Compendium on Workmen's Compensation

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Chapter 4

United States Workmen's Compensation Programs: Major Characteristics

The major characteristics of the present workmen's compensation programs, as summarized in this chapter, are coverage, benefits, administration, financing, security, and safety. Each of these characteristics is the subject of at least one chapter in part IV.

COVERAGE

Covered Employment

While most of the State workmen's compensation laws apply to both private and public employment, none of the laws covers all forms of employment. For various historical, political, economic, or administrative reasons, each of the laws has certain gaps. Laws that are elective rather than compulsory permit the employer to reject coverage, but in the event he does he loses the customary common law defenses: assumed risk of the employment, negligence of a fellow servant, and contributory negligence.

A few States still restrict compulsory coverage to so-called hazardous occupations. Many laws exempt employers having fewer than a specified number of employees. The most common exception is for employers having fewer than three employees; the range goes from fewer than two employees in two States to fewer than 15 in one State. Most of the laws exclude farmwork, domestic service, and casual employment. Many laws also contain other exemptions, such as employment in charitable or religious institutions.

Two other major groups outside the coverage of the compensation laws are interstate railroad workers and maritime employees. Railroad workers, any part of whose duties involve the furtherance of interstate commerce, are covered by the Federal Employers' Liability Act (FELA). Maritime workers are subject to the Jones Act, which applies provisions of the FELA to seamen. The Federal Employers' Liability Act is not a workmen's compensation law. It gives an employee an action in negligence against his employer and provides that the employer may not plead the common law defenses of fellow servant or assumption of risk; moreover, the principle of comparative negligence is substituted for the common law concept of contributory negligence.

According to the Bureau of Labor Statistics, nearly 12.9 million persons worked in public employment—Federal, State, and local—in 1971. About 10.2 million of these were employed by State and local governments, including public school systems, and about 2.7 million by Federal agencies, excluding the Armed Forces.

Civilian employees of the Federal Government are covered by the Federal Employees' Compensation Act (FECA), administered by the Office of Federal Employees' Compensation, U.S. Department of Labor. This coverage is all-inclusive and compulsory.

As to the State and local employees, the actual number of these employees subject to workmen's compensation or provided with such protection

voluntarily is not available. All States as well as Puerto Rico and the District of Columbia have some coverage of public employees but with marked variations. Some laws specify no exclusions or exclude only such groups as elected or appointed officials. Others limit coverage to employees of specified political subdivisions or to employees engaged in hazardous occupations. In still others, coverage is entirely optional with the State or with the city or political subdivision.

Certain other groups, such as the self-employed, unpaid family members, volunteers, and trainees, generally are not protected by workmen's compensation.

The number of workers covered by State and Federal workmen's compensation laws was between 58.8 million and 59.0 million in 1970, according to estimates of the Social Security Administration. This figure represents about 83.4 percent of the employed wage and salary workers, a slight increase over the proportion covered during the 1950's and early 1960's. Because of the many differences in the coverage provisions of the State laws, the number of workers actually covered as a percentage of total employed wage and salary labor force varies considerably from State to State, ranging from well under 70 percent to about 95 percent.

Gradual extension of coverage over the years has been achieved by piecemeal actions: replacement of elective laws by compulsory provisions, elimination or reduction of numerical exemptions, and adoption of amendments granting protection to farm workers and other previously excluded groups. States still must strive for complete coverage.

Covered Injuries and Diseases

Workmen's compensation is presently intended to provide coverage only for certain work-related conditions, not all of the worker's health problems. Statutory definitions and tests have been adopted to provide the line of demarcation between those conditions which are compensable and those which are not. Because, in drafting workmen's compensation laws, all jurisdictions relied to some extent on the English system or other statutes which in turn relied upon the English model, their statutory language is remarkably similar. Nevertheless, as there are variations in language as well as differences in interpretation, a condition considered compensable in one State may be held noncompensable in others.

The statutes usually limit compensation benefits to personal injury caused by accident arising out of and in the course of the employment. Although this presents four distinct tests which must be met, in practice they are often considered in pairs: The personal injury and by accident requirements in one set, and the arising out of and in the course of requirements in the other.

