

## SB 863 Cost Monitoring Update

By the WCIRB Actuarial Services Team

### Summary

Senate Bill No. 863 (SB 863) was signed into law by Governor Brown in 2012. SB 863 increased benefits effective January 1, 2013 and January 1, 2014 and provided for a number of structural changes to the California workers' compensation benefit delivery system. The proponents of SB 863 contended that SB 863 would provide approximately \$1 billion annually in increased permanently disability benefits to injured workers that would be more than offset through reform savings, particularly those related to frictional costs in the system. The WCIRB published a prospective estimate of the cost impact of SB 863 in October 2012.<sup>1</sup>

Prospective estimates often involve broad assumptions and actual reform impacts depend on implementation regulations, judicial interpretation, and shift in stakeholder practice patterns. As such, the WCIRB also published annual retrospective evaluations of SB 863 from 2013 through 2016 that reflected actual post-SB 863 emerging costs.<sup>2</sup> Since 2016, the WCIRB has continued to refine its estimates of the cost impact of SB 863 based on later emerging data.

Workers' compensation reforms are not implemented in a vacuum. Post-reform cost levels are impacted not only by those reforms but also subsequent legislation, regulations and judicial action as well as other economic or claims-related phenomena. As a result, it can be challenging to isolate the impact of specific reforms from that of other factors. Nevertheless, it is clear that SB 863 has been a principal factor in reducing workers' compensation cost levels in California. While permanent disability benefits have increased as expected, frictional cost savings have not emerged as initially projected. However, reductions in medical cost levels have been far greater than expected. These savings have largely driven a series of advisory pure premium rate decreases totaling more than 40% and have resulted in the lowest average charged premium rates in the marketplace in more than forty years.

Figure 1 shows a summary of the WCIRB's current retrospective cost estimate of the impact of SB 863 by component. In total, the WCIRB estimates that SB 863 has saved \$2.3 billion to the California workers' compensation system annually, or 12% of total loss and loss adjustment expense (LAE) costs. There appears to have been little evidence of erosion of these reform impacts as of this time. As result, these savings have generally been sustained and have accumulated to a total system-wide savings of over \$10 billion since SB 863's implementation.

Figure 1 – Summary of SB 863 Impact

	Total Cost or Savings (\$ mm)	Total % Impact on Losses & LAE
<b>Indemnity Cost Components</b>		
Increase in Weekly PD Min & Max	\$650	3.4%
Change to SJDB	\$40	0.2%
Replacement of FEC Factor in PD Rating	\$550	2.9%
Elimination of PD Rating Add-ons	-\$170	-0.9%
Elimination of Three-Tiered Weekly PD Benefits	-\$100	-0.5%
Elimination of <u>Ogilvie</u> Decision	-\$130	-0.7%
Indirect Impact on Overall Indemnity Utilization	-\$220	-1.2%
<b>Medical &amp; LAE Cost Components</b>		
Changes to Lien Filings	-\$480	-2.5%
Spinal Implant Hardware Reimbursements	-\$110	-0.6%
Changes to Ambulatory Surgical Center Fees	-\$80	-0.4%
IMR Impact on Frictional Costs	\$70	0.4%
IBR Impact on Frictional Costs	\$0	0.0%
Medical Provider Network Strengthening	-\$190	-1.0%
RBRVS Changes to Physician Fee Schedule	-\$330	-1.7%
Indirect Impact on Overall Medical Utilization	-\$1,770	-9.3%
<b>Total Cost Impact of All Items</b>	<b>-\$2,270</b>	<b>-11.9%</b>

<sup>1</sup> See *WCIRB Evaluation of the Cost Impact of Senate Bill No. 863* (WCIRB, updated October 12, 2012).

<sup>2</sup> See *Senate Bill No. 863 WCIRB Cost Monitoring Report – 2016 Retrospective Evaluation* (WCIRB, November 17, 2016) for the WCIRB's most recent comprehensive report on SB 863.

