

Biennial Report of the Texas Department of Insurance To the 83rd Legislature

Division of Workers' Compensation

December 2012



Rod Bordelon

Commissioner of Workers' Compensation



Texas Department of Insurance

Commissioner of Workers' Compensation, Mail Code MS-1

7551 Metro Center Drive, Suite 100 • Austin, Texas 78744-1609

512-804-4000 • 512-804-4001 fax • www.tdi.state.tx.us

December 1, 2012

The Honorable Rick Perry, Governor
The Honorable David Dewhurst, Lieutenant Governor
The Honorable Joe Straus, Speaker

Dear Governor Perry, Lieutenant Governor Dewhurst and Speaker Straus:

In accordance with Section 402.066, Labor Code, I am pleased to submit the workers' compensation portion of the Department's biennial report to the Legislature. This report provides an update on the Texas workers' compensation system and a brief description of a legislative recommendation that I believe will improve my ability to effectively and efficiently regulate the workers' compensation system.

I am available to discuss any of the issues contained in the report and to provide you with technical assistance. This report will be incorporated into the Department's forthcoming report to the Legislature required by Insurance Code 32.022 which will cover other lines and financial aspects of insurance in Texas.

Please contact me or Melissa Hamilton, Associate Commissioner of Government Relations at 463-6123 if you have any questions or need any additional information.

Thank you for your consideration.

Sincerely,



Rod Bordelon
Commissioner of Workers' Compensation

Overview of the Status of the Texas Workers' Compensation System

It's been seven years since the 2005 landmark House Bill (HB) 7 legislative reforms and two years since the adoption of the Texas Department of Insurance, Division of Workers' Compensation's (TDI-DWC's) Sunset legislation (HB 2605), and the Texas workers' compensation system has shown significant improvements in a variety of areas, including injury rates, employer participation, claims costs, return-to-work outcomes, access to care, and insurance rates and premiums. Over the past seven years, TDI-DWC has spent a considerable amount of time working with system stakeholders to implement and monitor these legislative reforms in order to improve the operational effectiveness of the Texas workers' compensation system, while ensuring that the system meets the basic legislative goals of providing adequate benefits to injured employees at a reasonable cost to Texas employers.

Going into the upcoming legislative session, it is clear that while additional improvements can always be made, the system as a whole has improved dramatically. While other states face increasing claims costs, rising insurance rates, an opioid prescription drug crisis, and poor return-to-work results, Texas continues to serve as an example of how sound legislative reforms combined with clear and strong regulation and careful monitoring and implementation can result in a strong workers' compensation system that serves the needs of all system participants.

Recognizing the need for system stability, the passage of TDI-DWC's Sunset bill last session (HB 2605) did not make wholesale changes to the overall structure of the Texas workers' compensation system, but rather reinforced the agency's existing authority to administer and regulate the system. HB 2605 also aligned network and non-network dispute appeal processes; clarified the medical quality review process; increased TDI-DWC's oversight of designated doctors; expedited medical claims for certain seriously injured first responders; and clarified injured employees' authority to obtain second opinions from their treating doctors for designated doctor determinations. TDI-DWC has diligently implemented these Sunset recommendations over the past two years and will continue to monitor the impact of these recommendations over the next biennium.

While the implementation of the Sunset recommendations in HB 2605 is still relatively new, it should be noted that all of the key provisions of the 2005 legislative reforms (HB 7) have been implemented by TDI and TDI-DWC and the system is now able to fully analyze the impact of this

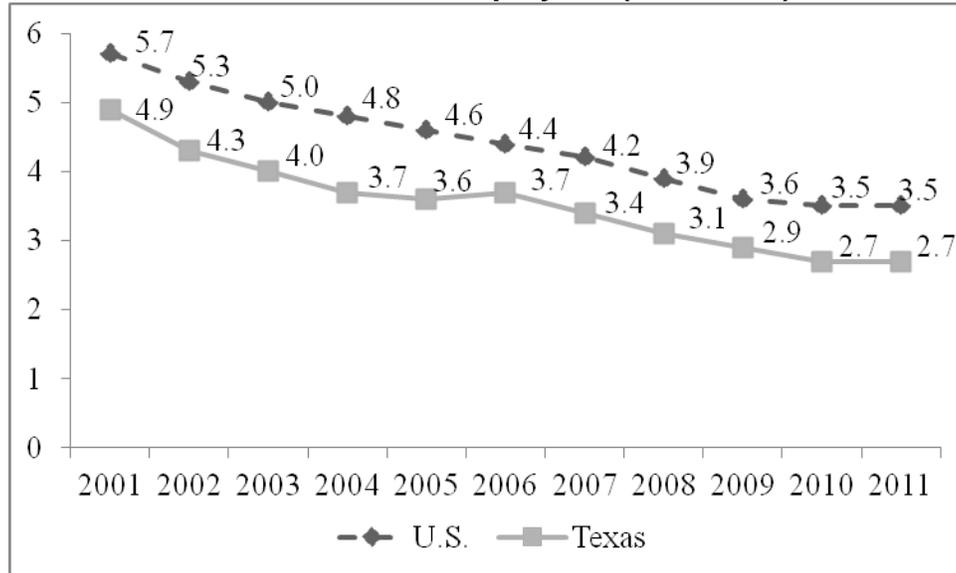
legislation. The system trends presented in this report allow TDI-DWC, policymakers, and system participants to gauge the relative “health” of the system and consider whether legislative changes are necessary to “fine-tune” past reform efforts, improve major program areas, and address lingering statutory questions needing further directive.

Injury Rates and Claim Frequency Continues to Decrease

The Texas workers’ compensation system continues to experience marked reductions in both the non-fatal occupational injury and illness rate and the overall number of reportable claims filed with TDI-DWC. Since the passage of HB 7 in 2005, the nonfatal occupational injury illness rate in Texas decreased 25 percent from 3.6 to 2.7 injuries per 100 full-time employees. Workplace injury and illness rates vary widely by industry. However, the incidence rates for industries such as agriculture, forestry, fishing and hunting, construction, transportation and warehousing, retail trade, manufacturing, and leisure and hospitality have experienced significant declines since 2005 (between 10 percent and 33 percent decline for each industry sector listed), while industries such as utilities, financial activities and educational services have experienced increased injury rates. The industry sectors with the highest rates include: transportation and warehousing (4.5 injuries/illnesses per 100 full-time employees), agriculture, forestry, fishing and hunting (4.1 injuries/illnesses per 100 full-time employees), utilities (4.1), retail trade (3.6), health care and social assistance (3.5), education and health services (3.4), and manufacturing (3.2). Compared with the rest of the nation, the injury rate in Texas has been consistently below the national average (see Figure 1).¹

¹ Changes to the federal Occupational Safety and Health Administration recordkeeping logs in 2002 and the transition from the Standard Industrial Classification (SIC) system to the North American Industry Classification System (NAICS) in 2003 may limit comparability of pre-2003 data series.

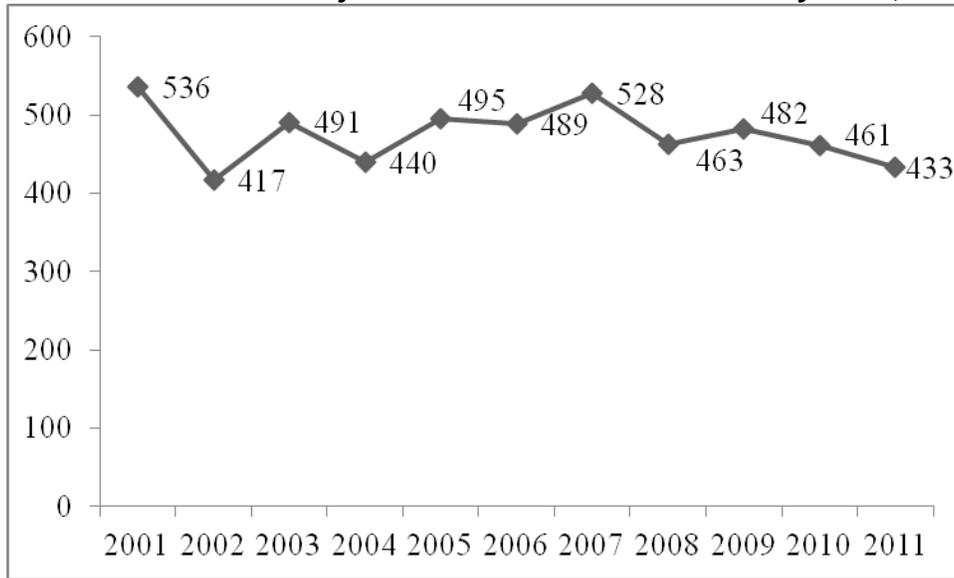
Figure 1: Texas and U.S. Nonfatal Occupational Injury and Illness Rates Per 100 Full-time Employees (2001-2011)



Source: Texas Department of Insurance, Division of Workers' Compensation and U.S. Department of Labor, Bureau of Labor Statistics, *Annual Survey of Occupational Injuries and Illnesses*, 2012.

In addition to the reduction in the non-fatal occupational injury and illness rate in Texas, the number of fatal occupational injuries in Texas fluctuated from 2005 to 2009 and has since declined to the lowest levels Texas has seen since 2002 (see Figure 2). Texas recorded a six percent decrease in work-related fatalities in 2011, the second consecutive year of decreases. Transportation incidents continue to be the leading cause of work-related fatalities in Texas (168 in 2011 - a 14 percent decline from 2010). Following transportation incidents, violence and other injuries by persons or animals was the second highest cause of fatalities (70 fatalities in 2009, including 42 fatalities involving workplace homicides) and falls was the third highest cause (67 fatalities – a 34 percent increase from 2010). The vast majority (93 percent) of fatal work-related injuries involved private-sector employees, with the service producing industries representing more than half of these fatalities. White, non-Hispanic employees experienced fewer fatalities in 2011 than in 2010 (217 incidents in 2011 compared to 257 incidents in 2010); however, the number of fatalities involving Black, non-Hispanic and Hispanic or Latino employees increased (205 incidents in 2011 compared to 191 incidents in 2010).

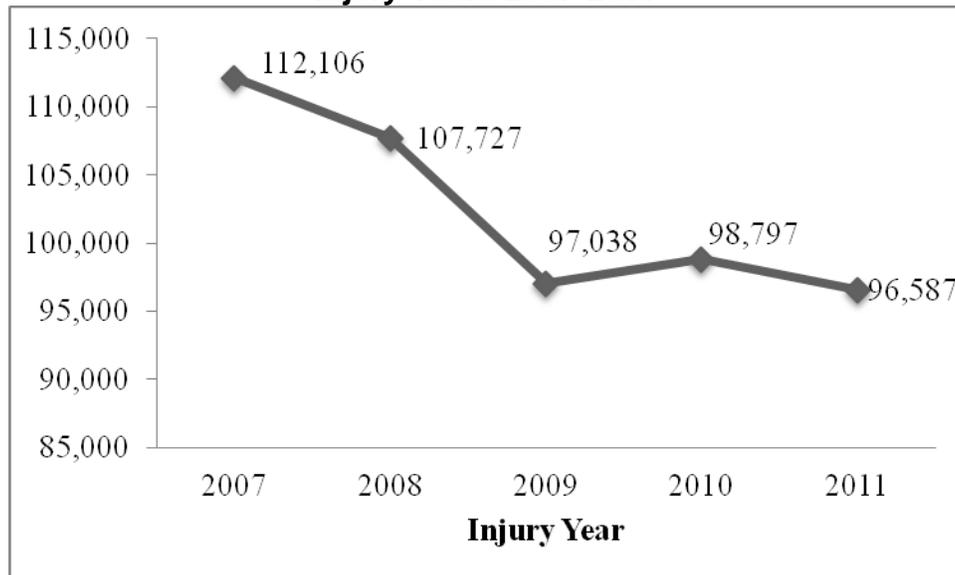
Figure 2: Number of Fatal Injuries and Illnesses in Texas by Year, 2001-2011



Source: Texas Department of Insurance, Division of Workers' Compensation and U.S. Department of Labor, Bureau of Labor Statistics, *Census of Fatal Occupational Injuries*, 2012.

