MASSACHUSETTS
WORKERS' COMPENSATION ADVISORY COUNCIL

REPORT ON
THE ANALYSIS OF FRICTION COSTS
ASSOCIATED WITH THE MASSACHUSETTS
WORKERS' COMPENSATION SYSTEM

VOLUME I - EXECUTIVE SUMMARY

Prepared by:

Milliman & Robertson, Inc.
Danvers, MA

and

John Lewis, Independent Consultant

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VOLUME I : EXECUTIVE SUMMARY

SECTIONS:

INTRODUCTION

I. BACKGROUND

II. SCOPE OF THE PROJECT

III. FINDINGS AND RECOMMENDATIONS

IV. SOURCES OF DATA AND INFORMATION

V. REPORT LIMITATIONS

INTRODUCTION

This report was prepared by an interdisciplinary team consisting of John Lewis, an independent consultant, and Milliman & Robertson (M&R), an independent actuarial consulting firm. Due to the length of the report, we have divided it into three volumes as follows:

Volume I, the Executive Summary, which you are now reading contains the following Sections:

Section I - BACKGROUND
Section II - SCOPE OF PROJECT
Section III - FINDINGS AND RECOMMENDATIONS
Section IV - SOURCES OF DATA AND INFORMATION
Section V - REPORT LIMITATIONS

John Lewis prepared the report that appears in Volume II and analyses the following issues:

Section VI - ASSESSMENT OF CONCILIATION PROCEDURES
Section VII - THE LUMP SUM PROCESS
Section VIII - ASSESSMENT OF ATTORNEY FEE STRUCTURE

Meanwhile, M&R prepared the report that appears in Volume III, which discusses the following issues:

Section IX - RESEARCH AND ANALYSIS OF YEARLY CLAIM FILINGS

Section X - DISTRIBUTION OF PREMIUM AND BENEFIT DOLLARS MASSACHUSETTS VS OTHER STATES

Section XI - OTHER AREAS OF ANALYSIS

Each Volume contains a brief introduction and a table of contents section. Although we have divided the report into three volumes, we would emphasize that Volume I which includes the Background, Scope of Project, Sources of Data and Information and Report Limitations sections should be read in conjunction with and be considered an integral part of Volumes II and III.

SECTION I - BACKGROUND

A Workers' Compensation system can be viewed as having three major constituencies:

Workers, who are the intended beneficiaries of the system,

Employers, who pay the cost of the system, and

Insurance companies which act as financial intermediaries in providing the required benefits.

Self-insured employers can be viewed as playing two roles, that of an employer and that of an insurance company.

A symptom of problems in the Workers' Compensation system is dissatisfaction by one or more of the three groups. Workers may believe that benefits are too low. Employers may believe that the cost of the system is too high. Insurers may believe that the premiums are inadequate to support the claims, expenses, and risks that they bear.

In 1985 a number of legislative changes were enacted to the Workers' Compensation system in Massachusetts, These were

designed to accomplish a number of objectives including the following:

1. Streamline the adjudication system,
2. Adjust benefits levels,
3. Increase the speed of dispute resolution,
4. Improve rehabilitation services.

Since the passage of the 1985 law changes, there have been three rate level changes as follows:

1/1/88	+19.9%
1/1/89	+14.2%
1/1/90	+26.2%

The combined impact of these three changes was an increase in manual rates of over 70%. Even with this substantial rate activity a number of carriers feel that the current pricing level is inadequate. During the same period of time, the volume of business written in the involuntary market has risen from 20% in 1986 to 30% in 1988 to an estimated 40% in 1989.

There is considerable dissatisfaction with the Massachusetts Workers' Compensation system. The dissatisfaction exists even though, based on data reported to the Department of Industrial Accidents (DIA,) it seems that the number of first reports of

SECTION II - SCOPE OF THE PROJECT

The scope of the project as outlined by the Advisory Council includes:

1. Assessment of Conciliation Procedures - Assessment of the conciliation procedure in relation to its intended goal of achieving early case resolution, reducing litigation, and identifying/narrowing issues and recommendations for change. (Volume II, Section VI)

2. The Lump Sum Process - Assessment of the lump sum approval process in its utilization of personnel and its institution of procedures to facilitate efficient and equitable lump sum settlements. Identification of the economic impact of lump sum settlements for workers, employers and insurers. (Volume II, Section VII)

3. Assessment of Attorney Fee Structure - Assessment of the attorney fee structure in its relation to claims flow through the conciliation and dispute resolution processes. Determine whether attorney fee schedules influence the settlement of claims at various points of claims flow process. (Volume II, Section VIII)

4. Research and Analysis of Yearly Claim Filing - Research and analysis of yearly claim filings to determine causes of increases or decreases in filings, impact on system delays, and systemic factors which encourage or discourage the filing of claims. (Volume III, Section IX)

5. Distribution of Premium Dollars - Identification of how premium dollars are ultimately distributed and how such distribution compares with the allocation of premium dollars in other states. (Volume III, Section X)

In addition, we added item 6 below to the project list, in that the items were identified to be of interest to the Advisory Council.