Personal injury by accident.—If interpreted narrowly, personal injury would deal solely with bodily harm, such as a broken leg or a cut, while the by accident test would refer to the cause, such as a blow to the body or an episode of excessive or improper lifting. In practice, however, the distinctions are blurred.

The by accident concept is a carryover from the English law. Early judicial interpretations of the English law made it quite clear that for their purposes the by accident requirement was intended to do little more than deny compensation to those who injured themselves intentionally.[1] A number of U.S. jurisdictions, however, have applied the test so as to narrow the range of unintentional injuries which can be compensated.

One of the early victims of the by accident requirement was occupational disease coverage. As the typical judicial holding was that occupational disease and accidental injury were mutually exclusive, special legislation was required in order to provide disease coverage. At present, occupational diseases are almost always treated separately in compensation law.

Although most jurisdictions cover all occupational diseases, about nine States limit the coverage to scheduled diseases. Even those jurisdictions that employ a general definition of occupational disease often attach other limitations. For example, they may require that the diseases not be an ordinary disease of life. Thanks largely to relaxation of the by accident concept and dissatisfaction with the restrictive provisions of most occupational disease statutes, awards can be and have been made for diseases as injuries by accident when there was something particularly unusual about the cause of the disease and the mode of conveyance was specific, such as the entry of bacteria through a slight cut.

The by accident concept was also used in many jurisdictions to deny compensation unless the injury was caused by some sort of unusual, traumatic

occurrence, generally requiring the application of outside force or an outside agency. Obviously this would and did drastically limit the kinds of cases which could be compensated. At present, this use of the by accident test is limited to a few narrow areas.

Impairment involving psychological difficulties has been the source of much controversy based on application of the personal injury requirement. In some cases, a mental stimulus such as fear can produce a physical lesion, such as a cerebral hemorrhage. In event of a physical lesion, the courts have not encountered much difficulty in conceding personal injuries. Compensation is usually approved also if, as a result of a clear physical injury, the patient suffers psychological disorder.

As might be expected, disagreement is most likely when it is alleged that mental stimulation has resulted in a mental illness without obvious physical change. Although many jurisdictions award compensation in such cases, others still are reluctant to perceive that psychological disorder is a physical injury.

Work-related impairment.—The term "arising out of and in the course of the employment," applied by almost every jurisdiction, is meant to define a certain level of relationship between the employment and injury or disease as a condition of eligibility for workmen's compensation. The phrase obviously lacks certainty. Often it is quite difficult to determine whether a given set of facts will support an award of compensation.

The "course of the employment" aspect of this test refers primarily to the time frame of the injury. Virtually every jurisdiction holds that an employee is within the course of his employment, barring certain types of unusual circumstances or unreasonable conduct, from the moment he steps onto the employer's premises at the beginning of the work day to the moment he leaves the premises at the end of the day.

Although this test appears to be relatively simple to apply, it has not been so. One uncertain issue is, what are the premises? Injuries which clearly occur off premises but appear to deserve compensation lead to a search for exceptions and encourage courts to modify the basic rules. Many workers are not attached to particular premises. Even though an injury occurs off premises, as in travel to and from work, the employee may be compensated if a sufficient employment relationship can be found, such as payment for time or expense of travel or the provision of a company vehicle for transportation. In these circumstances, the period of travel time to and from home may be incidental in the course of employment.

The "arising out of" segment of the test is intended to provide a causal relationship between the employment and the injury. For example, it is not enough that an employee suffer a heart attack while at work. He must show that the heart attack arose out of the employment or, in other words, that it was causally related to the employment.

This means that at a minimum (some States have more stringent rules) it must be shown that it was the stress and strain or exertion of the employment that caused the heart attack, not merely a spontaneous breakdown of the cardiovascular system.

The degree of employment relationship necessary varies from State to State and has been modified as workmen's compensation law has evolved. In earlier years, it was generally felt that the hazard causing injury must be peculiar to the particular employment or be increased by the employment before the injury could be said to "arise out of the employment." This rather narrow view of compensability has been modified and to some extent abandoned in recent years.