Similar to the non-fatal occupational injury and illness rates seen in Figure 1, the number of workers' compensation claims actually reported to TDI-DWC has declined steadily since 2001; however, these declines have begun to slow down in recent years (see Figure 3). The reasons for those reported declines, both nationally and in Texas, stem from a variety of factors, including increased safety awareness among employers and employees, enhanced health and safety outreach and monitoring efforts at the federal and state level, improvements in technology, globalization, increased use of independent contractors, and the possibility of under-reporting of workplace injuries and illnesses. At the national level, states have begun to see increases in claim frequency as a result of the economic recovery. However, additional monitoring is needed to determine if claim frequency in Texas has finally begun to plateau or whether increases in the number of employees in Texas, even with declining injury rates, will result in increased claim frequency in the future.

Figure 3: Number of Workers' Compensation Claims Reported to TDI-DWC, Injury Years 2007-2011



Note: Data updated through June 2012. These numbers include the claims that are required to be reported to TDI-DWC, including fatalities, occupational diseases, and injuries with at least one day of lost time. Medical-only claims are not required to be reported to TDI-DWC.

Source: Texas Department of Insurance, Division of Workers' Compensation, 2012.

Insurance Rates and Premiums Continue to Decline

HB 7 requires the Commissioner of Insurance to report on the affordability and availability of workers' compensation insurance for Texas employers. The Property and Casualty Actuarial Office of TDI monitors insurance rate filings and reports workers' compensation insurance metrics as part of a biennial report to the Texas Legislature on the impact of HB 7 on insurance rates and premiums.²

Two important measures of the financial health of the Texas workers' compensation insurance market are the loss ratio and the combined ratio. The loss ratio is the relationship between premium collected and the losses incurred (i.e., amounts already paid out plus amounts set aside to cover future payments) by insurance companies. The combined ratio is similar to the loss ratio, except that it compares the premiums collected with both the losses and expenses incurred by the insurance company. A combined ratio of less than 100 percent indicates that an insurance company earned a

² For additional information on the effect of the reforms on the workers' compensation insurance market, see *Setting the Standard: An Analysis of the Impact of the 2005 Legislative Reforms on the Texas Workers' Compensation System, 2012 Results*.

profit on its insurance operations (also known as an underwriting profit). A ratio of over 100 percent indicates a loss on insurance operations, although this loss may be more than offset by earnings on investments. For example, if the projected ultimate combined ratio is 110.0 percent, then for every \$1.00 in premium that is collected by the insurance company it is projected that \$1.10 will be used to pay losses and expenses incurred by the insurance company. The insurance company will need to find other sources to pay the 10 cents that is not covered by the premium. This may come from investments or even a direct charge against the insurance company's surplus. In 2011, the projected accident year combined ratio was 94.9 percent. This means that for every dollar collected by the insurance company, it will pay an estimated 94.9 cents to cover losses and expenses. The insurance company will keep the remaining approximately five cents as profit.

Table 1 shows the loss ratio and the combined ratio, both of which reflect that the last seven years have been very profitable for workers' compensation insurance companies. In 2008 and 2009, the accident year combined ratios deteriorated relative to the prior three years. In 2010 and 2011 the combined ratios deteriorated again, but remained profitable.

Table 1: Projected Ultimate Calendar Year/Accident Year Loss and Combined Ratios

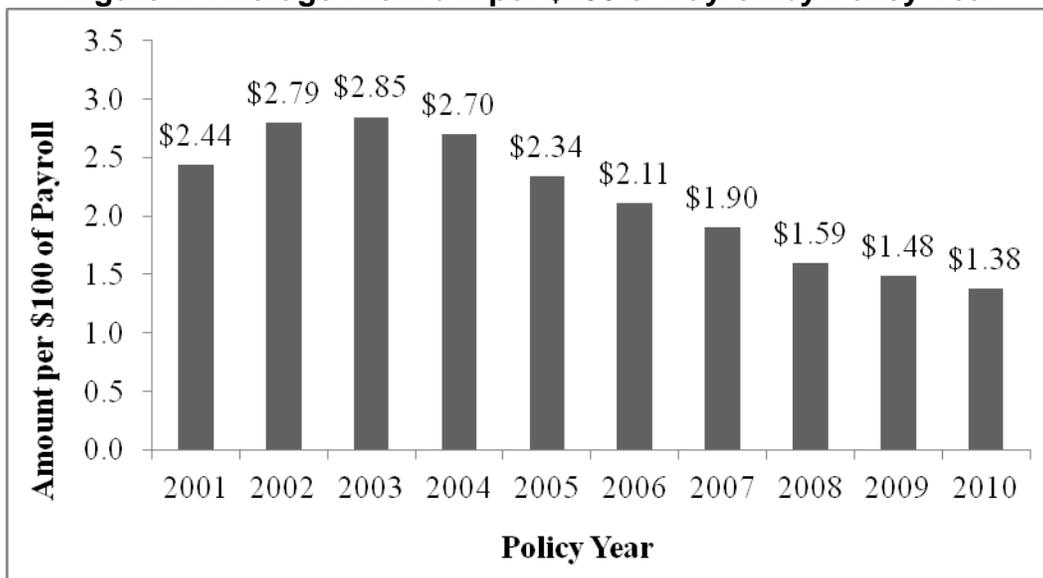
Accident Year	Direct Earned Premium	Ultimate Losses	Loss Ratio	Combined Ratio
2005	\$2,131,103,682	\$759,805,337	35.7%	73.0%
2006	2,201,815,184	792,228,947	36.0%	70.4%
2007	2,199,889,123	871,174,776	39.6%	74.7%
2008	2,210,241,056	965,664,860	43.7%	84.4%
2009	1,944,612,874	814,329,705	41.9%	83.4%
2010	1,729,558,428	887,418,371	51.3%	94.7%
2011	1,819,827,507	922,905,594	50.7%	94.9%

Source: Texas Workers' Compensation Financial Data Call, Texas Compilation of Statutory Page 14, and Texas Compilation of the Insurance Expense Exhibit. Loss development factors used in determining the ultimate losses are from the Financial Data Call Package as of December 2011.

Since 2003, workers' compensation insurance rates have come down almost 50 percent. This number includes changes in insurance companies own deviations to the workers' compensation classification relativities set by TDI, as well as changes made to the overall classification relativities by TDI. The rate decrease also includes the impact from companies that adopted the initial loss costs filed by the National Council on Compensation Insurance. In preparation for the 2012 biennial rate hearing on workers' compensation insurance, TDI requested that insurance companies provide their "rate indications," which is the actuarial determination of how its rate or premium level should change going forward. These indications are based on the insurance companies' own calculations and do not reflect any judgments or assumptions made by TDI. For the 149 companies that filed rate indications with TDI, the average premium-weighted indication is 1.3 percent. This suggests that the industry estimates the need for a 1.3 percent increase in current premium levels to cover losses and expenses and produce the targeted profit. Even though the companies' indications suggest a small increase in premium levels on average, few companies proposed a rate change with their filing.

While the rate changes filed by the insurance companies in the last few years show how much rates have come down, these rates are just the start of the workers' compensation insurance pricing process. What employers actually pay, the premium, reflects not only rates, but also mandated rating programs (such as experience rating and premium discounts) as well as optional rating tools (such as scheduled rating plans and negotiated experience modifiers) to recognize individual employer risk variations. These rating tools can be used to achieve desired premium levels. Figure 4 shows the average premium per \$100 of payroll for policy years 2001 – 2010, reflecting year to year changes in premiums charged. Since policy year 2003, the average premium per \$100 of payroll has continued to decline from \$2.85 in policy year 2003 to \$1.38 in policy year 2010.

Figure 4: Average Premium per \$100 of Payroll by Policy Year



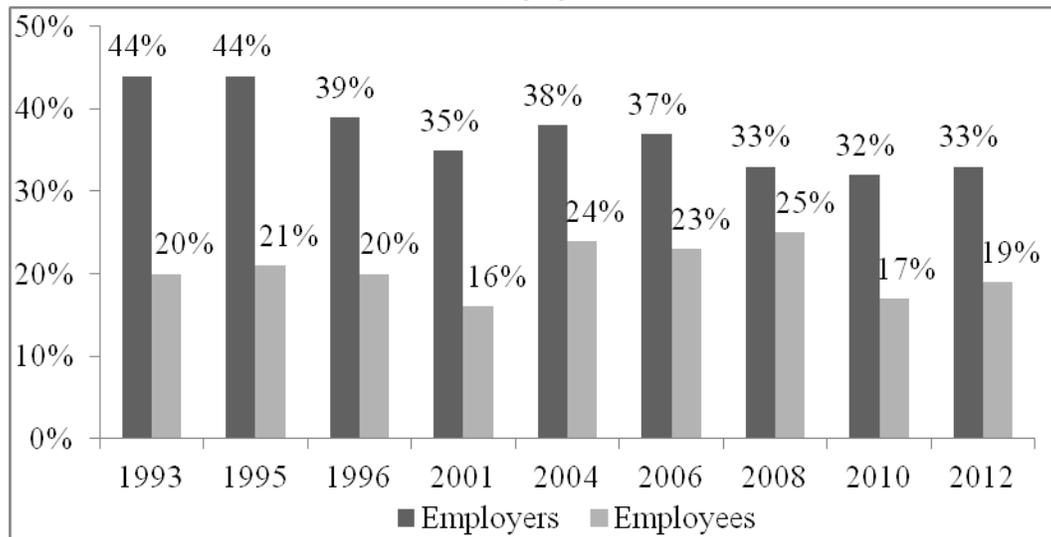
Source: The Texas Workers' Compensation Financial Data Call and TDI's 2011 Classification Relativity Study.

Employer Participation and Employee Coverage Rates Have Improved

Texas is the only state where private-sector employers (regardless of employer size or industry) are allowed the option of obtaining workers' compensation coverage or becoming "non-subscribers" to the workers' compensation system. Employers who choose to not obtain workers' compensation coverage (either through purchasing a commercial policy or becoming a certified self-insured employer or a member of a certified group of self-insured employers) lose the protection of statutory limits on liability and may be sued for negligence by their injured employees.

