



# The impact of US health care reform on Workers' Compensation and other Casualty lines



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## **1. Introduction**

In March 2010 Congress passed sweeping reform of the US health care system. While it will take months and in some cases years to know the full impact of the reforms, several key themes are emerging for Property & Casualty insurers, including the impact on Workers' Compensation lines and liability coverages.

The reform is not specifically directed at the Workers' Compensation system or the tort liability system. Some provisions regulate health insurer practices that are not applicable to Workers' Compensation medical and others create mechanisms to expand the insured population. However, the legislation may have an indirect effect on Workers' Compensation medical costs and on the cost structures underlying the medical portion of tort liability settlements and judgments. This will depend on the success (or failure) of provisions in the legislation designed to increase the supply of medical providers to meet increasing demand and efforts to bend the cost curve downward.

This report examines the principal provisions of the legislation and offers observations on the potential impact on insurers that write Workers' Compensation and other casualty lines of business. It is by no means exhaustive, and due to its early release it does not purport to explain the full impact of the legislation. In fact, the major provisions of the legislation do not take effect until 2014, and any cost changes affecting Casualty lines are expected to emerge over time.

## **2. Workers' compensation**

The Senate bill, as amended by the Reconciliation bill, has now been enacted into law. The focus of the reform is on the broad health care system, as less than 5% of total health care costs are in Workers' Compensation medical. Concerns that health care reform would mandate 24 hour coverage through the regular health insurance mechanisms via a one-payer system were unfounded as the bill was finalized and enacted into law.

Still, this massive social legislation is bound to have some impact on Workers' Compensation costs over time. Whether or not US health care reform increases or decreases costs in Workers' Compensation, the impacts are likely to be gradual and will likely be reflected in normal Workers' Compensation ratemaking processes. Many of the most important provisions do not even take effect for several years. Nevertheless, it is important to be alert to any sudden demand-supply imbalance problems or immediate cost shifting pressures as features of the law are implemented.

While future impacts are speculative right now, insurers are advised to follow events closely as they unfold and consider what they mean for Workers' Compensation medical.

There are four objectives addressed by the reform. We will consider each objective, how and when it is to be accomplished, and potential impact on Workers' Compensation costs.

### **3. Objective 1: Reform private health care insurance**

Exclusion of pre-existing conditions is ended immediately for children and ends in 2014 for adults. Health care rescissions (canceling or non-renewing policies for insureds with bad health) are prohibited, effective in 2010.

Lifetime limits are prohibited and use of annual limits is restricted in 2010 (and annual limits are prohibited in 2014).

Modified community rating will be in place by 2014, where health insurers may vary premiums only by age (maximum 3:1 differential), tobacco use (maximum 1.5:1 differential), geography and family size.

These reforms will have little to no impact on Workers' Compensation as they address issues in the health insurance system that are not problems with Workers' Compensation. There is no indication that reform will regulate in any way Workers' Compensation cancellation/non-renewal practices or Workers' Compensation pricing. Workers' Compensation medical is virtually unlimited, pre-existing conditions are irrelevant to the question of compensability for a workplace injury/disease and a terminated policy has no impact on the Workers' Compensation insurer's responsibility for a worker injured during the period of coverage.

#### **4. Objective 2: Reduce the uninsured population**

The bulk of these reforms are not effective until 2014, although there are some stopgap measures in place prior to that date.

Health insurance exchanges will be opened in each state in 2014. Individuals and small employers will be able to purchase insurance through these exchanges. Approved private insurers will offer four standardized health insurance packages for purposes of simplified comparison.

As of 2014, there will be an individual mandate requiring everyone to have acceptable insurance coverage. Penalties for non-compliance will rise gradually over time, but will be well under the cost of actual insurance coverage for an individual or family. Questions of how these modest penalties will be enforced are still unanswered.

As of 2014, Medicaid eligibility will be expanded to 133% of poverty level and there will be health care tax credits available through the exchange on a sliding scale for individuals or families with incomes up to 400% of poverty level.

As of 2014, there will be an employer mandate requiring an employer of 50 or more workers to either provide health insurance or face a penalty based on size of the work force if even one of the employer's workers purchases individual coverage through the exchange and receives a tax credit. The penalty is assessed at \$2,000 for each full time employee in excess of 50 employees.

Immediate stopgaps include a provision that all health insurance plans provide coverage for single dependent children up to age 26 under the parents' health care insurance, a provision that establishes a temporary reinsurance program for companies that provide early retiree benefits (ends when the exchanges are in place) and a provision that offers a temporary high risk pool for people with pre-existing conditions until pre-existing conditions are barred in 2014.

Major reductions in the uninsured population could have a positive effect on Workers' Compensation costs. Those newly insured may be less likely to attempt to bring a non-work injury into the Workers' Compensation system.