Although it is difficult to place each jurisdiction in a particular category as to what it will hold sufficient to meet the "arising out of" test, two additional theories have been developed and followed. The first and more widespread is the "actual risk doctrine", which requires that the hazard resulting in injury be a risk of the particular employment, without regard to whether it was also a risk to which the general public is exposed. The second or "positional risk doctrine" could also be called the "but for" test. Here, if the employment places the worker in a position where he is injured ("but for" the employment the injury would not have occurred) the injury "arises out of the employment."

BENEFITS

Almost $3 billion in cash and medical benefits were received by workers in 1970 through the workmen's compensation system. Benefits include medical services, cash benefit payments to the worker

while totally disabled, payments for residual partial disability, burial allowances (in all but one State) for work-related deaths and benefits to the worker's dependent survivors.

Some States provide special benefits also to cover attendants or prostheses; about three-fourths of the States provide maintenance and other services for rehabilitation. The largest proportion of benefits are in cash, either as periodic payments or as lump sums in settlement of claims. About $1.9 billion, almost two-thirds of the $3 billion 1970 benefit total, were paid to workers or their survivors in cash.

Benefits are paid through three channels: Commercial insurance policies; publicly operated State insurance funds; and self-insured employers. In 1970, more than $1.8 billion in workmen's compensation were paid by private insurers, $0.7 billion by State funds, and $0.4 billion by self-insurers.

Income Replacement

Of the $1.9 billion benefits paid in 1970 as cash income, almost 90 percent went to disabled workers and the other 10 percent to survivors of workers killed on the job. Although 70 percent or more of recent workmen's compensation cases are for temporary total disablement, such cases have accounted roughly for only one-fourth of cash benefits. At the same time, income benefits in the last few years to workers for permanent partial disabilities accounted for two-thirds of the total dollar amount.

Basic features.—In general, the cash benefits provided for temporary total disability, permanent total disability, permanent partial disability, and death are payable as a wage-related benefit: The weekly amount is computed as a percentage of the worker's wage. The benefit varies by State and by type of disability but most commonly is set at 66.67 percent of wages. In some States the statutory percentage varies with the worker's marital status and the number of dependent children, especially for survivors' benefits, which in a majority of States pay 50 percent or less of the deceased worker's wage to surviving widows without dependent children.

The benefit rate is limited to less than 66.67 percent for many beneficiaries by another statutory provision, the maximum ceiling on the weekly benefit payable. Disabled workers whose wages are at or above the statewide average receive benefits below the statutory benefit rate in almost all States because of this ceiling, despite an occasional increase in the weekly ceiling by amendments to the law.

As inflation boosts wage levels, some States have attempted to prevent the deterioration in effective benefit-wage rates by providing for future increases in the maximum without need for further legislation: 14 automatically adjust the maximum (for new beneficiaries only) in relation to changes in the State's average weekly wage. Much less common but gaining more interest in the last few years are provisions that, as wage levels of workers rise, raise benefits for beneficiaries already on the rolls: five States plus the Federal Employees' Compensation Act provide such automatic increases.

Another type of limitation on benefits sets maximum time periods or aggregate dollar amounts. Such limitations in permanent total disability and death cases may cut off benefits even though the income need continues. Nevertheless, a majority of States limit the duration or total dollar benefits to widows and orphans.

In order to reduce administrative costs and to discourage malingering, benefits in all States are payable only after a waiting period following the report of disability. This delay in payment applies to the cash indemnity payments, not to medical and hospital care. The waiting period ranges from 2 days to 7. In all States workers who are disabled beyond a specified minimum period of time receive payment retroactively for the waiting period. For more than three-fourths of covered workers, the minimum period for retroactive payment is a disability exceeding 2 weeks.

Benefits by type of disability.—Most compensation cases concern workers who incur temporary disability but recover completely. The maximum weekly benefit for temporary total disability is at least $65 in more than half the States. In only eight States is the maximum benefit as high as two-thirds the State's average weekly wage. Although about two-thirds of the States have provisions limiting the duration of temporary benefits, these limits do not seriously affect adequacy of benefits as few temporary injuries persist beyond such limits, typically set between 6 and 8 years. For workers with dependents, about one-third of the

States augment the weekly benefit for temporary disability, usually by some dollar amount for each dependent up to a specified total.