Non-subscription rates remain an important performance measure in the workers' compensation system since it generally measures employers' perspectives regarding whether the benefits of participating in the workers' compensation system are greater than the costs of obtaining the coverage. The percentage of Texas employers that are non-subscribers to the workers' compensation system decreased to 33 percent in 2012 – the second lowest percentage since 1993 (an estimated 113,000 employers in 2012). However, an estimated 19 percent of Texas employees (representing approximately 1.7 million employees in 2012) worked for non-subscribing employers – an increase of two percentage points since 2010, but the third lowest percentage since 1993 (see Figure 5). It should be noted that the employee coverage rates in 2012 were affected somewhat by the decision of one of the largest Texas employers to become a nonsubscriber this year.

Figure 5: Percentage of Texas Employers That Are Nonsubscribers and the Percentage of Texas Employees That Are Employed by Nonsubscribers, 1993-2010



Source: *Survey of Employer Participation in the Texas Workers' Compensation System*, 1993 and 1995 estimates from the Texas Workers' Compensation Research Center and the Public Policy Research Institute (PPRI) at Texas A&M University; 1996 and 2001 estimates from the Research and Oversight Council on Workers' Compensation and PPRI; and 2004, 2006, 2008, 2010 and 2012 estimates from the Texas Department of Insurance, Workers' Compensation Research and Evaluation Group and PPRI.

The percentage of Texas employers who have workers' compensation coverage has increased since the passage of HB 7 in 2005 (from 62 percent of Texas employers in 2004 to 67 percent of Texas employers in 2012), due primarily to lower insurance premiums and the increased availability of workers' compensation health care networks. Results from the 2004 through 2012 employer surveys highlighted the trend of larger employers choosing to opt out of the Texas workers' compensation system for reasons that centered primarily on the ability to adequately control medical costs for their injured employees.

However this trend for large employers reversed after 2008. An increased percentage of large employers, especially those with more than 500 employees, chose to purchase workers' compensation coverage in 2010 and to a slightly lesser degree in 2012. The non-subscription rates among large employers fell from 26 percent in 2008 to 15 percent in 2010 and 17 percent in 2012 (see Table 2). Some medium-sized employers (i.e., those with 50-99 employees) increased their non-subscription rates moderately, while many medium-sized and small employers stabilized at the 2008 levels. The decline in non-subscription rates for large employers after 2008 coincides with an economic downturn nationwide and in Texas, which resulted in some of the lowest non-

subscription rates since the 2001 recession when the non-subscription rate was 14 percent. The industries that have higher non-subscription rates (such as Arts/Entertainment/Accommodation/Food Services, Finance/Real Estate/Professional Services, Health Care/Educational Services and Wholesale Trade/ Retail Trade/Transportation) may have also been disproportionately affected by the U.S. recession, meaning that their workforce has been temporarily reduced, which lowered the overall number of employees employed by non-subscribers.

Table 2: Percentage of Texas Employers That Are Non-subscribers, by Employment Size

Employment Size	1995	1996	2001	2004	2006	2008	2010	2012
1-4 Employees	55%	44%	47%	46%	43%	40%	41%	41%
5-9 Employees	37%	39%	29%	37%	36%	31%	30%	29%
10-49 Employees	28%	28%	19%	25%	26%	23%	20%	19%
50-99 Employees	24%	23%	16%	20%	19%	18%	16%	19%
100-499 Employees	20%	17%	13%	16%	17%	16%	13%	12%
500 + Employees	18%	14%	14%	20%	21%	26%	15%	17%

Source: *Survey of Employer Participation in the Texas Workers' Compensation System*, 1993 and 1995 estimates from the Texas Workers' Compensation Research Center and the Public Policy Research Institute (PPRI) at Texas A&M University; 1996 and 2001 estimates from the Research and Oversight Council on Workers' Compensation and PPRI; and 2004, 2006, 2008, 2010 and 2012 estimates from the Texas Department of Insurance, Workers' Compensation Research and Evaluation Group and PPRI.

Compliance Efforts Regarding Reporting Requirements for Non-subscribing Employers

While the types and amounts of benefits provided to injured employees who work for non-subscribing employers as well as the administration of those benefit programs fall outside of the jurisdiction of TDI's and TDI-DWC's regulation, non-subscribers are still subject to certain reporting requirements under the Workers' Compensation Act and Rules. Non-subscribers are required to report annually to TDI-DWC that they have elected to opt out of the workers' compensation system by filing the DWC Form-005 form with TDI-DWC.³ Additionally, non-subscribers who employ at least five employees are required to file a notice with TDI-DWC (using the DWC Form-007 form) for every fatality, occupational disease, and every work-related injury that results in more than one day of lost time.⁴ Failure to comply with these reporting requirements may result in enforcement action and administrative penalties levied up to \$25,000 per day per occurrence.

Three sessions ago the 80th Legislature added an appropriation rider to TDI's budget, which requires TDI-DWC to submit, as part of its biennial report to the legislature, a report regarding the compliance of non-subscribing employers with these reporting requirements as well as any administrative penalties levied against non-complying employers. Prior to the 2007 legislative session, non-subscriber reporting compliance efforts on behalf of the agency were primarily complaint driven; however, historically, TDI-DWC (and its predecessor the Texas Workers' Compensation Commission) only received a relatively small number of complaints regarding non-subscriber reporting compliance. Since 2009, TDI-DWC processed approximately 1,111 complaints (including internal and external complaints) on nonsubscriber reporting compliance, resulting in 140 warning letters issued to employers and approximately \$45,950 in penalties issued against non-subscribers for failing to respond to requests and filing required forms.

Over the last four years, TDI-DWC has undertaken efforts to not only increase employer awareness about non-subscriber reporting requirements, but also to proactively identify potential non-

³ See Section 406.004, *Labor Code*.

⁴ See Section 411.032, *Labor Code*.

complying employers. Using workers' compensation policy data collected by TDI-DWC's Statistical Agent - the National Council on Compensation Insurance (NCCI), as well as information collected by the Texas Workforce Commission (TWC) regarding the identity of employers who participate in the TWC Unemployment Insurance program, TDI-DWC compiled a list of employers who were potential non-subscribers. This list of employers was then compared with the list of non-subscribers who submitted a DWC Form-005 form to TDI-DWC to develop a list of potential non-complying employers.

Given the large volume of potential non-complying employers, TDI-DWC prioritized its notice and compliance efforts starting with the largest employers (i.e., those with more than 500 employees) and expanding that notice to smaller and smaller employers. TDI-DWC sends a batch of letters semi-annually to potentially non-compliant employers. In these letters, TDI-DWC asks these employers to provide information regarding their current workers' compensation coverage status. To date, TDI-DWC has contacted approximately 2,230 employers, with the following results:

- 51 percent had workers' compensation coverage;
- 35 percent filed their DWC Form-005 upon the notification;
- 12 percent returned mail (out of business);
- 2 percent did not respond and were referred to Enforcement for failure to respond to a request by TDI-DWC.

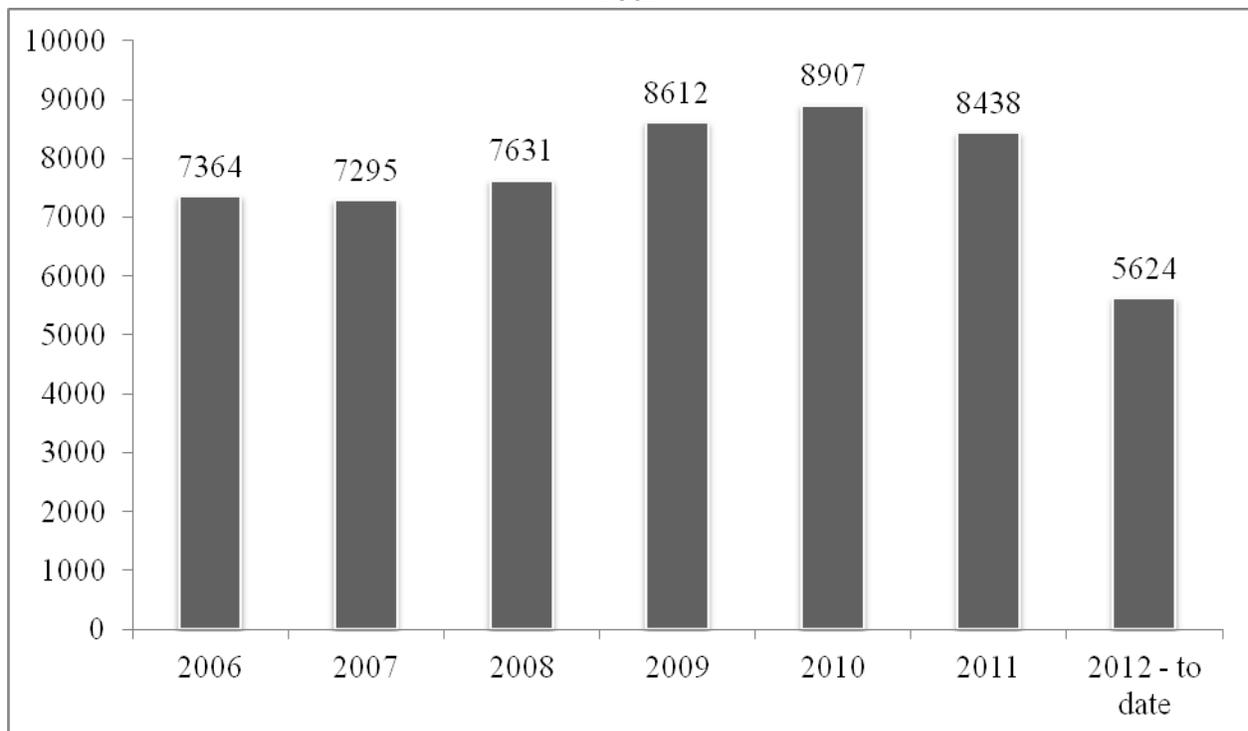
Identifying potential non-complying employers has proved to be challenging for the agency for several reasons, including the completeness, accuracy and timeliness of workers' compensation policy data and employer identifying data collected by TDI-DWC and other Texas state agencies. For example, an employer may have filed for unemployment insurance purposes with the TWC using the Federal Employment Identification Number (FEIN) of the parent organization, but may have different workers' compensation insurance policies under various FEIN's and names of subsidiaries of the parent organization. As a result, it is somewhat difficult for TDI-DWC to identify individual employers that may be non-subscribers and to check for these employers' compliance with reporting requirements.

Additionally, twice a year TDI-DWC sends letters to 300 randomly selected employers who had filed the DWC Form-005 to inquire whether these employers had any occupational injuries, illnesses and fatalities during the previous six months that should be reported to TDI-DWC using the DWC

Form-007. Since 2008, TDI-DWC has contacted approximately 1,800 Texas employers – 831 of these employers indicated that they had no reportable injuries and illnesses to report (46 percent); 451 reported injuries and illnesses that they had not previously reported (25 percent); 159 indicated they now had workers’ compensation coverage (9 percent); 111 reported having fewer than five employees and are exempt from these reporting requirements (6 percent); and the remaining employers either were out of business or did not respond to TDI-DWC’s request (14 percent).