## Updated Results by Component

### Indemnity Benefits

SB 863 provided for increases in the minimum and maximum weekly permanent disability (PD) benefits and a number of changes to the manner in which PD impairment ratings are computed. These have resulted in both increases and decreases to indemnity costs, summarized as follows:

- Increase in the weekly PD minimum and maximum (effective January 1, 2013) with a further increase in the weekly PD maximum (effective January 1, 2014)
- Replacement of the factor for future earning capacity (FEC) in PD ratings, which previously ranged from 1.1 to 1.4, with a uniform 1.4 adjustment factor
- Changes to the supplemental job displacement benefit (SJDB) to be a maximum of \$6,000 and the basis upon which the SJDB is paid<sup>3</sup>
- Elimination of increases to PD impairment ratings with add-ons for psychiatric impairment, sleep disorder, or sexual dysfunction, with the exception of psychiatric add-ons for catastrophic injuries
- Elimination of the previous system of three-tiered weekly PD benefits based on the status of a return-to-work offer
- Effective elimination of the impact of the *Ogilvie* decision<sup>4</sup> because of elimination the FEC adjustment factor

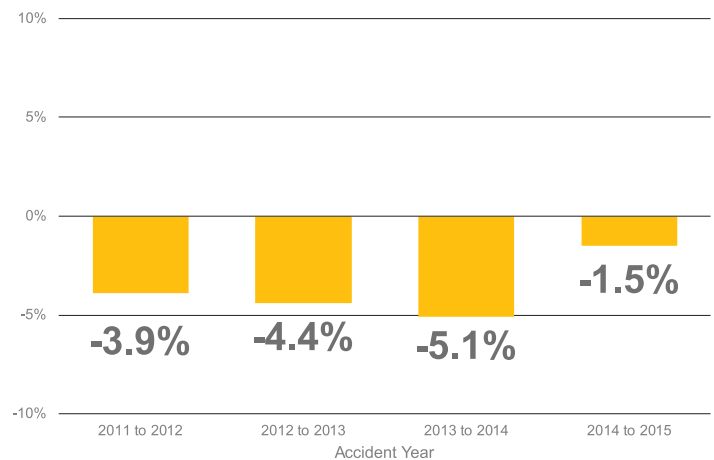
Detailed estimates of the cost impact of these components based on post-SB 863 experience is included in the WCIRB's 2016 SB 863 cost monitoring report. As additional data on PD claims has emerged since 2016, the WCIRB has found that many of these cost components have continued to emerge consistently with earlier estimates.<sup>5</sup> In particular, the utilization of PD add-ons has diminished significantly<sup>6</sup> and other changes intended to simplify the PD rating and medical treatment resolution processes has significantly increased the speed at which PD claims have settled. The WCIRB estimates that of all the SB 863 provisions directly impacting indemnity benefits have resulted in a net annual increase in total system costs of \$0.8 billion, or 4.4% of total losses and LAE.

In addition to the components of SB 863 directly impacting indemnity benefits, provisions of SB 863 have accelerated the medical treatment resolution process, thereby reducing overall indemnity cost levels. Figure 2 shows the changes in estimated average indemnity costs per claim after adjusting, or "on-leveling", for the measurable components of SB 863 as well as for annual wage inflation impacting indemnity costs. There was a significant decline in these average on-level costs over the 2012 to 2015 period driven by reduced temporary disability duration and permanent disability ratings. Specifically, the WCIRB

estimates that temporary disability duration has declined by an additional 5% since the implementation of SB 863 and average and median PD ratings have also declined.<sup>7</sup> In consideration of these factors, the WCIRB estimates that SB 863 has indirectly reduced indemnity costs by 4.5%, or \$0.2 billion savings annually.

Figure 2 – Projected Changes in On-Level Indemnity Severity

Change in On-level Indemnity Cost per Indemnity Claim



Source: WCIRB aggregate financial data and projections as of March 31, 2019. On-level adjustments include the measurable components of SB 863 and the impact of wage inflation on indemnity benefits but does not include any adjustment for the impact of SB 863 on overall indemnity cost levels.