Benefits for permanent total disability are for disabilities that preclude any work or regular work in any well-known branch of the labor market and that can be of indefinite duration. These are similar to benefits for temporary total disability benefits. In a few States, the weekly payment for permanent disability benefits is less than for temporary. About one-third of the States restrict the duration of benefits for permanent disabilities, typically to from 6 to 10 years.

Residual limitations on earning capacity after recovery; i.e., permanent partial disabilities, are awarded benefits on a relatively complex basis. Partial disabilities are divided into two categories: "schedule" injuries, those listed in the law such as loss of specific bodily members; and "nonschedule" injuries, those which are of a more general nature, such as back and head injuries.

Weekly benefits for schedule injuries are a percentage of average weekly wages, often the same as the benefit rate for permanent total disability. The maximum weekly benefit is for the most part the same as or lower than that for total disability.

Nonschedule injuries are paid at the same or similar rate but as a percentage of wage loss, the difference between wages before injury and the wages the worker is able to earn after injury.

The schedule benefits are paid for fixed periods varying according to the type and severity of the injury. For example, most State laws call for payments ranging from 200 to 300 weeks for loss of an arm and 20 to 40 weeks for loss of a great toe.

The maximum period for nonschedule injuries for each State is the same as or, more generally, less than the duration limits established for permanent total disability.

In the majority of States, compensation payable for permanent partial disability is in addition to that payable during the healing period or while the worker is temporarily and totally disabled. In some States, lower benefits (or no benefits) are payable for permanent partial disability due to occupational disease than for disability due to accidental injury.

Death benefits are intended to furnish income replacement for families dependent upon the earnings of an employee whose death is work-related. As is true for the other types of benefits, the amount of survivor benefits and the length of time they are paid vary considerably from State to State. Benefits computed as a percentage of the deceased worker's wage often are less than that for permanent total disability benefits if the survivor is a widow without dependents. If there are dependent children, the benefit in many States will be augmented. In most States, the duration of benefits is limited usually in a range from 250 to 600 weeks. In 28 States, payments to widows continue usually as long as they do not remarry and to children until they are no longer dependent, usually to age 18. Benefits may be terminated earlier in the 10 of these 28 States which also limit total dollar benefits.

In addition to benefits for widows and children, some States pay survivor benefits to dependent invalid widowers, parents, or siblings of the dead worker. The program for Federal civilian employees pays survivor benefits to widowers under the same circumstances as to widows; i.e., invalidity is not required. Burial expenses are payable in all States except Oklahoma.

Medical Benefits

For many years, disbursements for medical services provided under workmen's compensation have comprised about one-third of total outlay for benefits. Care includes first-aid treatment, services of a physician, surgical and hospital services, nursing and drugs, supplies, and prosthetic devices. Some large employers, in addition to first-aid facilities, employ staff physicians for workers. Most employers insure their medical care responsibility as they do the income benefits under workmen's compensation.

Every State law requires the employer to provide for medical care to the injured worker. In most jurisdictions such treatment is provided without limit either through explicit statutory languages or administrative interpretation. Only nine States limit the total medical care available for work-related injuries by specified maximum dollar amounts or maximum periods. In some of these nine, the initial ceiling may be exceeded by administrative decision. Even among States which provide unlimited medical care following on-the-job accidents, almost a third limit medical services for specified occupational diseases. Also, if spe-

cified types of injuries or disease are denied cash benefits, medical care also is denied.

A major issue concerning medical benefits for workmen's compensation is the procedure for choosing the physician who is to furnish the care. About half the States give the employer the right to designate the physician. In practice the insurance company of the employer will ordinarily select the physician since it is the insurer that handles the claim for benefits. Where the doctor is chosen in this way, the medical care furnished may be more highly skilled and effective because of the selected physician's specialized experience. On the other hand, workers feel that a more important consideration is the emphasis that their personal family physician is likely to put on their health and well being. They feel other considerations may be at work with a physician they do not select.