Despite TDI-DWC’s recent compliance and education efforts about these reporting requirements, the volume of DWC Form-005 forms filed with TDI-DWC has not significantly increased (see Figure 6). Overall non-subscriber compliance with existing reporting requirements remains low - less than 10 percent of non-subscribers (an estimated 113,000 private employers are non-subscribers in 2012) are estimated to be in compliance with the DWC Form-005 filing requirement.

Figure 6: Total Number of DWC-005 Forms Received by TDI-DWC by Calendar Year



Source: Texas Department of Insurance, Division of Workers’ Compensation, 2012.

In an effort to make it easier for Texas employers to report their non-subscriber status with TDI-DWC, the agency has recently updated and clarified its existing rules regarding reporting

requirements for non-subscribing employers and automated the DWC-005 form (see <http://www.tdi.state.tx.us/wc/employer/index.html#nocov>), which allows employers to directly enter their information and obtain a verification of submission online at no charge. These new and amended rules concern the reporting by subscribing and non-subscribing employers of insurance coverage status to the TDI-DWC and to employees; and, reports of injury and occupational diseases to the TDI-DWC by subscribing and non-subscribing employers. The newly adopted rules primarily reorganize, update and clarify existing requirements and specify the form and manner for employers to use to satisfy these requirements. The rules incorporate more current methods of information submission and simplify the reporting of the DWC Form-005 so that it is reported by all non-subscribers at the same time each calendar year. The rules also align the types of data elements included in an employer report of injury between subscribing and non-subscribing employers to the extent possible. As a result, the TDI-DWC also revised and streamlined the DWC Form-007 (report of injuries/illnesses for non-subscribing employers).

In addition to clarifying and simplifying reporting requirements for non-subscribing employers, the rules incorporated two new reporting requirements for political subdivisions that provide medical benefits to employees by directly contracting with health care providers and subscribing employers whose employees opt out of workers' compensation coverage under Labor Code Section 406.034. Finally, the rules updated employer coverage and non-subscriber notices that must be posted in the workplace and must be individually provided to employees.⁵

TDI-DWC has also recently re-organized its employer resources website to better assist employers in locating pertinent workers' compensation information. The employer resources website (see www.tdi.state.tx.us/wc/employer/index.html) now features a direct link to the automated DWC Form-005 form as well as Online Reporting Help and Frequently Asked Questions. Additionally, in response to the Sunset Advisory Commission recommendation that TDI-DWC should closely coordinate with other state agencies to include non-subscription reporting requirements in their print and electronic publication, TDI-DWC identified other state agency websites that contain employer resource information (e.g., Comptroller's, Texas Workforce Commission's, Office of the

⁵ See 28 TAC §§110.7 and 110.103, which became effective on August 2, 2012 and 28 TAC §§110.1, 110.101, and 110.105, which become effective January 1, 2013.

Governor's and Secretary of State's websites) and updated those websites with the new TDI-DWC employer resource information. TDI-DWC has also distributed information about these reporting requirements and the adoption of new rules to state business and non-subscriber associations in order to increase employer awareness of these non-subscriber reporting requirements and to more effectively enforce these requirements for those employers who have been notified.

Medical Costs Have Stabilized in the System, Despite Continued Medical Inflation

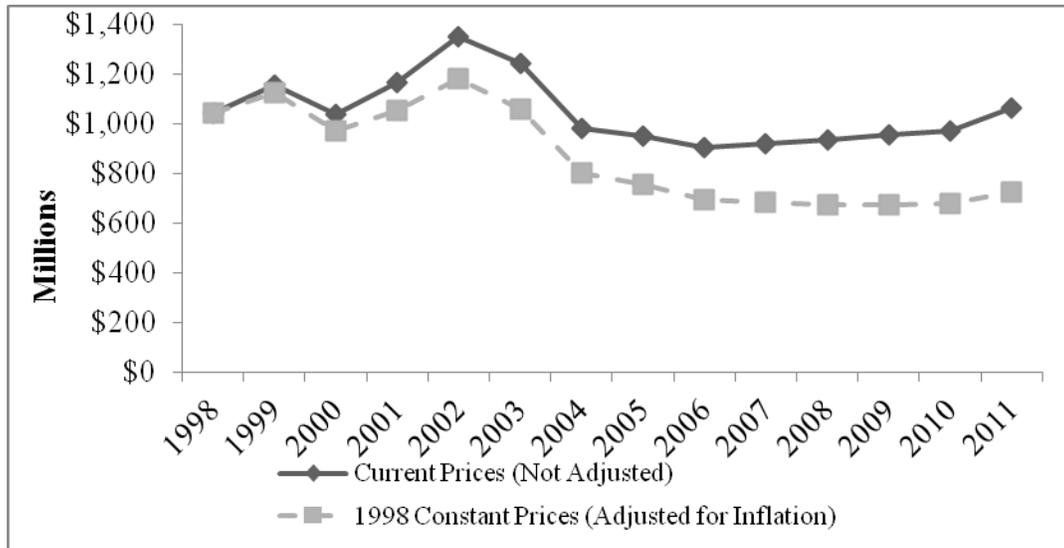
Over the past 12 years, a significant amount of attention has been placed on the issue of lowering medical costs through a reduction in the utilization of medical services provided to injured employees. The issue of reducing medical costs and improving the quality of medical care provided to injured employees was also a key component driving the passage of a new health care delivery model in HB 7 – workers' compensation health care delivery networks.

Figures 7 and 8 illustrate the medical cost trends that the system was experiencing prior to and just after the implementation of the 2001 and 2005 legislative reforms. As Figure 7 illustrates, when total medical payments for professional and hospital services are analyzed without taking into account inflationary changes, it appears that total payments have stabilized in the Texas workers' compensation system (from \$1.04 billion in 1998 to \$1.06 billion in 2011 – an increase of only 1.8 percent). However, when medical prices are adjusted using the Medicare Economic Index to account for medical inflationary changes over time, it shows that there has been roughly a 30 percent decrease in total payments since 1998 (see Figure 7). These changes in medical payments over time are due to a variety of factors, including fewer claims being filed and reductions in the amount of certain types of care being rendered for new claims. Increases in the professional services fee guideline in 2008 (including annual increases in the fee guideline in conjunction with changes to the Medicare Economic Index) in order to improve access to care as well as rising hospital costs have led to recent increases in unadjusted total medical payments.⁶ The elimination of

⁶ On August 1, 2003, the system's first Medicare-based professional service fee guideline took effect. While this fee guideline increased reimbursement for some categories of services, including primary care, reimbursements for specialty surgery services were significantly reduced. On the whole, the reimbursement rates for professional medical services in the Texas workers' compensation system went from approximately 140 percent of Medicare to approximately 125 percent of Medicare.

informal and voluntary network discounts off of the TDI-DWC fee guidelines for non-network claims will likely result in additional increases in payments starting in 2011.

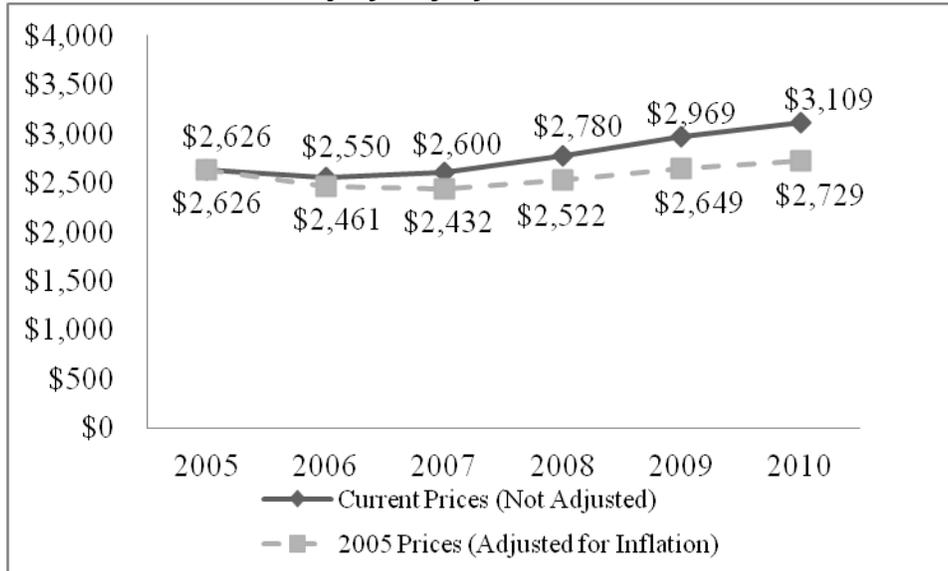
Figure 7: Total Medical Payments (Professional and Hospital), Service Years 1998-2011



Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.

As injury rates continue to decline in Texas, there have been some changes in the types of injuries and the proportion of claims with lost time in the workers' compensation system. Looking at Figure 8, it appears that the average medical cost per claim has increased since 2005, even with all of the legislative reforms, but is still relatively stable compared to the double-digit increases in medical costs that the system was experiencing in the late 1990's and early 2000's prior to the passage of HB 7. After accounting for medical inflation, the average professional and hospital medical cost per claim increased approximately 3.9 percent since 2005 from \$2,626 in injury year 2005 to \$2,729 in injury year 2010. Unadjusted medical costs per claim show an 18 percent increase over the same time period from \$2,626 in injury year 2005 to \$3,109 in injury year 2010.

Figure 8: Average Medical Cost per Claim (Professional and Hospital), One-Year Post Injury, Injury Years 2005-2010



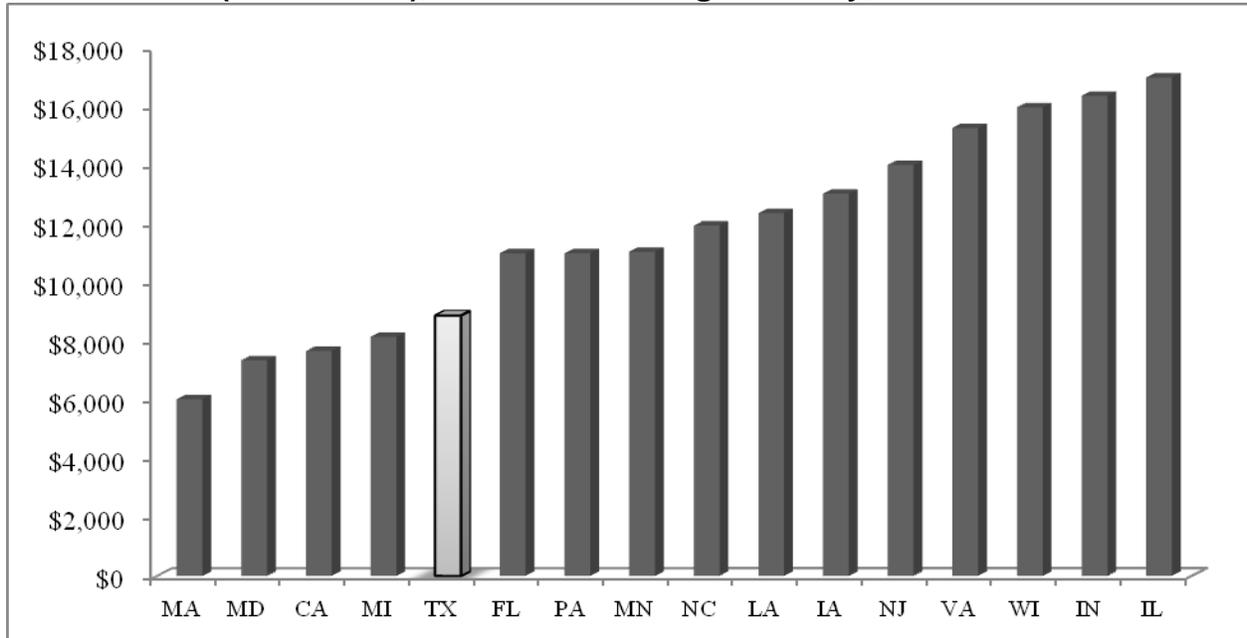
Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.

