| Minor 0.25-14.75 | 0.0655 | 4.9% | 6.6% |
| Temporary | 0.0373 | 0.0% | 1.6% |
| Non-Serious | 0.1293 | 3.6% | 5.2% |
| Indemnity (Serious & Non-Serious) | 0.3210 | 7.0% | 8.7% |
| Medical | 0.6790 | 0.0% | 1.4% |
| **Total** | **1.0000** | **2.3%** | **3.7%** |

[1] This includes change to the permanent disability weekly benefit maximums and minimums, change to the supplemental job displacement benefit, increase of the burial allowance, elimination of the FEC, and the application of a 1.4 adjustment to each impairment but prior to the elimination of the rating add-ons for psychiatric impairment, sleep disorder and sexual dysfunction.

## Estimated Cost Impact On Accident Year 2013 - SB 863

Changes in Statutory Benefit Levels[1]

| | (1) Benefit Effective 1/1/2013 Present | (2) Benefit Effective 1/1/2013 Proposed[1] |
|---|---|---|
| Death | | |
| 1. Effect of amendment on death | $196,955.94 | $201,955.94 |
| | | 1.025 |
| Permanent Total | | |
| 2. Average compensation | $1,048.62 | $1,048.62 |
| 3. Effect of amendment on permanent total | | 1.000 |
| Major 70-99.75 | | |
| 4. Average duration, temporary disability | 98.8 | 98.8 |
| 5. Average compensation, temporary disability | $632.33 | $633.28 |
| 6. Average duration, permanent disability | 530.6 | 577.5 |
| 7. Average compensation, permanent disability | $273.21 | $293.29 |
| 8. Average duration, life pension | 967.2 | 908.1 |
| 9. Average compensation, life pension | $187.85 | $219.49 |
| 10. Average cost of education vouchers | $3,382.91 | $2,560.04 |
| 11. Average total cost: (4)x(5)+(6)x(7)+(8)x(9)+(10) | $392,552.00 | $433,841.63 |
| 12. Effect of amendment on major 70-99.75 | | 1.105 |
| Major 25-69.75 | | |
| 13. Average duration, temporary disability | 75.7 | 75.7 |
| 14. Average compensation, temporary disability | $530.46 | $535.65 |
| 15. Average duration, permanent disability | 189.9 | 208.9 |
| 16. Average compensation, permanent disability | $229.59 | $237.81 |
| 17. Average duration, life pension | --- | 1,075.0 |
| 18. Average compensation, life pension | --- | $2.56 |
| 19. Average cost of education vouchers | $2,339.19 | $1,893.27 |
| 20. Average total cost: (13)x(14)+(15)x(16)+(17)x(18)+(19) | $86,111.32 | $94,875.71 |
| 21. Effect of amendment on major 25-69.75 | | 1.102 |

[1] This includes change to the permanent disability weekly benefit maximums and minimums, change to the supplemental job displacement benefit, increase of the burial allowance, elimination of the FEC, and the application of a 1.4 adjustment to each impairment but prior to the elimination of the rating add-ons for psychiatric impairment, sleep disorder and sexual dysfunction.

**Estimated Cost Impact On Accident Year 2013 - SB 863**

Changes in Statutory Benefit Levels[1]

| | (1) Benefit Effective 1/1/2013 Present | (2) Benefit Effective 1/1/2013 Proposed[1] |
|---|---|---|
| Minor 15-24.75 | | |
| 22. Average duration, temporary disability | 61.8 | 61.8 |
| 23. Average compensation, temporary disability | $476.13 | $481.40 |
| 24. Average duration, permanent disability | 69.9 | 77.8 |
| 25. Average compensation, permanent disability | $226.77 | $229.33 |
| 26. Average cost of education vouchers | $1,135.95 | $1,247.65 |
| 27. Average total cost: (22)x(23)+(24)x(25)+(26) | $46,387.99 | $48,820.71 |
| 28. Effect of amendment on minor 15-24.75 | | 1.052 |
| Minor 0.25-14.75 | | |
| 29. Average duration, temporary disability | 40.6 | 40.6 |
| 30. Average compensation, temporary disability | $455.06 | $457.26 |
| 31. Average duration, permanent disability | 23.6 | 27.6 |
| 32. Average compensation, permanent disability | $221.28 | $223.99 |
| 33. Average cost of education vouchers | $501.69 | $623.32 |
| 34. Average total cost, (29)x(30)+(31)x(32)+(33) | $24,188.54 | $25,374.27 |
| 35. Effect of amendment on minor 0.25-14.75 | | 1.049 |
| Temporary | | |
| 36. Average compensation | $456.26 | $456.26 |
| 37. Effect of amendment on temporary | | 1.000 |