Rehabilitation

Along with industrial safety, medical care, and cash compensation, rehabilitation of workers is recognized at least theoretically as one of the primary goals of the workmen's compensation system. At present the most widespread benefits offered through workmen's compensation laws to restore a worker to his fullest economic capacity are the special maintenance benefits authorized in about three-fifths of the States. These benefits usually are paid (sometimes in addition to the regular disability compensation) for various training, education. testing, and other services designed to aid the injured person to return to work. In addition, some State programs provide for travel expenses and for books and equipment needed for the training.

Ohio, Oregon, Rhode Island, Washington, and Puerto Rico directly operate rehabilitation facilities under the workmen's compensation program. Some insurance companies also have in-house facilities for rehabilitating workers.

Probably the main source of retraining and rehabilitation is the Federal-State vocational program. The facilities operated by this program accept individuals with work-related disabilities as well as others. In all States, these institutions are directed by State vocational rehabilitation agencies. They provide medical care, counseling, training, and job placement. Unfortunately, not all workmen's compensation cases referred for vocational rehabilitation can be accepted promptly. Many others are never brought to their attention.

One notable drawback preventing full utilization of available rehabilitation facilities is the often protracted, adversary proceedings for determining a worker's right to benefits. Because the determination of whether there should be an award for permanent partial or total disability (and how large an award should be for partial disability) is conditioned on the worker's lack of ability to work, the claim may be a strong disincentive for rehabilitation. Further, in the many compromise settlements, the employer's (or insurer's) motivation is to pay an agreed amount of money and foreclose future responsibility for medical, vocational, or other needs arising from the injury. Such settlements also work against a full-fledged effort to restore the worker to full health and productivity.

ADMINISTRATION

The goal of workmen's compensation is to provide for quick, simple, and inexpensive determination of all claims for benefits and to provide such medical care and rehabilitation services as are necessary to restore the injured worker to employment. Nearly all of the States have agencies to carry out these administrative responsibilities. In about 20 jurisdictions, the agency is in the labor department; in 27, it is a separate workmen's compensation board or commission; in five, administration is left to the courts. Several States have separate, independent appeals boards to review claims when agency decisions are appealed.

Objectives

The agency's many correlated responsibilities include close supervision over the processing of cases. The primary objective is to assure compliance with the law and to guarantee an injured worker's rights under the statute. Administration by a division within the labor department or by a board or commission has been found to be more effective in achieving the full purpose of the law than administration by the courts. The courts are not organized and equipped to render the services needed.

One criticism of State agencies concerns the delays in the first payment of compensation to the disabled worker. Although in most States insurers

mail the checks, the State administrative agency has the responsibility to see that payments commence promptly. Full and prompt payment is essential because few workers can afford to wait long for benefits due. In one State, with perhaps the best reputation in this respect, about 85 percent of the claims are paid within 15 days; in most States, however, it appears that the first payment comes at least 30 days late. (Precise information is lacking.)

Another responsibility of the agency is to see that the injured worker gets the full benefit due. To do this, it is important to follow an injury from the first report to the final closing of the case. Some States not only check the accuracy of total payments but also require signed receipts for every compensation payment. Some require the filing of a final receipt which itemizes the purpose of each element in the total outlay, to permit a complete audit of individual payments.

Frequently, however, the legislation itself requires a workmen's compensation agency to operate on the presumption that each injured worker is responsible for securing his rights and that its primary function is to adjudicate contested claims. Even where the law does not favor this policy, lack of staff may force the agency to this restricted role.

Although it is known that many workers are not familiar with the provisions of their workmen's compensation act, in only a few States does the administrator, as soon as possible after the injury is reported, advise the worker of his rights to benefits, medical and rehabilitation services, and assistance available at the commission's office. Too many States fail to insist on prompt reporting of accidents by employers, on prompt payment of benefits, or on final reports which spell out the amount paid to and how these amounts were computed. Although prompt reporting is usually required, sometime no penalty is imposed for violation.

Handling Cases

Workmen's compensation claims may be either uncontested or contested. In uncontested cases, the two main methods followed are the direct payment system and the agreement system.