When compared with other states, Texas has experienced significant reductions in medical costs per claim as a result of legislative reforms in 2001 and 2005. According to a 16-state comparison of claims with more than 7 days of lost time by the Workers' Compensation Research Institute, in 2001, Texas was among the highest nationally in terms of medical costs per claim. By 2010, Texas was almost 23 percent below the median cost of those same 16 states (\$8,885 per claim in Texas compared with \$11,506 per claim for the 16-state median), including Florida, Pennsylvania, Louisiana and Illinois (see Figure 9).

Based on the analysis available to date, the reduction in the total amount of medical payments made in the system between 2002 and 2006 can be attributed mostly to fewer claims being filed, as well as lower utilization of specific types of services. Greater scrutiny on certain types of services through the mandatory preauthorization of physical and occupational therapy services (required by HB 7 in 2005), as well as the implementation of the TDI-DWC adopted treatment guideline – the *Official Disability Guidelines: Treatment in Workers' Comp*, published by the Work Loss Data Institute (adopted in 2007) have resulted in fewer overall professional service visits per claim and services per visit. Utilization reductions and claim frequency appear to be flattening out in recent years and medical cost increases since 2007 appear to be more price-driven than utilization driven, which may signal

increased medical costs in the future unless additional utilization reductions can be achieved or prices controlled.⁷

Figure 9: Average Medical Cost for Claims with More Than 7 Days of lost Time (All Services), 12 months Average Maturity, 2010/2011



Source: Workers' Compensation Research Institute, *Monitoring the Impact of Reforms in Texas: CompScope™ Medical Benchmarks*, 13th Edition, 2012.

Note: 2010/2011 refers to claims arising from October 1, 2009 through September 30, 2010, evaluated as of March 31, 2011.

Preliminary Impact of Closed Pharmacy Formulary on New Claims Shows Significant Reduction in Use of Opioids for Injured Employees

The last component of the 2005 HB 7 reforms implemented by TDI-DWC was the adoption of a closed pharmacy formulary for Texas workers' compensation claims, which became effective in January 2011. The closed pharmacy formulary includes all FDA-approved drugs, except for investigational and experimental drugs and excludes drugs listed as "N" drugs (or "not

⁷ The Workers' Compensation Research Institute has also mainly attributed recent increases in medical payments per claim in Texas to fee schedule changes in 2008. See Workers' Compensation Research Institute, *Monitoring the Impact of Reforms in Texas: CompScope™ Medical Benchmarks*, 12th edition, 2012.

recommended” drugs) in Appendix A of TDI-DWC’s adopted treatment guidelines - the *Official Disability Guidelines: Treatment in Workers’ Comp*, published by the Work Loss Data Institute. Under this formulary, which took effect for new workers’ compensation claims with dates of injury on or after September 1, 2011, prescriptions for drugs that are excluded from the formulary require pre-approval from the insurance carrier before they can be dispensed.

The workers’ compensation closed pharmacy formulary will take effect for older claims (i.e., claims with dates of injury prior to September 1, 2011) on September 1, 2013. TDI-DWC estimates that approximately 15,000 of these older claims will need to be re-evaluated by insurance carriers and prescribing doctors to determine the appropriate course of treatment going forward for these claims, which may include continued use of an “N” drug, switching to a comparable drug that is not on the “N” list, completing a weaning regimen or other appropriate treatments.

In an effort to facilitate a safe and smooth transition for these older claims to the closed formulary on September 1, 2013, TDI-DWC has developed template communication letters insurance carriers can use to inform prescribing doctors, injured employees and pharmacies of the application of the closed pharmacy formulary and to initiate claim-level discussions to determine the appropriate course of treatment for these claims. TDI-DWC has also held several stakeholder meetings to get input on the status of the transition process in order to identify any potential barriers to securing treatment agreements for these claims. If treatment agreements can be reached between insurance carriers and prescribing doctors on individual claims, then these agreements may supercede the application of the formulary’s preauthorization requirements. In order to more precisely track the progression of the formulary transition for these older claims, TDI-DWC will be initiating a data call to monitor the status of treatment agreements in the Spring of 2013 and a follow-up data call in the Summer of 2013. The results of this data call will be incorporated into the REG’s updated research study on the impact of the closed formulary next year.

A preliminary study by the REG in 2012 shows that the new closed pharmacy formulary has had a significant impact on new injuries.⁸ The study compared injuries that occurred between September

⁸ For more information, see Texas Department of Insurance, Workers’ Compensation Research and Evaluation Group, *Impact of the Texas Pharmacy Closed Formulary, A Preliminary Report*, 2012.

and November 2011 with injuries that occurred during the same timeframe in 2010 and in 2009. To ensure comparability, both sets of claims were analyzed at six months post-injury to account for differences in claim maturity. The study found that under the closed formulary the percentage of claims receiving “N” drugs was reduced by 56 percent between 2010 and 2011 and the total number of claims receiving “N” drugs was reduced by 60 percent over the same timeframe (see Table 3).

Table 3a: Frequency of Claims Receiving “N” Drugs, Injury Years 2009-2011 (Sept – Nov) - “N” Drugs

Injury Year	2009	2010	2011	2010-2011 Percentage Change
Number of claims	4,326	4,661	1,870	-60%
Percent of all claims	18%	18%	8%	-56%

Source: Texas Department of Insurance, Workers’ Compensation Research and Evaluation Group, 2012.

Table 3b: Frequency of Claims Receiving “N” Drugs, Injury Years 2009-2011 (Sept – Nov) – Other Drugs

Injury Year	2009	2010	2011	2010-2011 Percentage Change
Number of claims	23,752	25,649	24,392	-5%
Percent of all claims	98%	97%	99%	+2%

Source: Texas Department of Insurance, Workers’ Compensation Research and Evaluation Group, 2012.

The closed pharmacy formulary appears to have had a significant impact on prescription drug costs in the Texas workers’ compensation system. Overall, total prescription drug costs for services rendered between Sept-Nov 2011 were reduced by 26 percent (approximately \$1.4 million) when compared to 2010 claims. These cost reductions were even more significant for “N” drugs. Prescription drug costs attributed to not-recommended (“N”) drugs for 2011 claims were reduced by 81 percent (approximately \$841,000) when compared to 2010 and the average “N” drug cost per claim was reduced by approximately 54 percent (see Table 4).

Table 4: Comparison of “N” Drug Costs, Injury Years 2009-2011 (Sept – Nov)

Injury Year	2009	2010	2011	2010-2011 Percentage Change
Total cost of N-drug prescriptions	\$972,198	\$1,032,395	\$191,302	-81%
N-drug cost as a percentage of total drug costs	19.3%	19.3%	4.4%	-75%
Average N-drug cost per claim	\$225	\$221	\$102	-54%

Source: Texas Department of Insurance, Workers’ Compensation Research and Evaluation Group, 2012.

As Table 5 indicates, the frequency of “N” drug prescriptions being dispensed to injured employees was reduced by 68 percent from 2010 to 2011, while the number of “N” drug prescriptions per claim that received an “N” drug was reduced by 32 percent. The reduction in “N” drug prescriptions did not result in an overall increase in other types of prescriptions. In fact, there were slight decreases in the number of “other drug” prescriptions to injured employees during this time. In addition to reductions in the usage of “N” drugs, there were also reductions in the use of opioids (including opioids in the “N” drug and other drugs categories) for claims subject to the closed formulary. The frequency of all opioid prescriptions was reduced by 10 percent and the frequency of “N” drug opioids was reduced by 57 percent between 2010 and 2011.

Additional data is needed to determine the long-term effects of the closed pharmacy formulary on the utilization and costs of “N” drugs in the Texas workers’ compensation system. However, the preliminary analysis of new claims indicates that the formulary will significantly reduce the utilization and costs associated with these “not recommended” drugs as well as reduce the overall utilization of opioids, which may not only help to contain medical costs, but may also have an impact on the ability of injured employees to return to work. TDI-DWC has been working closely with all stakeholders to ensure the smooth transition of these older claims who have been receiving “N” drugs for an extended amount of time to the closed formulary in September 2013. These efforts have placed greater emphasis on the need for closer monitoring of prescription drug usage by both

prescribing doctors and insurance carriers to ensure that injured employees get the medical care they need to get back to work quickly and safely.

Table 5a: Number of “N” Drug Prescriptions, Injury Years 2009-2011 (Sept – Nov) - “N” Drugs

Injury Year	2009	2010	2011	2010-2011 Percentage Change
Number of prescriptions	8,345	9,515	2,952	-68%
Number of prescriptions per claim	1.93	2.04	1.58	-32%

Source: Texas Department of Insurance, Workers’ Compensation Research and Evaluation Group, 2012.

Table 5b: Number of “N” Drug Prescriptions, Injury Years 2009-2011 (Sept – Nov) – Other Drugs

Injury Year	2009	2010	2011	2010-2011 Percentage Change
Number of prescriptions	88,200	95,753	89,262	-7%
Number of prescriptions per claim	3.71	3.73	3.66	-2%

Source: Texas Department of Insurance, Workers’ Compensation Research and Evaluation Group, 2012.

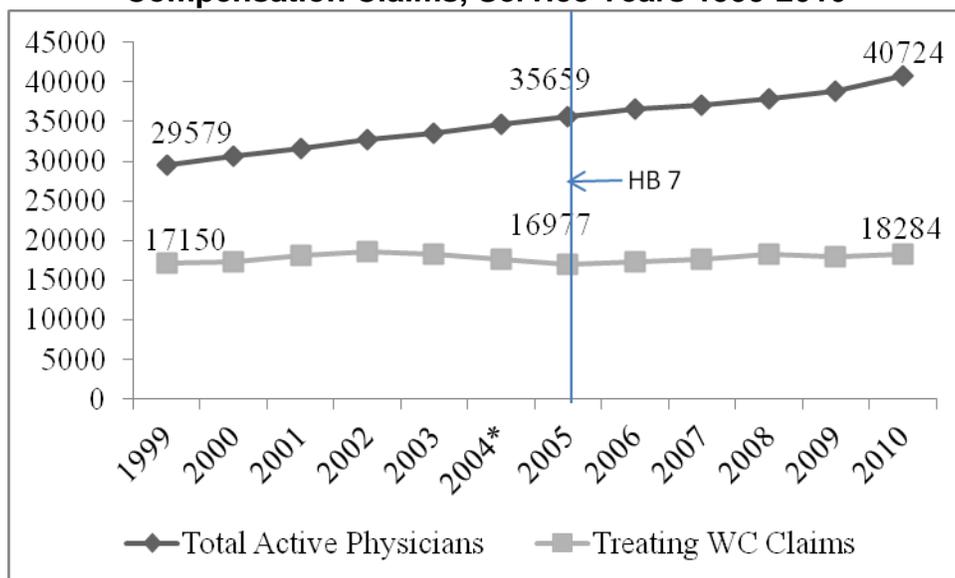
Access to Care Has Improved

Ensuring that injured employees have adequate access to medical care is an important function of the workers’ compensation system. Without sufficient access to care, necessary medical care is delayed, which exacerbates total medical and income benefit costs and unnecessarily prolongs time off of work. System participants have raised concerns in the past that the workers’ compensation system was experiencing an “access to care problem” and that many health care providers, particularly physicians, were concerned with the “hassle factor” associated with treating injured employees and the compensation rates that accompanied that medical care. Indeed, the passage of the first Medicare-based professional services fee guideline in 2002 (the guideline became effective in August 2003 after a court battle between the former Texas Workers’ Compensation Commission and the Texas Medical Association/Texas AFL-CIO) spurred controversy when the compensation

rate for workers' compensation professional services was set at 125 percent of Medicare. For some specialty providers, such as surgeons, this was a significant cut in compensation and many providers stated that they would no longer accept injured employees as patients.