[1] This includes change to the permanent disability weekly benefit maximums and minimums, change to the supplemental job displacement benefit, increase of the burial allowance, elimination of the FEC, and the application of a 1.4 adjustment to each impairment but prior to the elimination of the rating add-ons for psychiatric impairment, sleep disorder and sexual dysfunction.

**Exhibit 2.1**
Updated October 12, 2012

**Estimated Cost Impact On Accident Year 2014 - SB 863**
Change in Statutory Benefit Levels[1]

| Type of Injury | Distribution of Incurred Losses | Impact Prior to Utilization Adjustments | Impact Subsequent to Utilization Adjustments |
|---|---|---|---|
| Death | 0.0063 | 0.0% | 0.0% |
| Permanent Total | 0.0106 | 0.0% | 0.0% |
| Major 70-99.75 | 0.0070 | 0.0% | 1.6% |
| Major 25-69.75 | 0.1730 | 10.1% | 11.9% |
| Serious | 0.1969 | 8.9% | 10.5% |
| Minor 15-24.75 | 0.0271 | 7.1% | 8.8% |
| Minor 0.25-14.75 | 0.0676 | 4.6% | 6.2% |
| Temporary | 0.0368 | 0.0% | 1.6% |
| Non-Serious | 0.1315 | 3.8% | 5.4% |
| Indemnity (Serious & Non-Serious) | 0.3284 | 6.9% | 8.5% |
| Medical | 0.6716 | 0.0% | 1.3% |
| **Total** | **1.0000** | **2.3%** | **3.7%** |

[1] This includes the change to the permanent disability weekly benefit maximums.

## Estimated Cost Impact On Accident Year 2014 - SB 863

Change in Statutory Benefit Levels[1]

| | (1) Benefit Effective 1/1/2014 Present | (2) Benefit Effective 1/1/2014 Proposed |
|---|---|---|
| Death | | |
| 1. Effect of amendment on death | $203,808.05 | $203,808.05 |
| | | 1.000 |
| Permanent Total | | |
| 2. Average compensation | $1,078.89 | $1,078.89 |
| 3. Effect of amendment on permanent total | | 1.000 |
| Major 70-99.75 | | |
| 4. Average duration, temporary disability | 98.8 | 98.8 |
| 5. Average compensation, temporary disability | $652.29 | $652.29 |
| 6. Average duration, permanent disability | 540.1 | 540.1 |
| 7. Average compensation, permanent disability | $279.57 | $279.57 |
| 8. Average duration, life pension | 957.7 | 957.7 |
| 9. Average compensation, life pension | $195.37 | $195.37 |
| 10. Average cost of education vouchers | $2,387.15 | $2,387.15 |
| 11. Average total cost: (4)x(5)+(6)x(7)+(8)x(9)+(10) | $404,964.77 | $404,964.77 |
| 12. Effect of amendment on major 70-99.75 | | 1.000 |
| Major 25-69.75 | | |
| 13. Average duration, temporary disability | 75.7 | 75.7 |
| 14. Average compensation, temporary disability | $546.37 | $546.37 |
| 15. Average duration, permanent disability | 193.2 | 193.2 |
| 16. Average compensation, permanent disability | $228.10 | $273.93 |
| 17. Average cost of education vouchers | $1,887.60 | $1,887.60 |
| 18. Average total cost: (13)x(14)+(15)x(16)+(17) | $87,323.81 | $96,176.76 |
| 19. Effect of amendment on major 25-69.75 | | 1.101 |

[1] This includes the change to the permanent disability weekly benefit maximums.