Under the direct payment system, the employer or his insurer takes the initiative and begins the payment of compensation to the worker or his dependents. The injured worker does not need to enter into an agreement and is not required to sign any papers before compensation starts. The laws prescribe the amount of benefit. If the worker fails to receive this, the administrative agency can investigate and correct any error. Jurisdictions whose laws provide the direct payment system include Arkansas, Michigan, Mississippi, New Hampshire, Wisconsin, the District of Columbia, and the Longshoremen's and Harbor Workers' Compensation Act.

Under the agreement system, in effect in a majority of the States, the parties—that is, the employer or his insurer, and the worker—agree upon a settlement before payment is made. In some cases, the agreement must be approved by the administrative agency before payments start.

In contested cases, most workmen's compensation laws provide for a hearing by a referee or hearing officer, with provisions for an appeal from the decision of the referees or hearing officer to the Commission or Appeals Board and from there to the courts. As the administrative agency usually has exclusive jurisdiction over the determination of facts, appeals to the courts usually are limited to questions of law. In some States, however, the court is permitted to consider issues both of fact and law anew.

SECURITY REQUIREMENTS

All States except Louisiana require their employers in private industry to demonstrate that they are able to pay the benefits required under the workmen's compensation law. About two-thirds of the States have a similar provision for public employers. These security provisions in effect require that active steps be taken by employers to guarantee that workers, when they are disabled, will receive the benefits called for by the law.

Types of Insurers

Most laws allow employers to satisfy the security requirement by insuring with private companies or to self-insure. As of January 1, 1972, only six States (Nevada, North Dakota, Ohio, Washington, West Virginia, Wyoming), Puerto Rico, and the Virgin Islands, required employers to pur-

chase protection from exclusive State operated funds. Three of these States (plus one that has no State fund) and Puerto Rico and the Virgin Islands also prohibit self-insurance. Besides the jurisdictions with exclusive State funds, 12 others have publicly operated programs in competition with private insurers. Regardless of the method of protection purchased, the same statutory benefits must be provided to the injured worker in that State.

Compliance Checks

In order to insure that workmen will receive benefits as intended, States need a method of checking that employers do in fact meet the security requirements. The workmen's compensation agency ordinarily requires not only notice of insurance secured by employers but of cancellations of such insurance. In more than a fifth of the States, however, no formal procedures are in effect to insure that all employers have given proper notice.

Generally, it is believed that most employers comply with security requirements. In part, a high degree of compliance may be expected because of sanctions available to the State for noncompliance. In almost four-fifths of the State, noncomplying employers become liable to worker suits with the employer's traditional common law defenses abrogated; in some States, the business may be stopped from operating. In addition some statutes call for fines against the employer or imprisonment or both.

Regulation of Insurers

Where employers are allowed to self-insure, they must generally demonstrate sound financial condition. An employer may have to make a deposit of a specified amount with the workmen's compensation agency or post a surety bond. In at least a third of the States, all applicants for self-insurance must meet this requirement; in a similar proportion of States, at the discretion of the agency, this deposit may not be required. Other types of requirements imposed on self-insurers in various States are minimum payroll size, minimum number of employees, type of business, safety record, and proof of proper facilities for administering claims.

Besides restrictions imposed upon employers directly, activities of workmen's compensation insurers also are regulated. Such regulation serves in part to assure that workers receive benefits when disabled. In order to write workmen's compensation insurance, insurers must conform to rules and regulations of both the State insurance department and the State agency administering the workmen's compensation act, usually the industrial commission.

The insurance department primarily regulates the conditions for establishment of insurance companies in the State, their continuing solvency, and their business practices. Like self-insurers, in many States insurance companies must post bond or make a deposit with the State insurance department.

Generally the role of the industrial commissions in regulating insurers is limited. Few have either authority concerning companies' rights to underwrite workmen's compensation in their State or information about financial status and operations of insurers. Further, although industrial commissions would seem to have a direct interest and concern in the claims-handling performance of insurers, few State agencies collect data on promptness of payment, amount of benefits paid, number of beneficiaries currently receiving benefits, and similar aspects of benefit operations. Generally, industrial commissions—to the extent they supervise claims operations—do so through review of individual cases, often only in the event of a dispute.