An analysis of the medical billing and payment data collected by TDI-DWC combined with the licensing information from the Texas Medical Board indicates that between 2002 and 2005 there was a decline in the number of active physicians (i.e., those physicians that had an active license and were practicing) who treated workers' compensation claims, even though the total number of active physicians in Texas continued to increase (see Figure 10). With the passage of tort reform legislation in 2003, more physicians have set up active practices in Texas. This influx of new physicians has resulted in an increase in the number of physicians treating workers' compensation claims since 2005 (from 16,977 physicians treating workers' compensation claims in 2005 to 18,284 physicians treating workers' compensation claims in 2010 – an 8 percent increase).

Figure 10: Total Number of Active Physicians Who Treated Workers' Compensation Claims, Service Years 1999-2010



Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.
 *2004 shows an average of 2003 and 2005 due to incomplete data.

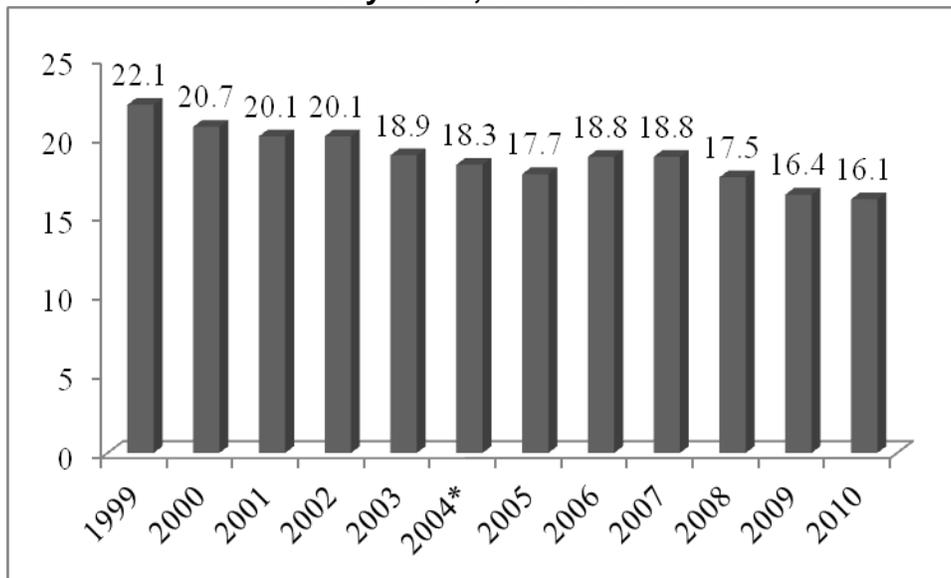
With the consistent decline of injury rates and reported workers' compensation claims along with a stable number of physicians participating in the Texas workers' compensation system since HB 7, the average workers' compensation caseload for each participating physician has declined, resulting in fewer injured employees competing for the same physician (see Figure 11). In 2005 there were

approximately 17.7 workers' compensation claims per treating physician compared to 16.1 claims in 2010 – a 9 percent decrease.

Less competition for physicians willing to treat workers' compensation claims has also resulted in a higher percentage of claims receiving the first non-emergency service within seven days after the injury (see Figure 12). In 2005, approximately 79 percent of workers' compensation claims were able to obtain non-emergency medical care within one week of the injury, compared to 82 percent of claims in 2010.

Initial research shows that medical costs increase significantly if the injured employee receives his or her first non-emergency medical service a week or more after the injury.⁹

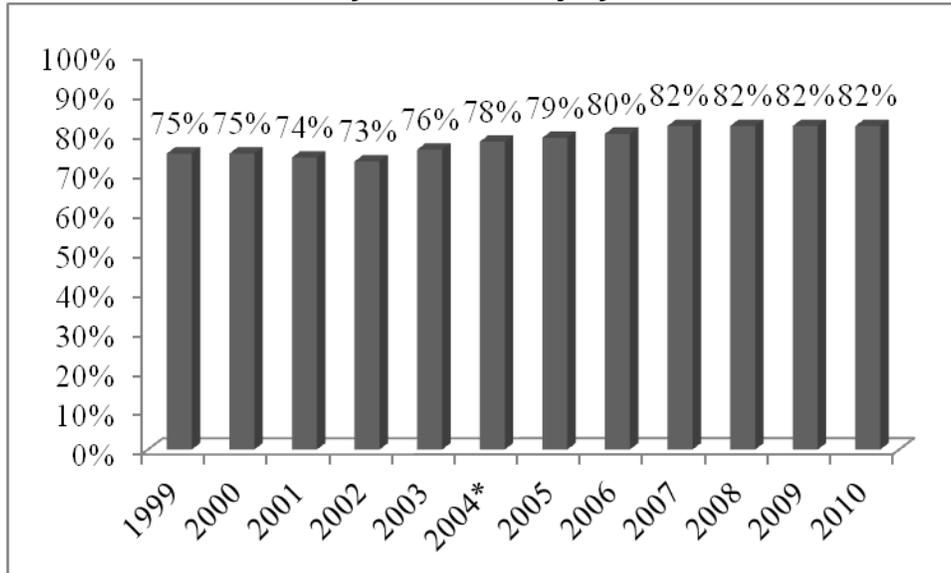
Figure 11: Average Number of Claims per Workers' Compensation Participating Physician, 1999-2010



Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.
*2004 shows an average of 2003 and 2005 due to incomplete data.

⁹ For more access to care research results, see Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, *Access to Medical Care 1998-2010*, 2012.

Figure 12: Percentage of Claims Receiving the First Non-Emergency Service within 7 Days after the Injury, 1999-2010



Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.
*2004 shows an average of 2003 and 2005 due to incomplete data.

Return-to-Work Rates Continue to Improve, but the Recent Recession Has Had an Impact

One of the most basic objectives of the Texas workers' compensation system is to return injured employees to safe and productive employment. Effective return-to-work programs can not only help reduce the economic and psychological impact of a work-related injury on an injured employee, but it can also reduce income benefit costs and curb productivity losses for Texas employers.

Previous studies by both the Research and Oversight Council on Workers' Compensation (ROC) and the Workers' Compensation Research Institute (WCRI) indicated that compared to similarly injured employees in other states, Texas injured employees were generally off work for longer periods of time and were more likely to report that their take-home pay was less than their pre-injury pay.¹⁰ Armed with these study findings, policymakers and system participants have placed considerable attention on improving return-to-work outcomes in recent years.

¹⁰ See Research and Oversight Council on Workers' Compensation, *Returning to Work: An Examination of Existing Disability Duration Guidelines and Their Application to the Texas Workers' Compensation System: A Report to the 77th Legislature*, 2001; and Workers' Compensation Research Institute, *CompScope Benchmarks for Texas, 6th Edition*, 2006.

Several components of HB 7 placed significant focus on the importance of return to work, including a requirement for TDI-DWC to adopt return-to-work guidelines;¹¹ the institution of a return-to-work reimbursement program for employers;¹² greater coordination of vocational rehabilitation referrals between TDI-DWC, the Office of Injured Employee Counsel and the Department of Assistive and Rehabilitation Services (DARS); improvements in return-to-work outreach efforts; and TDI-DWC's adoption of rules to implement changes in the work-search requirements for injured employees who qualify for Supplemental Income Benefits (SIBs).¹³

Since the passage of HB 2600 in 2001 and the passage of HB 7 in 2005, there has been a steady increase in the percentage of injured employees receiving Temporary Income Benefits (TIBs) (i.e., injured employees with more than seven days of lost time) who have initially returned to work post-injury. The percentage of injured employees receiving TIBs who went back to work within six months of sustaining a work-related injury rose steadily from 75 percent in injury year 2006 to 81 percent in injury year 2009, but then declined to 78 percent in injury year 2010 (see Table 6). This change in return-to-work rates between 2009 and 2010 injuries are likely a reflection of the downturn in the U.S. economy, which began in late injury year 2007 or early 2008 in most states, and continuing higher unemployment rates nationwide and in Texas. Case mix, or injury type and severity of claims, may also play a part in lower return-to-work rates.¹⁴

¹¹ The Division adopted the Medical Disability Advisor, published by Presley Reed, as its return-to-work guideline, which became effective on May 1, 2007.

¹² For more information on the employer return-to-work reimbursement program, see <http://www.tdi.state.tx.us/wc/rtw/documents/smlemplyrpilot.pdf>.

¹³ See 28 Texas Administrative Code §130.102 for details regarding the work search compliance requirements for injured employees seeking eligibility for Supplemental Income Benefits.

¹⁴ For more information on these and other return-to-work statistics, see Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, *Return-to-Work Outcomes for Texas Injured Workers*, 2012.

Table 6: Percentage of Injured Employees Receiving TIBs Who Have Initially Returned to Work (6 months to 3 years post-injury)

Injury Year	Within 6 Months Post Injury	Within 1 Year Post Injury	Within 1.5 Years Post Injury	Within 2 Years Post Injury	Within 3 years Post Injury
2004	74%	83%	86%	88%	93%
2005	75%	84%	87%	88%	93%
2006	75%	86%	90%	92%	94%
2007	76%	87%	91%	93%	96%
2008	78%	88%	94%	94%	94%
2009	81%	89%	91%	N/A	N/A
2010	78%	N/A	N/A	N/A	N/A

Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.

While the percentage of injured employees who initially return to work is an important benchmark of system performance, whether these injured employees remain employed once they go back to work is a more accurate measure of the system's ability to promote "successful" return to work. As Table 7 indicates, the percentage of injured employees receiving TIBs who have initially returned to work and remained employed for at least three successive quarters (or nine months) also continues to improve. Roughly 72 percent of employees injured in 2010 who initially returned to work within the first six months of their injuries remained employed for three consecutive quarters, compared to only 66 percent of employees injured in 2004. Like the initial return-to-work rates in Table 6, the percentage of TIBs recipients who returned to work and remained employed declined from 2009 to 2010 due to the impact of the U.S. recession and continuing higher unemployment rates. TDI-DWC will continue to monitor the impact of the recession and the subsequent economic recovery on return-to-work rates for workers' compensation claims in future reports.