## Estimated Cost Impact On Accident Year 2014 - SB 863

Change in Statutory Benefit Levels[1]

| | (1) Benefit Effective 1/1/2014 Present | (2) Benefit Effective 1/1/2014 Proposed |
|---|---|---|
| Minor 15-24.75 | | |
| 20. Average duration, temporary disability | 61.8 | 61.8 |
| 21. Average compensation, temporary disability | $489.34 | $489.34 |
| 22. Average duration, permanent disability | 70.2 | 70.2 |
| 23. Average compensation, permanent disability | $222.81 | $270.53 |
| 24. Average cost of education vouchers | $1,150.02 | $1,150.02 |
| 25. Average total cost: (20)x(21)+(22)x(23)+(24) | $47,015.46 | $50,364.77 |
| 26. Effect of amendment on minor 15-24.75 | | 1.071 |
| Minor 0.25-14.75 | | |
| 27. Average duration, temporary disability | 40.6 | 40.6 |
| 28. Average compensation, temporary disability | $467.95 | $467.95 |
| 29. Average duration, permanent disability | 24.6 | 24.6 |
| 30. Average compensation, permanent disability | $222.29 | $268.61 |
| 31. Average cost of education vouchers | $600.40 | $600.40 |
| 32. Average total cost, (27)x(28)+(29)x(30)+(31) | $25,072.72 | $26,214.30 |
| 33. Effect of amendment on minor 0.25-14.75 | | 1.046 |
| Temporary | | |
| 34. Average compensation | $468.97 | $468.97 |
| 35. Effect of amendment on temporary | | 1.000 |

[1] This includes the change to the permanent disability weekly benefit maximums.

## Estimated Cost Impact on Accident Year 2013 - SB 863

Effect of Removal of Add-ons for Psychiatric Impairment, Sleep Disorder, and Sexual Dysfunction

**Removal of All Add-Ons**

| | | | Without Utilization Effects | | With Utilization Effects | |
|---|---|---|---|---|---|---|
| Add-On | % of Ratings Affected (a) | Change in Average Rating (a) | % Impact on Total Losses | Loss Dollar Impact (in $MM) (b) | % Impact on Total Losses | Loss Dollar Impact (in $MM) (b) |
| Psychiatric Impairment | 2.6% | -2.1% | -0.5% | ($77) | -0.8% | ($121) |
| Sleep Disorder | 1.7% | -0.7% | -0.2% | ($23) | -0.2% | ($36) |
| Sexual Dysfunction | 0.5% | -0.2% | 0.0% | ($7) | -0.1% | ($11) |
| Total All Add-ons | 4.1% | -2.7% | -0.7% | ($107) | -1.1% | ($168) |

**Removal of Add-Ons with 10% Offset for Psychiatric Impairments (c)**

| | | | Without Utilization Effects | | With Utilization Effects | |
|---|---|---|---|---|---|---|
| Add-On | % of Ratings Affected | Change in Average Rating | % Impact on Total Losses | Loss Dollar Impact (in $MM) (b) | % Impact on Total Losses | Loss Dollar Impact (in $MM) (b) |
| Psychiatric Impairment | --- | --- | -0.5% | ($69) | -0.7% | ($109) |
| Sleep Disorder | --- | --- | -0.2% | ($23) | -0.2% | ($36) |
| Sexual Dysfunction | --- | --- | 0.0% | ($7) | -0.1% | ($11) |
| Total All Add-ons | --- | --- | -0.6% | ($99) | -1.0% | ($156) |

Source: Approximately 20,000 permanent disability claims rated by the Disability Evaluation Unit from June 2011 to March 2012.
(a) Due to interactive effects, the sum of the individual components may not equal the total.
(b) Loss dollar impacts are re-weighted so that the sum of the individual components equals the total.
(c) An estimated 10% of the savings from the removal of psychiatric add-ons is offset for catastrophic injuries or injuries that were a result of a violent act based on the injury description characteristics reported on permanent disability claims from unit statistical data.