6. Other Areas of Analysis - Analysis of the causes of rate level changes since 1988 as well as the impact of economic factors during the period. (Volume III, Section XI)

As our proposal indicated, an interdisciplinary team was required to handle the issues in this project. As a result, our proposal represented a joint effort between M&R and John Lewis. M&R's role was to provide the actuarial input to the study, technical support, and to oversee the drafting of reports. With this in mind, the analysis, findings, and recommendations as set forth in Volume II, Sections VI, VII, and VIII are the result of John

Lewis' effort, based on his independent research and analysis. Volume III presents the results of Milliman & Robertson's research and analysis.

SECTION III - FINDINGS AND RECOMMENDATIONS

Set forth below is a brief summary of our findings from each of the major areas of the study. Readers are advised to study the individual sections in Volumes II and III in detail in order to gain an understanding of these findings and recommendations.

I. Assessment of Conciliation Procedures

Findings

1. The Conciliation process as currently practiced in Massachusetts does not appear to narrow issues.

   We were able to find little support among the people interviewed for the proposition that conciliation leads to significant narrowing of issues. One factor that may have a significant impact on the value of conciliation in narrowing issues is the time delay between conciliation and conference.

2. Two Important Conditions for Conciliation to be Successful are lacking in Massachusetts.

a. Delay Between Conciliation and Formal Dispute Resolution.

There must be little or no delay between the conciliation or similar activity and the more formal dispute resolution activities. If not, the conciliation effort will have little meaningful impact on many serious issues.

b. Relationship Among System Participants.

A good working relationship must exist among the attorneys, conciliators and judges, with timely, complete and consistent communication.

Recommendations

1. Allow conciliators the flexibility to use the telephone as well as conferences.

   Provide for initial conciliation efforts by telephone, with personal appearances limited to instances in which there is reason to believe that they are both necessary and would likely lead to resolution or substantial narrowing of issues.

2. Allow sanctions to be applied in certain cases.

Impose sanctions against lawyers, insurance carriers, employers and self-insurers that do not provide full disclosure of relevant information at or prior to conciliation, against attorneys that file claims prematurely, and against self-insurers and carriers that are not prepared to respond to conciliation recommendations at the time that they are made.

3. Limit the Issues Subject to Conciliation.

Limit conciliation to those issues for which there is a significant chance of success, such as initial liability questions that do not involve major medical and technical issues, medical bills, average weekly wage and loss of function/disfigurement.

4. Provide Educational Support for Conciliators.

Provide increased educational support for conciliators, attorneys and claims personnel, to improve conciliation skills, develop greater consistency in methodology and statistical reporting and obtain increased cooperation from the parties.

II. The Lump Sum Process

Findings

A. The Approval Process for Lump Sum Settlements.

1. Two Step Approval Process is Not Justified.

Although there is considerable respect for the individual disability analysts' efforts, there is a widely-held belief among those involved with the system that given the various time and resource pressures on the system and its participants, the two-step process is not of sufficient value to justify its continued use, and that comparable protection could be accomplished through some other type of approval process. With the exception of the disability analysts themselves, virtually every one of the members of the compensation community, including the Department of Industrial Accidents (DIA), who were interviewed regarding this issue indicated that in most instances there was little or no value to the two-step approval process.

2. Counseling Session of Questionable Value.

settlements, one of the goals of the process when it was adopted in 1985. For example, in a sample of 100 cases provided by the office of education and vocational rehabilitation, only 4 did not go on to settlement, and few of those had anything to do with the claimant changing his or her mind. In fact, lump sum utilization has increased substantially since the inception of the new approval process.

6. Counseling Can Catch Benefit Errors.

While the disability analysts report instances in which claimants benefited financially from the conference, such as through the correction of average weekly wage, or the discovery of unpaid medical bills, this occurs in other systems as well, despite their lower level of scrutiny and counseling.

7. Other Jurisdictions Use a Less Intensive Approval Process with Success.

Jurisdictions utilizing less intensive approval processes, including approval by affidavit, report that when such systems are used properly, the level of protection that is provided is very satisfactory. While there are states in which there are legitimate concerns

over the approval process, as was the case in Massachusetts prior to the law change, in virtually every instance the problems flow from a failure of those involved to take their responsibilities seriously, rather than an inherent weakness in the system.

8. Some Claimants May not Understand Their Rights.

Despite all of the efforts to provide claimants with accurate information, 27% of the telephone survey respondents indicated that at least one reason for settlement was that they were told that they had to settle. Since one of the goals of the approval process is to assure claimants that they do not have to settle their claims, this raises real questions as to whether the system is doing its job.

