Self-Payment of Workers' Compensation Claims in Nebraska
It's not legal…

The Department hears that self-payment and non-reporting of workers' compensation losses occur from time to time. This practice violates several workers' compensation and insurance laws designed to protect the injured worker as well as the integrity of the workers' compensation experience rating system and the determination of classification rates. While it is possible that this can occur on a sporadic basis without the producer or insurer being aware of it, it is not reasonable to believe that this practice could occur often or repeatedly without a producer being aware and perhaps even an insurer being complicit. The Department views this matter as being important and will not hesitate to take action against parties responsible for self-payment and non-reporting of losses.

Historical background.

There was a time from the 1980s to 1998 when a policyholder that was issued a nondeductible workers' compensation insurance policy was "money ahead" to pay its own small medical claims rather than reporting them to its insurer. While the policyholder bore the cost of the smaller claims, the policyholder still incurred a net savings due to the fact that these claims would not be recognized for three years in the experience rating plan. This more than paid back the cost. Even though this practice was not legal in many or most states, we still heard reports that insurance agents often counseled or encouraged their clients to engage in this activity.

In 1998, the National Council on Compensation Insurance (NCCI) made a change in its experience rating plan to reduce the weight given to medical-only claims by 70%. This change largely eliminated the financial incentive for this activity for policyholders that were not written on some type of deductible form. In Nebraska, this change was approved effective 7/1/1998.

For the most part, the arithmetic behind this "game" – which is still not legal – now works only for an experience-rated employer that purchases insurance with a deductible. In Nebraska, medical deductibles of $500, $1000, $1500, $2000 or $2500 are available, per Neb. Rev. Stat. § 48-146.03. With this deductible, the employer will not pay insurance premium for its small medical losses and it will get a lower experience rating if it self-pays these losses, doesn't report them to the insurer and doesn't get caught.

Reporting for experience rating must be complete.

The clearest and most unequivocal statement of the illegality of this practice is found in Neb. Rev. Stat. § 44-7529. It states, in part:

> "No person shall willfully withhold information that will affect the forms applicable, dividends payable, or rates or premiums chargeable from the director or any statistical agent, advisory organization, or insurer."

The penalty for violating §44-7530 is up to $1000 for every act or violation. This provision applies to individual policyholders as well as to insurance producers and insurers. The

Alan Wickman
Nebraska Department of Insurance
8/14/2007

Department can also suspend or revoke an insurance producer's license or an insurer's certificate of authority for a willful violation.

Insurance producers and insurers that play along or encourage self-payment and nonreporting of claims are advised that §44-7529 applies to reports of claim information throughout the entire information stream. That is, not only does it apply to the misreporting or withholding claim-related information by employers to insurers, but it also applies to insurers that knowingly report data to the NCCI that omits certain claims because the employer is self-paying those claims. While insurance producers do not regularly report data to the NCCI, they are certainly responsible if they knowingly transmit underwriting information (e.g., application material) to an insurer on behalf of an employer where they have counseled the employer to self-pay claims and/or where they know that the employer is likely to engage in this activity.

Related provisions in the Workers' Compensation Act.

While the Act does not focus on experience rating, every relevant provision of the Act is consistent with the premise that *all* claims must be reported to the employer's insurer and managed and paid by the insurer. For instance, Neb. Rev. Stat. § 48-146 provides:

> "No policy of insurance against liability arising under the Nebraska Workers' Compensation Act shall be issued … unless it contains the agreement of the workers' compensation insurer or risk management pool that *it will promptly pay to the person entitled to the same all benefits conferred by such act*…" (Emphasis added.)

There is no exception to the preceding statement.

While only a small number of large employers are able to qualify as self-insureds, there are many more employers that seek to reduce the total cost of their workers' compensation obligations by purchasing no more insurance than is necessary. In response to the interest of such employers, legislation was passed to offer both small deductibles, applying only to medical costs, as well as as so-called "large deductibles", typically $100,000 and up applying to all losses.

It is important to examine the language of §48-146.03 addressing medical deductibles. Subsection (2) provides:

> "The deductible form shall provide that the workers' compensation insurer shall remain liable for and shall pay the entire cost of medical benefits for each claim directly to the medical provider, shall remain liable for and pay the entire cost of benefits, claims, and expenses as required by the policy irrespective of the deductible provision, and shall then be reimbursed by the employer for any deductible amounts paid by the workers' compensation insurer. The employer shall be liable for reimbursement up to the limit of the deductible."