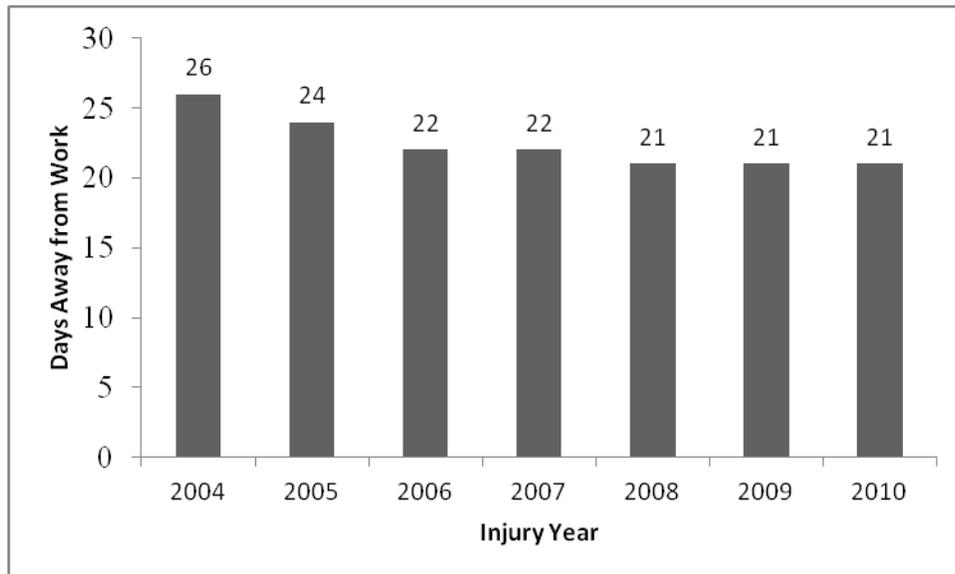
Table 7: Percentage of Injured Employees Receiving TIBs Who Have Initially Returned to Work and Remained Employed for Three Successive Quarters (6 months to 3 years post-injury)

Injury Year	Within 6 Months Post Injury	Within 1 Year Post Injury	Within 1.5 Years Post Injury	Within 2 Years Post Injury	Within 3 years Post Injury
2004	66%	73%	78%	80%	84%
2005	68%	76%	80%	83%	85%
2006	70%	77%	81%	83%	86%
2007	71%	77%	81%	84%	87%
2008	75%	79%	82%	84%	83%
2009	76%	78%	80%	82%	
2010	72%	78%	79%		

Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.

Not only have the percentage of injured employees who returned to work and remained employed improved since the 2005 HB 7 reforms, but the amount of time the average injured employee who received TIBs is off work after an injury has also decreased (see Figure 13).

Figure 13: Median Days Off Work for Injured Employees Who Returned to Work At Some Point Post-Injury, Injury Years 2004-2008



Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.

It is important to continue to monitor these return-to-work measures on a continuous basis to track the impact of the implementation of treatment and return-to-work guidelines and the impact of workers' compensation health care networks on return-to-work outcomes in Texas.

While Income Replacement for Employees Receiving Temporary Total Disability Benefits is High in Texas, Employees Are More Affected by the Statutory Maximum Benefit Caps for Permanent Partial Disability Benefits

As workers' compensation claim costs and return-to-work rates continue to improve, the issue of whether the current statutory benefit structure provides adequate income benefits continues to be raised. While system participants have not yet agreed on what constitutes an "adequate income benefit," some argue that third party liability must be maintained because income benefits are too low, while others argue that raising income benefits will increase system costs unnecessarily and will hinder return-to-work outcomes.

The various tiers of income benefits were designed so that one tier would be exhausted before another tier of benefits begins. The majority of injured employees (roughly two-thirds) receiving income benefits generally receive only the first tier of income benefit – Temporary Income Benefits (TIBs – also known as Temporary Total Disability Benefits in other states). Impairment Income Benefits - IIBs or Supplemental Income Benefits – SIBs (also known as Permanent Partial Disability Benefits in other states),¹⁵ are payable to injured employees with permanent impairments directly resulting from work-related injuries that do not qualify for Lifetime Income Benefits.¹⁶

The income replacement rates of these benefits (i.e., the extent to which an injured employee's lost wages are replaced by the income benefit) varies significantly by benefit type. TIBs tend to have higher income replacement rates and a lower percentage of injured employees capped at the statutory maximum benefit than the IIBs and SIBs benefits.

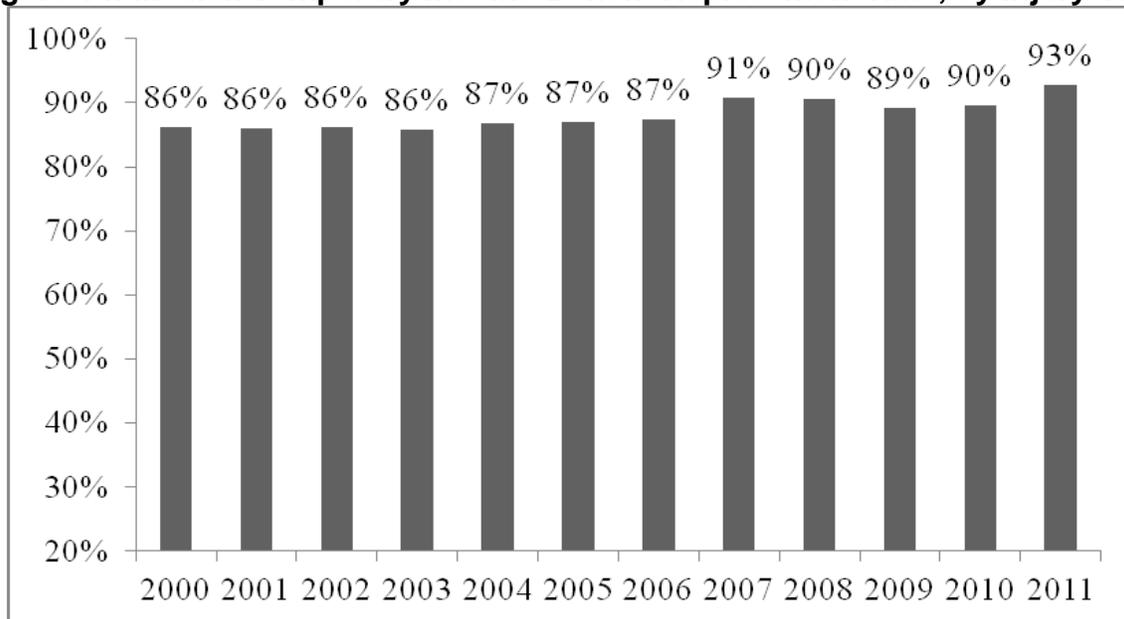
¹⁵ Lifetime Income Benefits (LIBs) are paid for the life of the injured worker for specific catastrophic injuries (e.g., loss of use of both feet or hands, blindness, severe burns over a majority of the body, etc.) as set forth in Section 408.161 of the Texas *Labor Code*.

¹⁶ For more income replacement research results, see Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, *Income Benefit Adequacy in the Texas Workers' Compensation System*, 2010.

It should also be noted that income benefits are not subject to federal income tax. Since income benefits are not taxable and since they are designed to encourage injured employees to go back to work after a work-related injury, the compensation rates for income benefits are generally set at less than 100 percent of the injured employee’s pre-injury wages (which are calculated using the wages for the most recent 13 weeks prior to the injury if available).

TIBs are designed to temporarily compensate injured employees for lost wages while they are off work. The current compensation rate for TIBs is generally set at approximately 70 percent of the injured employee’s pre-injury wage (the compensation rate may be as high as 75 percent for employees making less than \$8.50/hr). This compensation rate is higher than many state workers’ compensation systems, which generally compensate injured employees at 66 2/3 percent. As a result, the income replacement rate for injured employees in Texas receiving TIBs is relatively high (93 percent for injury year 2011) (see Figure 14).

Figure 14: Median Temporary Income Benefit Replacement Rate, by Injury Year

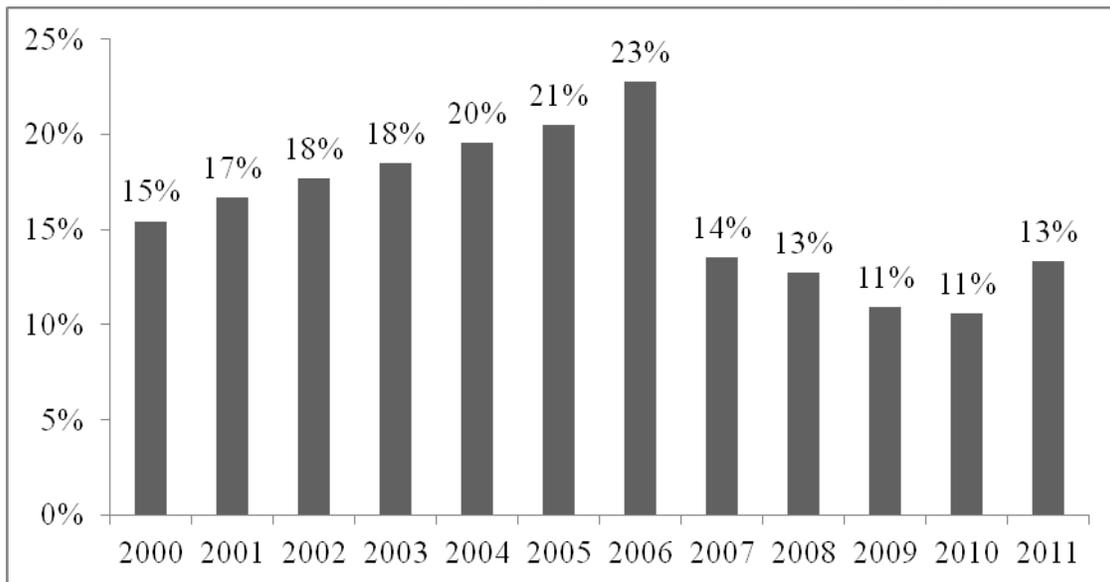


Source: Texas Workers’ Compensation Research and Evaluation Group, 2012.

Most state workers’ compensation systems also cap the total weekly benefit an injured employee can receive in order to contain system costs. In Texas, this cap was held constant by statute for several years until the legislature (HB 7 – 2005) changed the calculation method for determining the statutory maximum weekly benefit, which tied the State Average Weekly Wage (i.e., the baseline

wage for determining the maximum weekly benefit amount) to 88 percent of the average weekly wage of all employees covered by the state’s Unemployment Insurance program. As Figure 15 indicates, prior to HB 7 almost one quarter of TIBs recipients were capped by the maximum weekly benefit and for employees injured in 2007 – the first year the new calculation method was used, the percentage of TIBs recipients capped was significantly reduced. Approximately 13 percent of employees injured in 2011 had their TIBs capped at the statutory weekly maximum of \$766/week.

