Recession, Recovery and Workers' Compensation Claims

As the economy slowly recovers, the various impacts of the worst economic downturn since the Great Depression become clearer. According to the National Bureau of Economic Research, a private panel of economists, what is now widely known as the "Great Recession" began in December 2007 and ended in June 2009, making it the longest recession since World War II. Hundreds of trillions of dollars of wealth was destroyed, thousands of companies shut their doors and millions of people lost their jobs. Though the recession has been declared over, recovery is agonizingly slow.

The recession touched almost every aspect of operations for companies across America, including risk management and insurance. One area that was especially affected was workers' compensation. Because of layoffs, many companies saw their workers' compensation premiums fall. The recession also had an impact on workers' compensation claims. Several factors combined reduced, on average, the number of workers' compensation claims. The National Council on Compensation Insurance, Inc. (NCCI) statistics show that workers' compensation claim frequency fell 4 percent in 2009. As prosperity returns and companies begin to hire again, they need to take steps to assure that workers' compensation losses do not suddenly surge, which has happened during prior periods of economic recovery.

The Recession:

Since workers' compensation costs are directly related to payroll, it is important to understand the impact of the recession on employment and how the economic and labor landscape has changed. With the unemployment rate still hovering around 10 percent, it is clear that many employers have had to make difficult decisions. They have had to reduce headcount, do more with less and run more efficient operations. The impact of these decisions on workers' compensation costs runs deeper than may at first be obvious.

History tends to repeat itself and what has happened in previous recessions is holding true for this one as well. The most visible impact for employers is the reduction of premium due to lower payrolls, and the correlation of these reduced payrolls with the frequency of claims. Fewer employees, not surprisingly, translate into fewer claims. But the impact goes much further than a proportional reduction of claims as the workforce shrinks. Some factors lead to an even greater reduction in claim frequency as well as lower claim severity, while others push in the other direction and contribute to an increase in both frequency and severity of workers' compensation claims.

When employers decide to cut costs by reducing their workforce, they often do so by eliminating the less experienced and less skilled workers first. They want to maintain the best employees for when business turns around, and they feel that their more experienced employees can handle a bigger burden before they have to begin to hire new people. Despite a possible negative effect due to increased fatigue on an aging workforce, experience has shown that this situation leads to a decline in the frequency of workers' compensation claims. Beyond the fact that there are fewer employees, the employees who remain on staff often are more experienced, better trained and usually more loyal. US Bureau of Labor Statistics data show that more experienced employees have fewer and less severe workers' compensation claims: at normal employment levels, workers with less than one year of experience with an employer represent 25 percent of the workforce, yet have 34 percent of the lost-time claims and costs. Statistics from Zurich indicate that workers with less than one year of experience represent 38 percent of lost-time claims and 43 percent of lost-time claim costs.

Other theories that explain decreases in claims frequency tend to be more psychological in nature. In difficult economic times, employees who are injured on the job may prefer to work through their injuries rather than report them and take time off to recover. The fear is that, when they do recover and return to work, they may be targeted by management if there is another round of layoffs. The anxiety of being unemployed and trying to find another job during a recession may be enough to keep some employees from reporting injuries that they should have reported, and probably would have during better economic times.

Experience has shown that, overall, the number of workers' compensation claims tends to decline during a recession, but it is important for employers to realize that other factors related to labor reductions can have the opposite effect, contributing to a temporary spike in workers' compensation claims. For example, if it is known that a company is preparing for a large round of scheduled layoffs, or if a company plans on closing the doors to the business altogether, some employees may look at it as an opportunity to submit a fraudulent claim. The idea of collecting higher income under the workers' compensation benefit as opposed to the unemployment benefit may be appealing enough to tempt an employee to take the risk of falsifying a claim.

Business owners and managers also should be aware that, with the continued high unemployment rates and the extended length of time it takes an unemployed worker to find a new job, some employees may be incented to drag out workers' compensation payments. The phenomenon of malingering, which is always a concern for employers and insurance companies, becomes more prevalent in a recession. During uncertain times, some injured workers are more likely to exaggerate their illnesses and injuries so that they can stay out for extended periods. If they fear that when they return to work they are at risk of being terminated, they may do what they can to remain out on workers' compensation as long as possible.