FINANCING

The total cost of workmen's compensation to employers has increased slightly over the years and now is slightly above 1 percent of covered payroll (1.13 percent in 1970). Since insurance is the main vehicle for meeting the statutory requirements of the workmen's compensation acts, the programs are financed mostly through insurance premiums.

Financing Insured Benefits

For both public funds and commercial insurance, class premiums are established by an elaborate system of rates that take into account the general occupational classifications or industrial activities of the insured. About 15 percent of the

employers, paying about 85 percent of the premiums, are experience rated. That is, their premiums are modified to reflect their loss experience in the past relative to others in the same class. Also, the statistical reliability of that experience is taken into account: the larger the business, the more credible its experience. Since employers wtih a small number of workers are likely to experience volatile changes in injury rates from year to year, only employers of large numbers are experience rated.

Another factor in the premium setting procedure is that discounts are given according to the size of the risk, an advantage to large companies. Their rates thus reflect the economies of scale which result from spreading certain fixed costs over a larger amount of premium. Finally, large companies by retrospective rating may have their premiums adjusted at the end of a policy year to match their actual experience.

Most insurers use rates developed by a rating bureau. In some States the rates developed by the bureau are mandatory; in others advisory only. Almost half the premiums are written on a participating basis. Particpating policyholders receive periodic dividends that reflect insurer experience and sometimes their own.

Financing Self-Insured Benefits

Firms that cover workmen's compensation risks through private insurance companies or State funds pay a premium in advance. In contrast, self-insurers have several options for financing. They may simply pay for liabilities as they are experienced, directly from operating funds, or they may provide some advance funding in one or more ways. In those States requiring deposits of funds by self-insurers, part or all of the funding for outstanding liabilities is provided for in advance mandatorily. Even if not required, a self-insurer may set aside reserves, or even formally insure its risk through a wholly owned subsidiary insurance company created for this purpose. Such advance funding prevents severe disruptions in cash flow from unforeseen loss experience or accumulated liabilities.

Insurer Administrative Costs

One of the recurring issues in evaluating workmen's compensation is the financial efficiency of the insurance mechanism for providing benefits. A major part of the issue is the comparison between private and State fund insurance.

The premiums collected by private insurers are used not only to pay benefits but also for expenses associated with claims such as investigation and legal fees; for sales, supervision, and collection; for administration; for safety programs; and for taxes, licenses, and other mandatory fees as well as for earnings. In 1970, stock insurers that do not pay dividends to policyholders had expenses totaling 31 percent of premiums earned; their underwriting gain was 5 percent of premiums paid. For stock insurers that pay dividends to policyholders the expense ratio was 25 percent; the underwriting gain 14 percent. Mutual insurers had an expense ratio of 24 percent and an underwriting gain of 13 percent. The dividend-paying stocks and mutuals returned part of their underwriting gain to their policyholders. In addition to their underwriting gains, these insurers had investment profits.

State funds have much the same costs as private insurers with these exceptions: lower (or no) taxes and fees to the State government; no margin for private profit; and lower selling costs. Consequently, although the variation among individual funds is great, expenses have averaged less than 10 percent of total premiums paid, well below the ratio for private insurers. Some State funds incur smaller expenses for administrative and legal services, which may be financed from other government funds. On the other hand, State funds in some instances may insure greater proportions of high-risk companies than private carriers and incur proportionately heavier charges for benefits.

Other Administrative Costs

Another aspect of financing workmen's compensation relates to the cost of supporting the public agency that administers the program. The cost of operating the industrial commission (or other administering agency) is borne either by assessments upon insurers and self-insurers or through appropriations from public funds. In the former event, the cost of administering the program is simply one more expense item in the premium charge to the employer. Where funds for the industrial commission are obtained from legislative appropriations, this part of the program is paid

out of general taxes. More than one-third of State agency administrative costs nationally are funded by legislative appropriations.

In addition to that part of administrative costs financed by State general revenues, other elements in the workmen's compensation system may not be financed through insurance premiums paid for by employers. For example, many employers provide medical services at their establishment or by direct payments to medical facilities. Second- or subsequent-injury funds, which bear part of the cost of injuries to handicapped workers, are financed sometimes through assessments on insurers, reflected in premiums; in some States, as direct charges upon employers; as appropriations from State funds; in a few States as joint employee and employer contributions to the fund; or by other means. Other special funds, paid for by general revenues, have been established for such purposes as supplementing benefits depreciated by inflation or paying benefits for specified occupational diseases.