However, keep in mind that Workers' Compensation involves no cost sharing on medical treatment and also provides an indemnity benefit not available in health insurance. The Massachusetts health insurance reform contains similar provisions of exchange, subsidies, individual and employer mandates, and while the uninsured population has been effectively reduced, after two years there has been no measurable impact on Workers' Compensation utilization.

#### **5. Objective 3: Bend the cost curve downward**

Health insurance plans in the individual and small group market must spend 80% of premiums on medical services; the requirement is 85% in the large group market.

Insurers that don't meet these thresholds must provide rebates to policyholders. (2011)

"Wellness" is a major focus of the reform. In new health insurance plans preventive care is to be provided with no co-pays, and maximum "out of pocket" deductibles regulated. (2011)

A number of initiatives will be phased in over time and will address both wellness and innovative compensation models. In most cases these will affect the federal medical programs: Medicare, Medicaid and/or CHIPS. However, successes with these approaches are likely to spill over into the private market, especially into those programs listed on the exchanges. Some of the major initiatives are:

- New interagency council will fund and promote prevention and public health programs. (2010)
- HHS will develop a national quality strategy and implement quality improvement programs. (2010)
- A private, non-profit institute will be established to research comparative effectiveness of health treatments and strategies. (2010)
- A new Center for Medicare & Medicaid Innovation will test innovative payment and service delivery models to reduce costs and enhance quality. (2011)
- Payment reforms will be implemented to encourage physicians to join together in “accountable care organizations” to gain efficiencies and improve quality. (2012)
- A value based purchasing program will be established to incentivize enhanced quality outcomes for acute care hospitals. (2012)
- New financial incentives will be established to encourage hospitals to reduce preventable readmissions. (2012)
- A pilot program will address payment bundling where hospitals and doctors are paid based on overall service to the patient, rather than on individual services. (2013)
- HHS will implement enhanced institutional provider reporting for eventual value-based purchasing. (2014)
- An independent payment advisory board will be established to lower health care costs while improving health outcomes, and a physician value-based payment program will be created. (2015)

These reforms could affect Workers’ Compensation in three ways: two positive and one negative.

Positive: Workers’ Compensation insurers can learn some valuable lessons and best practices from health insurers who implement successful wellness programs (eg resulting in a decrease in obesity).

Positive: To the extent insurers can adapt results-based compensation to the Workers’ Compensation system, they could benefit from that as well.

Negative: However, to the extent that cost containment ends up meaning the government starves the provider community, insurers could face cost shifting into the Workers’ Compensation system.

The impacts of wellness and new compensation models are likely to be felt gradually, over a long period of time. We do not expect any immediate developments here.

#### **6. Objective 4: Expand access to primary care services**

There are a number of provisions that address incentives to encourage an additional supply of primary care providers, particularly health care facilities in rural areas. If reform is successful in decreasing the uninsured, it will be essential that providers expand to meet the new demand. Even in a regulated market such as health insurance, increased demand with stable or falling supply is likely to increase health care costs, not decrease them. There is some concern that in Massachusetts health insurance costs have been increasing largely because of a demand-supply imbalance.

Such cost pressures could impact Workers’ Compensation negatively as well and possibly over a relatively short period if the 2014 reforms stimulate a large increase in the number of insured before health care infrastructure to service them. Again, Massachusetts may provide early indications of what to expect nationally from 2014 on.

## **7. Special provisions affecting workers' compensation directly**

While the health care reform law for the most part does not directly apply to the Workers' Compensation system, there is at least one special provision that does apply. The 1981 Black Lung Benefits Act eliminated the presumption that a lung disease was contracted on the job.

The 2010 health care reform bill repeals that provision and replaces it with a presumption that a mine worker with 15 years or more service who suffers a lung disease contracted it on the job. It will now be difficult for employers to argue that a lung problem is caused by factors other than work, such as smoking. This new provision is retroactive to claims filed after January 1, 2005, so it will affect both old and new claims. Estimates point to increased expenses potentially in the hundreds of millions of dollars. Any Workers' Compensation arrangements with exposure to mining OD will have to consider the impact of the new standard.

The health care bill, as amended by reconciliation, is literally thousands of pages of arcane legislative language. It is difficult to know everything within those pages, at least initially. Other special provisions that would directly affect Workers' Compensation could emerge over time and it's important to stay abreast of those developments.

## **8. How will health care reform be funded?**

Some funding mechanisms should have no impact on Workers' Compensation medical costs. These include:

- Reductions of government contributions to Medicare Advantage will be phased in beginning in 2011.
- Excise tax on indoor tanning salons (2010).
- Medicare tax will be increased 0.9% on incomes above 200K (250K married filing jointly), and the full Medicare tax will be applied to net investment income for that income level (2013).
- Medicare Part D employer subsidy will be eliminated (2013).
- Annual fee (market share based) on health insurer providers (2014).
- Excise tax on high cost employer-sponsored health care plans (2018).