### Medical Benefits

SB 863 provided for changes to medical fee schedules as well as a number of structural changes to the medical benefit delivery system. These changes, which generally became effective in 2013, have significantly reduced medical costs and include:

- Restrictions on lien filings
- Elimination of duplicate payments for spinal surgery implant hardware
- Reduction in ambulatory surgical center (ASC) fees
- Strengthening of medical provider networks (MPN)
- Creation of the independent medical review (IMR) and independent bill review (IBR) processes to handle medical treatment and billing disputes
- Changes to the physician fee schedule to be based on the Resource-Based Relative Value Scale (RBRVS) (effective January 1, 2014 and phased in over a four year period)

<sup>3</sup> In addition to the SB 863 changes to the SJDB, the issuance of a SJDB is also the trigger to receive an additional benefit from the \$120 million return-to-work fund provided by SB 863.

<sup>4</sup> *Ogilvie v. City and County of San Francisco* (WCAB 2009 en banc decision), which allowed for the FEC component of the PD rating to be rebutted using other information.

<sup>5</sup> See Item AC17-12-02 of the December 5, 2018 WCIRB Actuarial Committee Agenda for more information. Although most components of SB 863 directly impacting indemnity benefits have been emerging as projected, SJDB costs have increased, though they represent an overall low proportion of total indemnity costs (approximately 2%).

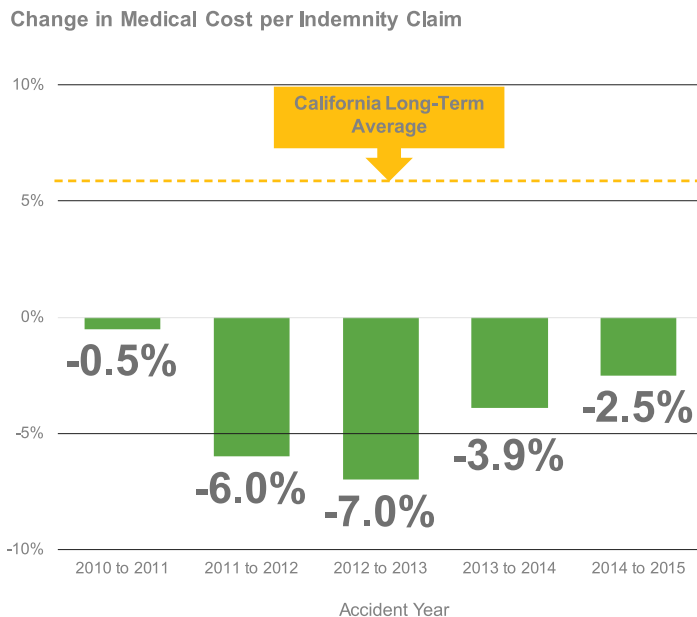
<sup>6</sup> In *Wilson v. State of California, Cal Fire* (WCAB May 2019 en banc decision), the WCAB set a number of criteria to determine if an injury is catastrophic and eligible for an add-on to PD for psychiatric impairment, some of which may have been broader than the assumptions made by the WCIRB in its prospective SB 863 cost estimate. The WCIRB will continue to monitor the impact of the *Wilson* case on PD ratings.

<sup>7</sup> See Item AC17-12-02 of the August 1, 2019 WCIRB Actuarial Committee Agenda for more information.

Detailed estimates of the cost impact of these components based on post-SB 863 experience is included in the WCIRB's 2016 SB 863 cost monitoring report. For a number of components directly impacting medical costs, including changes to lien filings, ASC fees, spinal implant reimbursements, and MPNs, the data emerging since 2016 has continued to show savings consistent with prior estimates. In addition, although the first two years (2014 and 2015) of the four-year transition of the physician fee schedule to an RBRVS basis showed significant savings in overall physician costs, the final two years of the phase-in (2016 and 2017) are showing an overall modest increase in physician fees; this is generally consistent with the WCIRB's prospective estimates. Also, as expected there have been increases in primary care service costs (such as evaluation and management and physical medicine) and decreases in specialty care service costs (such as anesthesia, radiology, and surgery).<sup>8</sup> The WCIRB estimates the total impact of these provisions directly affecting medical costs have resulted in an annual decrease in total system costs of \$1.2 billion, or 6.3% of total losses and LAE.