Similar provisions apply to "large deductibles," which include indemnity benefits as well. The clear intent of these provisions is not to allow any sort of an option whereby the policyholder pays its own claims under the deductible amounts.

Non-reporting of "first aid" expenses.

Section 48-144.01 of the Act defines "first aid" and provides that an injury involving no lost time where the only medical treatment is "first aid" does not need to be reported to the Workers' Compensation Court. From time to time, we encounter employers that attempt to justify self-payment and non-reporting of medical claims based on this "first aid" provision. The fallacy with this assertion is that this "first aid" provision does not allow the nonreporting of injuries by an employer to its workers' compensation insurer. The injury still needs to be reported to the insurer and the insurer needs to be the party that pays for the medical treatment, even if that treatment is nothing more than "first aid."

Policy provisions in the workers' compensation policy.

The Act requires workers' compensation policy forms to comply with the Act. In addition, the Act and Nebraska insurance law require workers' compensation policy forms to be filed with and approved by the Nebraska Department of Insurance prior to use. The standard workers' compensation policy provides that the insurer "will pay promptly when due the benefits required of the employer by the workers' compensation law...," and that the employer must "[t]ell the insurer at once if injury occurs that may be covered by the policy." The Department will not approve a policy or endorsement that is inconsistent with these provisions.

An insurer that is complicit with an employer that it knows is self-paying and non-reporting claims is either misrepresenting the terms of its policy, in violation of the Unfair Trade Practices Act, or is utilizing an unfiled agreement, in violation of the Property and Casualty Rate and Form Act.

Application of the Unfair Trade Practices Act to insurance producers and insurers.

Insurance producers and insurers that counsel policyholders to engage in self-payment and non-reporting of claims are violating the Unfair Trade Practices Act. At Neb. Rev. Stat. §44-1525(1), the first listed unfair trade practice is to, "make, issue, circulate, or cause to be made, issued, or circulated a statement or sales presentation that misrepresents the benefits, advantages, conditions, or terms of a policy." Advising an employer to self-pay and non-report claims is not an accurate representation of the terms of a workers' compensation policy and misrepresents the employer's legal obligations arising from related laws.

"Fairness" of using deductible losses for experience rating.

It is easy to understand that employers may feel they shouldn't be "penalized" for deductible losses for which the insurer is reimbursed. One can see how they may see this as "justification" to self-pay small medical losses and not report them to the insurer.

Alan Wickman
Nebraska Department of Insurance
8/14/2007

This view, however, reflects a failure to understand the actuarial underpinnings of the experience rating system. Omitting a lot of technical details, the experience rating system in Nebraska works by comparing an employer's actual losses with those that were expected based on the dollars of payroll that the employer has in various class codes. If some of the losses are not reported, this deceives the rating system by representing that the employer has experienced fewer losses. This produces a lower experience rating than is appropriate.

It is possible to design an experience rating system that omits deductible losses. In fact, these systems are used in a number of states. The difference between those rating systems and the one used in Nebraska, however, is that those rating systems compare the actual incurred losses, minus deductible losses, to the losses expected for the policyholder, *but with the expectation calculated minus deductible losses*. The difference is that the experience rating plan used in Nebraska compares a higher amount of actual losses to a higher amount of expected losses, while the plan used in some other states compares a lower amount of actual losses (i.e., losses minus the deductible) to a lower amount of expected losses.

The advantage to the system used in Nebraska is that it gives a better – and thus fairer – estimation of an employer's expected losses. The disadvantage to the system used in Nebraska is that it relies upon the honesty of the policyholder. If the policyholder is willing to break the law and resort to subterfuge – and if it doesn't get caught – then it can receive a better experience rating than is justified. The experience rating system that omits deductible losses doesn't do as well in distinguishing employers with good and poor loss experience, but it doesn't rely so much on the honesty of the policyholder.

Conclusion.

The Department views the integrity of the workers' compensation experience rating system, as well as the determination of classification rates, as being important, and will not hesitate to take action against parties responsible for self-payment and non-reporting of losses.

Alan Wickman
Nebraska Department of Insurance
8/14/2007