Other funding mechanisms may indirectly affect Workers' Compensation medical costs. These include:

- Annual fee (market share based) on pharmaceutical manufacturers (2011).
- Excise tax on medical device manufacturers (2013).
- Ongoing efforts to "crack down" on Medicare/Medicaid "waste, fraud, and abuse".

As health services providers (pharma, medical devices) pass on fees and taxes, this could drive up Workers' Compensation costs. If cracking down on waste, fraud and abuse becomes merely an excuse for reducing legitimate payments to providers, this could create cost shifting into the Workers' Compensation system.

## **9. Other casualty lines**

The impact of US health care reform is even more indirect for the other Casualty lines than for Workers' Compensation medical. While Workers' Compensation directly funds the medical care of injured workers and participates directly in cost containment efforts, the liability lines pay judgments and settlements determined only in part by actual and estimated future medical costs.

Medical cost trends will affect liability claim values, most likely on a gradual basis that will be reflected in the pricing of liability coverage. Any future impact is speculative at this point and there is a possibility of either increasing or decreasing cost trends as a result of the legislation.

## **10. General/Motor liability impacts**

Liability insurers bear ultimate responsibility (up to their policy limits) for health care costs in cases where an insured is legally responsible for injury to another, even if a health insurer first compensates the injured party. Health care reform does not change this situation.

If cost control efforts piloted in the reform are effective and become widespread, this would have a positive effect on present and future medical costs that underlie the medical portion of liability awards. Expert testimony could establish any proven efficacy of cost containment in estimating a fair value for future medical expenses.

Expansion of the medically insured population may have a positive impact on medical costs reimbursed by liability awards. The medical expenses accepted by a health insurer and subrogated to the liability insurer may be less than the amount of a medical lien that is based on whatever the medical provider elects to charge for the services.

It's unlikely Workers' Compensation insurers will experience a positive impact as injured persons simply use their medical insurance for an injury instead of going to the trouble of litigation to recover medical costs. The possibility of winning additional sums for pain and suffering, for example, would continue to make the tort alternative attractive. Moreover, health insurers would drive tort actions via subrogation rights.

If the government is unsuccessful in incentivizing increased supply of medical services, the resulting demand-supply imbalances with expansion of insureds could increase the cost of medical services. This would lead to higher medical cost trends and ultimately to higher liability costs.



## **11. Medical malpractice liability impacts**

While medical malpractice tort reform was a hot topic during the health reform debate, the final law does not include provisions specific to litigation reform. In 2011, the Secretary of Health & Human Services is authorized to award five-year demonstration grants to states to develop, implement and evaluate alternative medical liability reform initiatives such as health courts and early offer programs. For the time being, one must assume that there will be no effective federal reform measures on which to rely for cost containment.

There are some possible outcomes of health care reform that may have special impacts on medical malpractice insurers (and their reinsurers):

- (1) If cost containment efforts intensify pressures on primary care physicians as gatekeepers, this could cause treatment delays. Any resulting bad outcomes could be reflected in an increased frequency of medical malpractice cases.
- (2) In an attempt to increase the primary care resources to handle an increasing number of insureds, we may expect increased use of "physician extenders" such as nurse practitioners and physician assistants. These health care providers may be less adept at diagnosis of underlying health issues. Currently, 28 states are considering expansion of authority for nurse practitioners. In 2008, after the passage of its health care reform, Massachusetts passed legislation requiring health plans to recognize and reimburse nurse practitioners as health care providers. It is reasonable to believe that this will be necessary countrywide as US health reform expands the insured population after 2014.
- (3) If government efforts to increase supply of medical resources are unsuccessful and increased numbers of insureds are faced with demand/supply imbalances, not only may medical costs increase but medical errors from short-staffed and/or ill-equipped service providers may rise. This negative effect would especially affect med mal insurers.
- (4) On the other hand, better preventive care for more people could have a positive effect on timely diagnosis, cost containment and successful treatment of medical conditions.

As laws and associated regulations are implemented, underwriters will need to develop a keen understanding of the evolving exposure (including that from changing roles of providers) and develop appropriate underwriting and pricing strategies that respond to this evolution.

## **12. Conclusion**

It will take months and even years to fully understand the impact of US health care reform on Property & Casualty lines, especially Workers' Compensation and various liability coverages.

One thing that's for certain is the impact to the liability system will be indirect. The consensus view is that liability costs may either fall or rise (more than otherwise) based on the successes or failures of cost containment and the successes or failures of supply enhancement initiatives, and that developments are likely to be delayed and gradual. Massachusetts, with its similar law, is a potential early warning jurisdiction.

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