OCCUPATIONAL SAFETY

From its beginning, the workmen's compensation movement in the United States has been associated with the movement to prevent occupational injury or disease. Although some interest in this work was manifested by various employers before the enactment of workmen's compensation laws, the organized safety movement, as we know it, began shortly after the first compensation laws went into effect. This movement was due in large part to an assumption on the part of industrial leaders that one of the best ways to reduce compensation costs would be to reduce the number of accidents.

The first move toward an organized effort came at the convention of the Association of Iron & Steel Electrical Engineers at Milwaukee in 1912. A session devoted to safety set up a committee on organization, which called a meeting of all interested groups and individuals in New York City the following year. This meeting resulted in the formation of the National Council for Industrial Safety, which since 1915 has been called the National Safety Council.

Safety Activities of Insurers

Although the insurance business had been extended into the industrial accident field before the first workmen's compensation act was passed in this country, industrial accident insurance received great impetus from this legislation. As specific schedules of payments for all work-connected injuries made the risk more definitely calculable, the business became more attractive to the underwriter.

From the first, insurance companies writing workmen's compensation policies have had a large part in the movement to prevent accidents. They have developed or aided in the development of safety standards and safe practices and have contributed to the development of methods and techniques of accident prevention. Much of the basic data of safety engineering has been supplied by insurance engineers. An important motive for their accomplishment is, of course, the fact that their business thrives on a declining injury rate. Unduly large losses jeopardize the financial solvency of an insurance company. Progressively lower losses make it easier for the stock company to show a profit to its stockholders and for the mutual to pay dividends to its policyholders.

The effective work of insurers, however, has been confined mainly to large establishments. The cost of providing technical assistance in accident prevention makes it difficult for an insurer to provide service adequately to plants whose premiums are small. Owners of small plants, moreover, cannot expect to receive much reduction in premium rates either through dividends or experience rating, no matter how effective their safety program.

Precise statistics are not available showing the total amount of money invested by the insurance industry in safety. The insurance expense exhibit compiled by the National Council on Compensation Insurance shows that private insurance companies reported about $37.8 million or 1.1 percent of net premiums earned were applied to safety in 1970. The exhibit also shows that selected State insurance funds spent about 1.4 percent of net premiums earned, or $3.9 million.

Insurance Price Incentives

In addition to offering technical assistance, insurers have also tried, by various means, to make safety pay the policyholder in the form of immediately reduced premium rates. This monetary benefit for accident prevention is to some extent inherent in mutual insurance, since the surplus

remaining after losses and expenses is distributed among the policyholders. To offer a similar inducement to policyholders in stock companies and to give further incentive to mutual policyholders, a system of merit rating was adopted to obtain reductions in premium rates for policyholders. The first type of merit rating used was schedule rating, under which the reduction in premium rate was computed on the basis of the policyholder's performance in providing physical safeguards. This tactic proved unsatisfactory because safeguards, while vital, are only one part of prevention. The system now in general use is experience rating, described above.

Historically, it has been assumed by many authorities that merit rating provided a powerful stimulus to the safety movement. However, safety experts do not rely solely on the merit rating system to stimulate accident prevention efforts by industry. In fact, some recent studies have questioned the value of merit rating as a strong impetus to safety.[2]

References for Chapter 4

1. *Clover, Clayton & Co.* v. *Hughes* (1910) A.C. 242, 3B. W.C.C. 775; *Fenton* v. *Thorley & Co., Ltd.* (1903) A.C. 443.
2. See, for example, the Report of the Royal Commission of Inquiry, "Compensation for Personal Injury in New Zealand," (1967), pp. 1345; Report of the Commission of Inquiry, "Workmen's Compensation Act, Province of British Columbia," (1966), pp. 98–115; and A. F. Young, "Industrial Injuries Insurance," Routledge & Kegan Paul, Ltd. (London, 1964), pp. 169–70.