The Recovery:

In the early stages of the economic recovery, employers have been reluctant to increase their labor forces; they are relying on their current employees to meet the increased production needs by working longer hours. Because the recovery thus far has not created many jobs it has been coined the "jobless recovery." Extended unemployment also means that an aging workforce, once they return to work, likely will work past retirement age because of lost retirement funds and savings. So what does all of this mean for employers when the economy is in full recovery and hiring picks up?

As previously noted, history tends to repeat itself. In prior recoveries, when employers increased their workforce to meet the raised demand for their products and services, the number of workers' compensation claims tended to rise as well. New and less experienced employees were found to be significantly more likely to become injured. More experienced employees tended to search for other employment opportunities as compensation begins to take priority over job security. This resulted in a larger, less experienced workforce performing job duties that they were neither qualified for nor trained in.

The same concerns remain this time around. Not only will businesses be hiring less experienced people, they will also deal with an aging workforce to fill jobs that require new skills. The combination could be a serious cause for concern for employers. As was seen in previous recoveries, this could create real potential for increased claims activity that would result in much higher insurance costs. Employers need to keep in mind that deteriorating claims experience in the short term might impact their workers' compensation premiums for years to come: increased workers' compensation claim costs in 2011 and 2012 would impact Experience Modification Factors in 2013, 2014 and 2015, which can lead to higher premiums in those years. It is important that businesses learn from the past and develop strategies to help minimize the potential impact that the economic recovery can have on their workers' compensation costs.

The Solution:

In order to keep up with the demand for goods and services during the recovery, there is no way around hiring new and inexperienced people. But as we have seen, there is a relationship between an increase in workers' compensation claims and new employees. If businesses want to reduce workplace injuries and keep their workers' compensation premium to a minimum, they need to look at the potential causes of claims with new employees and develop a strategy to help reduce and minimize the frequency and severity of these claims.

According to a study by Zurich, the main factors that contribute to an increase in claims with employees on the job for less than one year are:

- Inappropriate job placement,
- Lack of appropriate orientation and training,
- Unfamiliar with hazards of the workplace or specific operation of equipment,
- Unfamiliar with work processes and unfamiliarity with co-workers affecting safety performance,
- Tendency to take short cuts with safety procedures to complete tasks on time, and
- Hesitancy to ask for help or information needed to work safely.

Some best practices to help minimize the potential impact that the economic recovery can have on workers' compensation costs include:

- Use current job analysis to attract qualified candidates for each job,
- Assure that recruiting and hiring practices comply with current regulations,
- Apply pre-placement and post-offer testing to validate new hire qualifications,
- Provide relevant training emphasizing worker and workplace safety, and
- Consider tenure of claimant in evaluating lost time claims to identify corrective action.

Amid continuing economic uncertainty, one thing is certain: it will be a while before the recovery gains enough momentum that employers will feel comfortable hiring large numbers of new employees. However, employers should not wait until hiring picks up and business is booming to begin planning how they will keep their workers' compensation costs under control during the recovery. While some increase in workers' compensation claims may be inevitable during the recovery, employers can reduce workplace injuries and control workers' compensation costs through a combination of careful hiring practices, training and heightened loss control activities. Managing workers' compensation costs requires foresight, preparation and execution, but business owners and managers do not have to go it alone. Help may be available from insurance brokers and workers' compensation insurers.

1 Business Cycle Dating Committee, National Bureau of Economic Research, (http://www.nber.org/cycles/sept2010.htm)

2 "NCCI Offers Precarious Outlook for Workers Compensation Insurance Market," (http://www.ncci.com/nccimain/AboutNCCI/Newsroom/NewsReleases/Pages/SOLPressRelease2010.aspx)

3 NCCI presentation to the Montana Economic Affairs Interim Committee, July 8, 2009, (http://leg.mt.gov/content/Committees/Interim/2009_2010/Economic_Affairs/Meeting_Documents/NCCI.pdf)

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