**Exhibit 4.1**
Updated October 12, 2012

**Estimated Cost Impact On Accident Year 2013 - SB 863**
Removal of Three-Tiered Weekly PD Benefits[1]

| Type of Injury | Distribution of Incurred Losses | Impact Prior to Utilization Adjustments | Impact Subsequent to Utilization Adjustments |
|---|---|---|---|
| Death | 0.0063 | 0.0% | 0.0% |
| Permanent Total | 0.0106 | 0.0% | 0.0% |
| Major 70-99.75 | 0.0071 | -1.8% | -2.1% |
| Major 25-69.75 | 0.1760 | -1.8% | -2.0% |
| Serious | 0.1999 | -1.6% | -1.9% |
| Minor 15-24.75 | 0.0273 | -1.0% | -1.3% |
| Minor 0.25-14.75 | 0.0677 | -0.2% | -0.5% |
| Temporary | 0.0368 | 0.0% | -0.3% |
| Non-Serious | 0.1318 | -0.3% | -0.6% |
| Indemnity (Serious & Non-Serious) | 0.3317 | -1.1% | -1.4% |
| Medical | 0.6683 | 0.0% | -0.2% |
| **Total** | **1.0000** | **-0.4%** | **-0.6%** |

[1] This is the impact of eliminating the 15% adjustment up and down in weekly PD benefits related to qualified return-to-work offer.

## Estimated Cost Impact On Accident Year 2013 - SB 863

Removal of Three-Tiered Weekly PD Benefits[1]

| | (1) Benefit Effective 1/1/2013 Present | (2) Benefit Effective 1/1/2013 Proposed[1] |
|---|---|---|
| Death | | |
| 1. Effect of amendment on death | $201,955.94 | $201,955.94 |
| | | 1.000 |
| Permanent Total | | |
| 2. Average compensation | $1,048.62 | $1,048.62 |
| 3. Effect of amendment on permanent total | | 1.000 |
| Major 70-99.75 | | |
| 4. Average duration, temporary disability | 98.8 | 98.8 |
| 5. Average compensation, temporary disability | $618.31 | $618.31 |
| 6. Average duration, permanent disability | 514.3 | 514.3 |
| 7. Average compensation, permanent disability | $285.21 | $272.41 |
| 8. Average duration, life pension | 909.1 | 909.1 |
| 9. Average compensation, life pension | $172.73 | $172.73 |
| 10. Average cost of education vouchers | $2,400.39 | $2,400.39 |
| 11. Average total cost: (4)x(5)+(6)x(7)+(8)x(9)+(10) | $367,209.62 | $360,628.59 |
| 12. Effect of amendment on major 70-99.75 | | 0.982 |
| Major 25-69.75 | | |
| 13. Average duration, temporary disability | 75.7 | 75.7 |
| 14. Average compensation, temporary disability | $532.29 | $532.29 |
| 15. Average duration, permanent disability | 200.4 | 200.4 |
| 16. Average compensation, permanent disability | $236.88 | $228.68 |
| 17. Average duration, life pension | 1,074.4 | 1,074.4 |
| 18. Average compensation, life pension | $2.23 | $2.23 |
| 19. Average cost of education vouchers | $1,861.61 | $1,861.61 |
| 20. Average total cost: (13)x(14)+(15)x(16)+(17)x(18)+(19) | $92,046.96 | $90,403.45 |
| 21. Effect of amendment on major 25-69.75 | | 0.982 |

[1] This is the impact of eliminating the 15% adjustment up and down in weekly PD benefits related to qualified return-to-work offer.

## Estimated Cost Impact On Accident Year 2013 - SB 863

Removal of Three-Tiered Weekly PD Benefits[1]