A number of provisions of SB 863, including the creation of IMR and IBR, have indirectly led to significant reductions in the overall utilization of medical services. In particular, the utilization of pharmaceuticals, particularly opioids, has decreased significantly.<sup>9</sup> In the WCIRB's 2016 report, the WCIRB estimated an overall 10% decrease to medical costs in addition to the savings resulting from specific components of SB 863. Figure 3 shows changes in average medical costs per claim. The reductions for 2011 through 2015 are significantly below the long-term average rate of medical inflation in California of approximately 6%. As declining medical loss development emerging on post-SB 863 accident years has continued, the WCIRB currently estimates a 17% reduction in medical services utilization, or \$1.8 billion in SB 863 savings annually.

Figure 3 – Projected Changes in Medical Severity



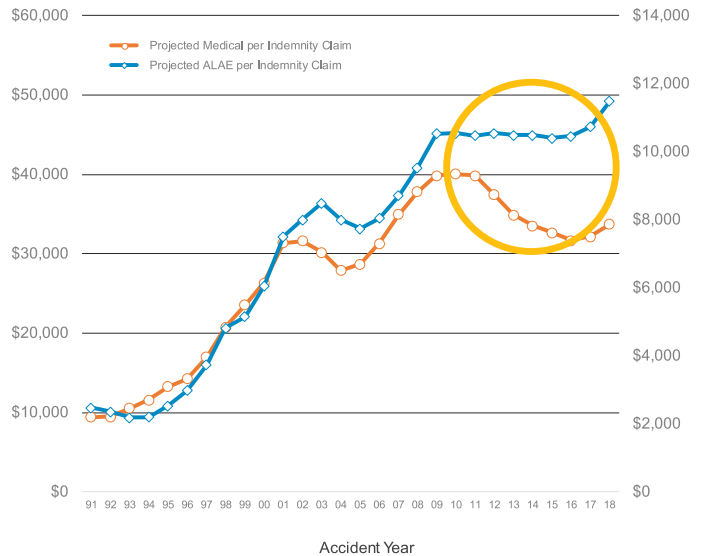
Source: WCIRB aggregate financial data and projections as of March 31, 2019.

### Frictional Costs

A number of SB 863 provisions, including those related to lien filings, IBR, and IMR, were intended to reduce frictional, or LAE, costs. As noted in the WCIRB's 2016 SB 863 cost monitoring report, although lien filings have decreased significantly, lien-related disputes have continued to occur prior to the filing of a lien, thereby keeping claims handling costs high. In addition, the number of IMR reports filed has been significantly higher than initially projected and this high level of IMR reports has continued through 2019. Medical-legal reports and expedited hearings on medical treatment issues, which were expected to be substantially replaced by the IMR process, have also continued to occur at or above pre-SB 863 levels.<sup>10</sup> As a result, the savings to LAE coming from SB 863 originally projected by the WCIRB have not materialized. In fact, in the years immediately following the implementation of SB 863, allocated loss adjustment expense (ALAE) costs increased significantly. As Figure 4 shows, although projections of ALAE costs for the immediate post-SB 863 years have moderated recently, they have not declined to the degree that medical costs have.

Figure 4 – Ultimate Medical and ALAE per Indemnity Claim

### Comparison of Average Medical and Average ALAE per Indemnity Claim



Source: WCIRB aggregate financial data and projections as of March 31, 2019. Medical cost containment program costs are included in medical for all years for consistency. ALAE is for private insurers only.

<sup>8</sup> See Item AC17-12-02 of the December 5, 2018 WCIRB Actuarial Committee Agenda for more information.

<sup>9</sup> See California Workers' Compensation Aggregate Medical Payment Trends – Updated through Calendar Year 2018 (WCIRB, September 2019) for more information.

<sup>10</sup> See Exhibits M8 and E13 of Item AC19-08-01 of the August 1, 2019 WCIRB Actuarial Committee Agenda for more information.