B. The Economic Impact of Lump Sums Settlements.

1. The possibility of a forced settlement unduly influencing claimants is not a significant factor in Massachusetts.

2. The economic repercussion on claimants of post-settlement return to work are significant.

3. Most arguments that the use of lumps sum settlements consistently raise system costs are subject to considerable debate.

4. There are possibilities that extensive use of lump sum settlements may bring about an increased volume of claims and increased costs in individual claims, especially as respects minor injuries.

5. The current backlog in the litigation process is having an important effect on increasing the costs of lump sums.

Recommendations

1. One Step Process.

   Use a single counseling and approval session, rather than the two that are now required.

2. Eliminate the Use of Administrative Law Judges (ALJ's) in the Lump Sum Approval Process.

   Vest approval authority in officials other than the ALJ's. A specific position could be created within the DIA for this purpose, or administrative judges or conciliators could be assigned the responsibility.

3. Settlement by Affidavit.

Permit settlement by affidavit in specific circumstances, such as when the claimant has returned to work, or is represented by counsel, or both. Based upon the information developed through the telephone survey, this would reduce the need for counseling and settlement hearings by approximately 25%.

4. Availability of Counseling Advice.

Permit the approving authority to refer individual cases to a disability analyst for counseling if deemed necessary.

5. Increase Settlement Agreement Information.

Increase the detail provided in settlement papers. Require that they include accurate reporting of information such as the basis for calculating average weekly wage, the period of time for which temporary disability benefits were or will be paid, the claimant's employment status, costs and fees to be paid, the results of the claimant's final or most recent medical examination, and whatever other information is normally

obtained through the counseling process. This will enable the approving authority to more quickly and effectively evaluate the proposed settlement, ask additional questions and reach a decision concerning approval.

6. Description of Claimant's Rights with Settlement Papers.

Include in the settlement papers a detailed description of the claimant's rights, and the impact of the settlement on those rights, and insure that claimants have read these statements or had them read to them.

7. Certification as to the Accuracy of Settlement Information.

Require that the claimant's attorney and the carrier or self-insurer certify to the accuracy of the information upon which the settlement is based. This does not mean that they should be required to vouch for all of the claimant's statements, but rather that reasonable efforts be made to insure that the factual information upon which the settlement is based is accurate.

8. Limited Random In-Depth Settlement Hearings.

Provide for limited random use of in-depth settlement hearings, with detailed review of settlement papers, terms and conditions, to encourage those involved with settlements to comply with the information and disclosure requirements described above.

9. Cooling Off Period After Approval.

Permit a cooling-off period after approval, so that claimants will not feel that they must make an irrevocable decision within the few minutes allotted to them before the approving authority.

We have not performed an analysis of the potential cost savings to the system of these recommendations, but it is clear that some of these items (Specifically 1 and 3) will reduce both the process time and costs.

III. Attorney Fee Structure

Findings

1. In general, the attorney fee structure is not being abused, but there may be some exceptions to this mode of behavior.

2. The presence of the current attorney fee structure may help serve to discourage the informal contact between parties that may lead to the prompt resolution of issues.

Recommendations

1. Attempt to resolve minor issues informally, before the Reconciliation procedure.

   Require that the DIA attempt to deal with minor issues such as small medical bills informally before conciliation is invoked and a fee generated. A few telephone calls before conciliation begins should in many cases be at least as effective as the existing process.

2. Require disclosure of factual information before the Insurer is required to act.

Require full disclosure of medical reports and other relevant factual information before the carrier or self-insurer is required to act or, alternatively, permit a specific defense to the payment of fees, based upon failure to make complete disclosure. This will limit the ability to hide evidence in order to earn a fee.

3. Administrative Oversight of Insurers.

Provide for active administrative oversight of carrier and self-insurer activity, with imposition of penalties for improper behavior. This is sometimes referred to as practices review. It requires the use of agency personnel to review claims files either randomly or in instances in which there is reason to believe that there has been improper performance. It supplements other penalty provisions, and is intended to discourage the kind of behavior that leads to otherwise unnecessary claims and conciliation activity.

4. Guidelines for Impairment and Disfigurement.

Establish written guidelines for evaluating and compensating disfigurement and impairment, or provide DIA specialists to furnish informal evaluations. This would

help provide consistency, and if implemented effectively would provide a more objective basis upon which these benefits are to be paid, reducing the opportunity for dispute.

5. Permit the payment of fees even in the absence of a lump sum settlement.

This option is somewhat more difficult in Massachusetts because of the open-ended nature of Section 35 benefits, which makes it more difficult to determine the value of the benefits obtained, to which a percentage fee can then be applied. This can be dealt with, as it is in Connecticut and other states, by paying the fee on a periodic basis, as a percentage of each of the claimant's benefit payments.

