

# Work Comp Insights

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## How Inflation Impacts Workers' Compensation Insurance

This past year has seen growing inflation concerns, impacting individuals and industries across the board. The commercial insurance market is no exception to these concerns. Similar to other goods and services, inflation can also elevate the cost of insurance.

In the scope of workers' compensation coverage, inflation issues have become increasingly evident through various sector trends—including labor shifts, rising wages, higher medical expenses and rate adequacy challenges. With this in mind, it's important for businesses to better understand these trends and learn what they can do to mitigate inflation concerns within their workers' compensation programs.

This article provides more information on how inflation impacts workers' compensation insurance, outlines key factors currently influencing coverage costs and offers best practices to help businesses keep such costs under control.

### Workers' Compensation Insurance and Inflation

The average change in expenses for consumer goods—also known as the consumer price index (CPI)—has reached 40-year highs over the past

year, according to the Bureau of Labor Statistics (BLS). Although these CPI trends highlight the prevalence of inflation issues for individuals and certain industries, it's important to note that such trends don't directly impact workers' compensation coverage.

Rather, this segment is primarily affected by medical inflation, which refers to rising prices for health care necessities (e.g., medical devices, treatment, supplies and pharmaceuticals). These prices are typically determined a year in advance based on projections by Medicare and private insurance contracts. Because such projections took place before inflation concerns skyrocketed last year, medical inflation has remained fairly low compared to CPI trends.

As a result, the workers' compensation insurance sector has yet to face the full impacts of rising inflation issues. Nevertheless, the coming year's projections could present increased medical inflation concerns, thus elevating claim costs and affecting overall coverage expenses going forward.

Fortunately, the segment is better equipped to handle inflation issues than other commercial lines of coverage. This is because the sector has stayed resilient in recent years, performing as an outlier by remaining profitable. According to the National Council on Compensation Insurance (NCCI), the segment's private carrier combined ratio in 2021 was 87, matching 2020's results and marking the eighth consecutive year of underwriting profit. The sector's net written premium also significantly declined in 2020 and remained stable in 2021.

Furthermore, many states have fee schedules in place for workers' compensation coverage, which are predetermined expenses for different medical services. These fee schedules are intended to keep treatment costs for injured or

ill employees and associated claim expenses reasonable, therefore combatting medical inflation concerns.

### Factors Influencing Workers' Compensation Insurance Costs

Although medical inflation is the main factor impacting the workers' compensation insurance segment, there are other elements currently influencing coverage costs. Specifically, the NCCI identified the following trends as key contributors to coverage expenses:

- **Labor shifts**—Over the past year, many employees have begun leaving their jobs in search of positions that offer greater work-life balance, flexibility and benefits, coining a new employment trend known as the “Great Reshuffle.” This trend has led to a surge in short-tenured employees and increased labor shifts between industries. According to the NCCI, short-tenured employees have significantly higher injury frequency rates than their long-tenured counterparts, contributing to additional workers' compensation claims and driving up coverage costs. The proportion of older employees is also on the rise, with those over the age of 55 predicted to account for nearly one-quarter of the workforce by 2024, according to BLS data. Similar to short-tenured employees, older workers are more prone to occupational injuries. What's worse, such workers' injuries are also usually more serious in nature, affecting claim frequency and severity and elevating coverage expenses.
- **Wage growth concerns**—In efforts to attract and retain employees amid the Great Reshuffle, many businesses have increased their workers' pay. Although this trend is happening across industry lines, it has been most prevalent in sectors with a large proportion of lower-wage positions (e.g., leisure and hospitality), according to the

NCCI. Because payroll is leveraged as an exposure base to calculate workers' compensation premiums, wage inflation could prompt increased rates. After all, higher wages are tied to greater benefits, and it's crucial for benefits and premiums to remain in balance to ensure workers are adequately reimbursed for lost income following occupational illnesses or injuries. The NCCI also reported that the surge in employees receiving raises and moving from lower-wage positions to higher-paying roles could increase the risk of payroll miscalculations and create short-term disconnects between wages, benefits and workers' compensation premiums. Most states have an index for wage inflation to make sure premiums and benefits keep up with each other, but it's still possible for errors to occur.

- **Health care technology advancements**—As previously mentioned, the full impacts of rising medical inflation issues within the workers' compensation insurance segment are still on the horizon, with elevated claim and coverage costs predicted in the year ahead. Compounding concerns, various advancements in health care technology have led to growing treatment costs. These increased costs have the potential to further exacerbate overall claim severity.
- **Rate adequacy challenges**—The initial onset of the COVID-19 pandemic and subsequent shift in the proportion of remote employees resulted in major fluctuations in the number of workers' compensation claims and their associated costs. While these fluctuations have led to reduced claim frequency and severity in recent years, insurance experts are unsure how long such trends will last—making it more difficult to accurately determine businesses' workers' compensation exposures and ensure rate adequacy.

### Steps Businesses Can Take

Amid growing inflation concerns in the workers' compensation insurance segment, there are measures that businesses can implement to help mitigate their coverage costs. Here are some best practices for businesses to consider:

- **Ensure accurate payroll projections.** Having correct wage information is critical for conducting accurate premium calculations. Errors in payroll projections could present serious consequences, such as inadequate rates, insufficient benefits or a lack of ample coverage following costly claims. As wage inflation concerns continue, it may be beneficial to consult a trusted insurance professional for further assistance with payroll projections.
- **Review fee schedules.** Pay close attention to applicable state-regulated and carrier-negotiated fee schedules for workers' compensation coverage. These fee schedules can help maintain reasonable treatment expenses by establishing set rates for various medical services. Through the utilization of fee schedules, employees can receive much-needed health care for work-related illnesses and injuries without significantly driving up claim costs—even with medical inflation issues on the rise.
- **Promote a safe work environment.** To reduce the risk of potential claims and related workers' compensation costs, it's important to utilize effective health and safety initiatives on-site (e.g., employee training and personal protective equipment). Additionally, having a return-to-work program in place can help employees safely and successfully resume their job duties following occupational illnesses or injuries, therefore keeping claim costs at bay and limiting the likelihood of further incidents.

- **Manage claims effectively.** Lastly, it's vital to have clear processes established for handling workers' compensation claims as diligently and efficiently as possible. Effective claim management protocols can often help mitigate claim severity and prevent similar losses from occurring in the future.

### Conclusion

Overall, it's evident that inflation is a rising issue within the workers' compensation insurance sector. By gaining a better understanding of inflation trends and implementing measures to mitigate coverage costs, businesses can maintain effective workers' compensation programs amid this shifting risk landscape.

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