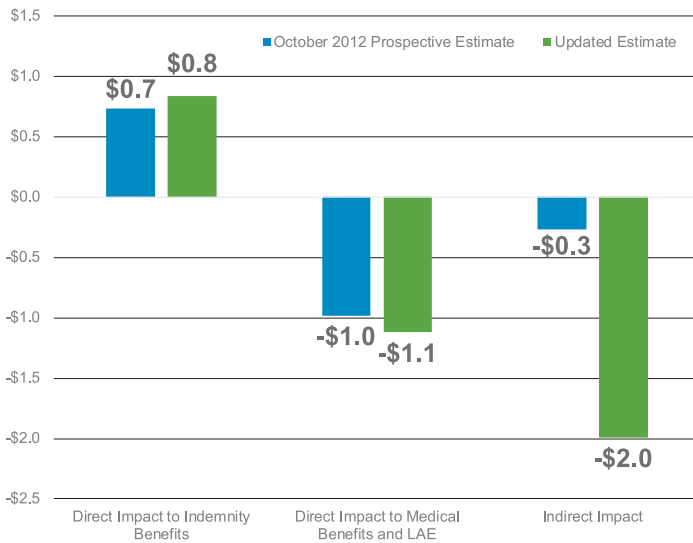
## Conclusion

SB 863 has achieved one of its original legislative intents to more than offset the increased permanent disability benefits though reform savings. Although the savings have generally not come from reduced frictional costs as initially expected, many of the provisions of SB 863 have sharply accelerated the claim resolution process which has resulted in significantly reduced utilization of indemnity and medical benefits. As shown in Figure 5, the indirect savings to indemnity and medical costs are more than twice the increases to PD benefits and are significantly greater than originally projected.

In large part due to the sustained impact of the SB 863 changes, cost levels in California have not returned to historical rates of inflation as had occurred in prior post-reform periods. In addition, continued attention to reform the workers' compensation system since SB 863, including Senate Bill No. 1160, Assembly Bill No. 1244, the new drug formulary adopted pursuant to Assembly Bill No. 1024, and efforts to fight medical provider fraud have also contributed to the recent modest cost trends and continued premium rate decreases.

Figure 5 – Comparison of SB 863 Estimates

### Annual Total System Impact of SB 863 in \$Billions



#### Notice

This *SB 863 Cost Monitoring Update* (Report) was developed by the Workers' Compensation Insurance Rating Bureau of California (WCIRB) for the convenience of its users. The WCIRB has made reasonable efforts to ensure the accuracy of this Report. You must make an independent assessment regarding the use of this Report based upon your particular facts and circumstances.

© 2019 Workers' Compensation Insurance Rating Bureau of California. All rights reserved.

No part of this work may be reproduced or transmitted in any form or by any means, electronic or mechanical, including, without limitation, photocopying and recording, or by any information storage or retrieval system without the prior written permission of the Workers' Compensation Insurance Rating Bureau of California (WCIRB), unless such copying is expressly permitted in this copyright notice or by federal copyright law. No copyright is claimed in the text of statutes and regulations quoted within this work.

Each WCIRB member company, including any registered third party entities, (Company) is authorized to reproduce any part of this work solely for the following purposes in connection with the transaction of workers' compensation insurance: (1) as necessary in connection with Company's required filings with the California Department of Insurance; (2) to incorporate portions of this work, as necessary, into Company manuals distributed at no charge only to Company employees; and (3) to the extent reasonably necessary for the training of Company personnel. Each Company and all agents and brokers licensed to transact workers' compensation insurance in the state of California are authorized to physically reproduce any part of this work for issuance to a prospective or current policyholder upon request at no charge solely for the purpose of transacting workers' compensation insurance and for no other purpose. This reproduction right does not include the right to make any part of this work available on any website or any form of social media.

Workers' Compensation Insurance Rating Bureau of California, WCIRB, WCIRB California, WCIRB Connect, WCIRB Inquiry, WCIRB CompEssentials, X-Mod Direct, eSCAD, Comprehensive Risk Summary, X-Mods and More and the WCIRB California logo (WCIRB Marks) are registered trademarks or service marks of the WCIRB. WCIRB Marks may not be displayed or used in any manner without the WCIRB's prior written permission. Any permitted copying of this work must maintain any and all trademarks and/or service marks on all copies.

To seek permission to use any of the WCIRB Marks or any copyrighted material, please contact the Workers' Compensation Insurance Rating Bureau of California at [customerservice@wcirb.com](mailto:customerservice@wcirb.com).