6. Provide for Low Level Fees when warranted.

Provide for the payment of a lower-level attorney's fee in instances in which services have been rendered, but no fees provided. For example, Illinois provides what is sometimes referred to as a "hand-holding" fee, paid by the claimant, to deal with situations in which there is no litigation or settlement, but some services rendered.

IV. Analysis of Yearly Claim Filings

Findings

1. Data on the number of Claims and Requests for Discontinuances and the number of Referrals to Conciliation available since 1987 indicates that the level of claims reported has increased substantially, with a large upward movement taking place in the middle of 1988.

2. It is difficult to identify specific causes for increasing frequency in 1988, but two possible items that may have influenced the level of claims include the increase in legal fees in 1988 and a downturn in the economy in 1988.

3. The overall level of claim activity is reported to be higher under the new law than under the old law. Possible causes for this include:

    a. Lawyers are allowed to advertise.
    b. Injured workers are more aware of their rights.
    c. The system does not discourage filing of claims.

d. The Prevalence of Lump Sums may lead to an increase in the frequency of small claims.

4. There does appear to be a potential seasonal influence on the number of claim filings. For example, 1987 and 1989 show similar monthly movements from January through July, but then they diverge. In addition, 1988 and 1989 show similar changes through approximately 10 months. In summary, the seasonal effect seems to generally show a decrease in June (which typically follows a surge in May.) August also may show a surge followed by a drop in September.

Based on the surveys and interviews conducted by John Lewis in Volume II, we have identified the following list of possible Systemic factors that may lead to delays:

1. Too many claims are coming in compared to the system resources available to process them.

2. The Two-step process required for Lump Sum settlements is time consuming.

3. The built in delay caused by the system backlog. It takes up to six or seven months to get a case heard.

4. The files at the DIA are poorly organized. This can add to delays by making important information hard to find, or by processing incorrect information and then having to go back and adjust for errors.

5. Increasing use of attorneys will add to delays.

6. The system is over-utilized by people who are not prepared. System resources could be used more efficiently.

V. The Relationship Between DIA Data and Insurance Industry Data

Findings

1. The insurance industry does not maintain data analogous to DIA Claim data.

2. DIA data is generally reported to be of questionable quality.

3. The level of first reports and incidents in DIA data are not necessarily inconsistent with insurance industry figures.

4. Due to the shift to a service economy, there has been change in the class mix. Based on this shift, we would expect fewer injuries, all other things being equal.

VI. The Distribution of the Premium Dollar in Massachusetts

Findings

1. There is a general lack of quality data in all states to analyze the amounts paid to claimant's attorneys.

2. Based on data from Massachusetts, a rough estimate is that in 1988, approximately 3% of insurer outlays went to Claimant's Attorneys, 76% went to benefits, 19% went towards insurance company expenses and 3% went to dividends to policyholders. Data from other states on amounts to claimant's attorneys is not readily available. (The amount is included with losses). However, ignoring the split of insurer losses into benefits and amounts to claimant's attorneys, the distribution in Massachusetts seems to be similar to that in other states.

II. The Distribution of Benefit Dollars in Massachusetts Compared to Other States.

There do not appear to be any outstanding differences between Massachusetts and the other states. In addition, the recent cost increases in Massachusetts do not seem to be driven by significant benefit cost differences with other states.

SECTION IV - SOURCES OF DATA AND INFORMATION

In the course of our analysis, we relied on data and information from a number of different sources including:

1. Data from the Department of Industrial Accidents,

2. Surveys of Claim Conciliators,

3. Telephone Survey of Claimants,

4. Interviews with Participants in the Workers' Compensation system including Claims Personnel, Lawyers, and Judges,

5. The Workers' Compensation Rating and Inspection Bureau of Massachusetts and

6. Other Insurance Industry Data.

We did not audit this data and information.

SECTION V - REPORT LIMITATIONS

We relied on the data and information sources sited in the previous section. We did not audit this data. Since insurance is subject to uncertainty regarding future events, actual results derived from changes in practices, procedures, or legislation may not have the intended effect.

We are available to meet with the Advisory Council to discuss this report.

It also should be noted that at our initial meeting with the Advisory Council, we discussed the lack of quality data available at the Department of Industrial Accidents and that it would prove to be a handicap to our research. In addition, we discussed the fact that even though there was a delay in starting the project due to delays in securing contract approval, the time frames as set forth in the original request for proposals would not be adjusted accordingly. The lack of quality data and the very limited time frame for conducting this study, did impact on the depth of our analysis.

As mentioned previously, Volume II of this report is based on the analysis and research efforts of John Lewis, an independent consultant, while Volume III of the report is based on the work of Milliman & Robertson, Consulting Actuaries.