| | (1) Benefit Effective 1/1/2013 Present | (2) Benefit Effective 1/1/2013 Proposed[1] |
|---|---|---|
| Minor 15-24.75 | | |
| 22. Average duration, temporary disability | 61.8 | 61.8 |
| 23. Average compensation, temporary disability | $481.03 | $481.03 |
| 24. Average duration, permanent disability | 77.0 | 77.0 |
| 25. Average compensation, permanent disability | $229.26 | $222.67 |
| 26. Average cost of education vouchers | $1,238.41 | $1,238.41 |
| 27. Average total cost: (22)x(23)+(24)x(25)+(26) | $48,608.55 | $48,101.03 |
| 28. Effect of amendment on minor 15-24.75 | | 0.990 |
| Minor 0.25-14.75 | | |
| 29. Average duration, temporary disability | 40.6 | 40.6 |
| 30. Average compensation, temporary disability | $457.24 | $457.24 |
| 31. Average duration, permanent disability | 27.6 | 27.6 |
| 32. Average compensation, permanent disability | $223.99 | $221.96 |
| 33. Average cost of education vouchers | $622.56 | $622.56 |
| 34. Average total cost, (29)x(30)+(31)x(32)+(33) | $25,361.96 | $25,305.89 |
| 35. Effect of amendment on minor 0.25-14.75 | | 0.998 |
| Temporary | | |
| 36. Average compensation | $456.26 | $456.26 |
| 37. Effect of amendment on temporary | | 1.000 |

[1] This is the impact of eliminating the 15% adjustment up and down in weekly PD benefits related to qualified return-to-work offer.

## Estimated Cost Impact of SB 863

Lien Filing Fee

| | |
|---|---|
| 1. Projected Number of 2013 Liens[1] | 640,000 |
| 2. Projected Reduction in Lien Filings[2] | 30% |
| 3. Number of Liens Avoided: (1) x (2) | 192,000 |
| 4. Average Lien Settlement Cost Savings[3] | $150 |
| 5. Total Lien Settlement Cost Savings: (3) x (4) | $29,000,000 |
| 6. Average Administrative and Legal Cost per Lien[4] | $400 |
| 7. Total Administrative and Legal Cost Savings: (3) x (6) | $77,000,000 |
| 8. Total Savings: (5) + (7) | $106,000,000 |

[1] *Bickmore Risk Services August 23, 2012 Projected Impact of Changes to CA Workers' Compensation*
Exhibit 7, Page 1 projected 2013 liens filed based on reported DWC lien counts.

[2] 2012 WCIRB Liens Survey proportion of lien settlements of $300 or less.

[3] 2012 WCIRB Liens Survey average lien settlement for lien amounts settling for $300 or less.
This amount reflects the filing fee and provision for expense the lien claimant incurs for preparing the lien filing.

[4] 2012 WCIRB Liens Survey lien legal cost of $150 plus provision for insurer administrative costs.

## Estimated Cost Impact of SB 863

Lien Statute of Limitations

| | | |
|---|---|---|
| 1. | Projected Number of 2013 Liens[1] | 640,000 |
| 2. | Percentage of Medical/Medical-Legal Liens Eliminated[2] | 11% |
| 3. | Number of Liens Avoided: (1) x (2) | 70,000 |
| 4. | Average Lien Amount[3] | $7,500 |
| 5. | Average Lien Settlement Rate[4] | 30% |
| 6. | Average Lien Settlement Cost: (4) x (5) | $2,250 |
| 7. | Total Lien Settlement Cost Savings: (3) x (6) | $158,000,000 |
| 8. | Average Administrative and Legal Cost per Lien[5] | $3,000 |
| 9. | Total Administrative and Legal Cost Savings: (3) x (8) | $210,000,000 |
| 10. | Total Savings: (7) + (9) | $368,000,000 |

[1] *Bickmore Risk Services August 23, 2012 Projected Impact of Changes to CA Workers' Compensation* Exhibit 7, Page 1 projected 2013 liens filed based on reported DWC line counts.

[2] The product of the proportion of liens filed two years or more from the service date from the *CHSWC 2011 Liens Report (23%)* , the proportion of liens that are medical from the WCIRB Liens Survey (70%) and the proportion of liens not eliminated by the lien filing fee (70% from Exhibit 5.1).

[3] 2012 WCIRB Liens Survey average lien amount for medical/medical-legal lien types excluding those liens eliminated by the lien filing fee.

[4] 2012 WCIRB Liens Survey average lien settlement rate for medical/medical-legal lien types.

[5] 2012 WCIRB Liens Survey lien legal cost of $1,400 plus provision for insurer administrative costs.

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