Figure 15: Percentage of Injured Employees Capped at Statutory Maximum Benefit Amount for Temporary Income Benefits, by Injury Year



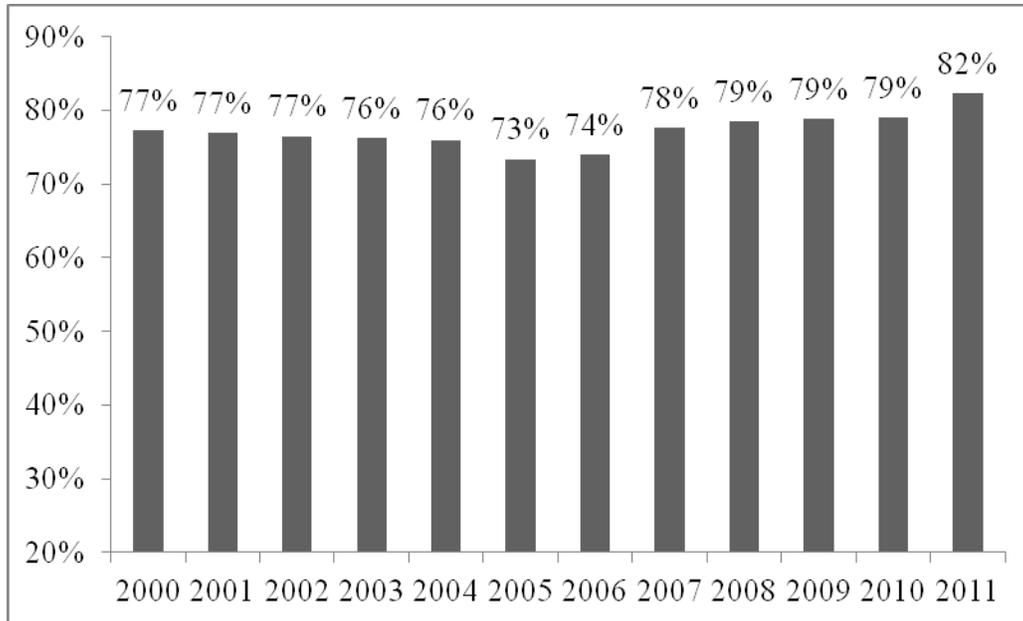
Source: Texas Workers’ Compensation Research and Evaluation Group, 2012.

Impairment Income Benefits are payable after TIBs are exhausted. Impairment Income Benefits were designed to compensate employees with serious injuries and are payable regardless of whether the employee has returned to work or not. The amount of time an employee may receive IIBs is directly related to that employee’s impairment rating, which measures the percentage of the employee’s body that is permanently impaired. Doctors, including the employee’s treating doctor, the Division’s Designated Doctor, or the insurance carrier’s Required Medical Examination doctor may assign employee’s impairment rating using the American Medical Association’s *Guides to the Evaluation of Permanent Impairment*, Fourth Edition. Each percentage point assigned translates into three weeks of IIBs (ex: a 10 percent impairment rating would result in 30 weeks of IIBs).

The current compensation rate for IIBs is set at approximately 70 percent of the injured employee’s pre-injury wage. This compensation rate is higher than many state workers’ compensation systems,

which generally compensate injured employees for permanent partial disability benefits at 66 2/3 percent. As a result, the income replacement rate for injured employees in Texas receiving IIBs is relatively high (around 82 percent in 2011), but lower than the income replacement rate for TIBs because a higher percentage of injured employees receiving IIBs are capped by the statutory maximum benefit (see Figure 16).

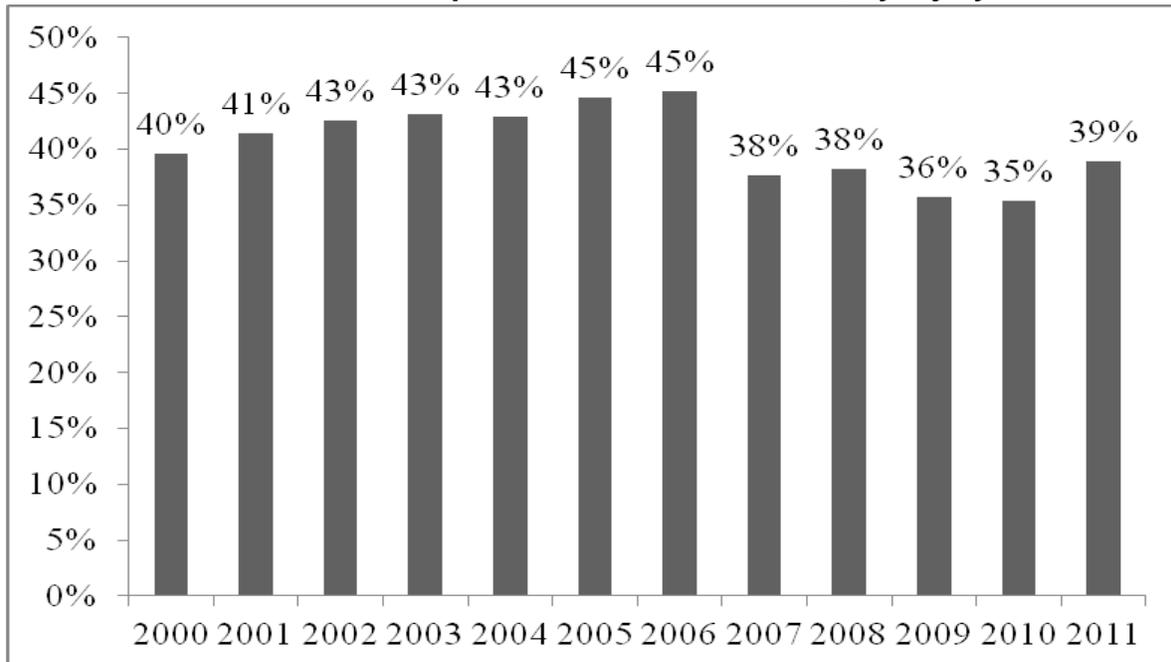
Figure 16: Median Impairment Income Benefit Replacement Rate, by Injury Year



Source: Texas Workers' Compensation Research and Evaluation Group, 2012.

The statutory maximum benefit amount for injured employees receiving IIBs and SIBs is lower than the statutory maximum for TIBs (70 percent of the SAWW for IIBs and SIBs and 100 percent of the SAWW for TIBs). As such, a much higher percentage of injured employees receiving IIBs or SIBs have their benefits capped. Similar to TIBs, the percentage of IIBs recipients capped at the statutory maximum was significantly reduced in 2007 when the new calculation method for the SAWW was implemented (see Figure 17).

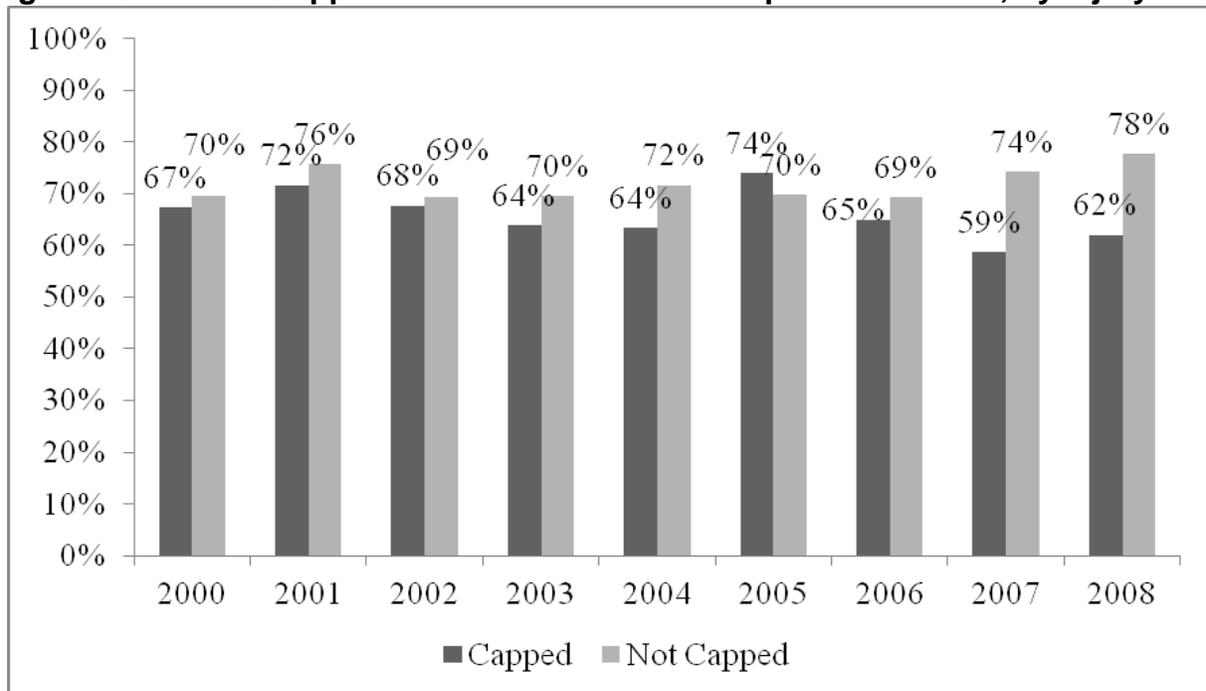
Figure 17: Percentage of Injured Employees Capped at Statutory Maximum Benefit Amount for Impairment Income Benefits, by Injury Year



Source: Texas Workers' Compensation Research and Evaluation Group, 2012.

Injured employees who have at least a 15 percent impairment rating and have not gone back to work or are underemployed may become eligible to receive SIBs once IIBs are exhausted. The compensation rate for SIBs is different than other benefit types – 80 percent of the difference between 80 percent of the injured employee’s pre- and post-injury wages. This compensation rate is a bit lower than other states, which generally compensate injured employees for permanent partial disability benefits at 66 2/3 percent. Based on the available data, between 30-40 percent of SIBs recipients injured before 2005 were capped at the statutory maximum benefit. Since SIBs benefits generally do not start until at least 3+ years after the injury, it is difficult to determine what impact the changes in the calculation of the SAWW starting in 2007 will have on SIBs recipients injured after that point. However, the income replacement rate for SIBs varies widely depending on whether an injured employee has had their benefits capped or not. As Figure 18 shows, injured employees who have had their benefits capped only replace approximately 60-65 percent of their pre-injury wages with SIBs, compared to an income replacement rate of between 70 percent and 78 percent for employees who have not had their SIBs capped at the statutory maximum.

Figure 18: Median Supplemental Income Benefit Replacement Rate, by Injury Year



Source: Texas Workers' Compensation Research and Evaluation Group, 2012.

Certified Workers' Compensation Health Care Networks Continue to Grow in Texas; However, the Initial Impact of Certified Networks on Cost and Outcomes Appear to be Mixed

TDI began accepting applications for the certification of workers' compensation health care networks on January 2, 2006. As of February 1, 2012, there are 30 certified workers' compensation health care networks (certified networks) extending over 250 counties. Currently, certified networks cover the vast majority of Texas counties, with the exception of a handful of counties in the Panhandle, the Valley and West Texas. Most Texas counties with network coverage support multiple networks, allowing insurance carriers and their policyholders various options for network coverage.

The TDI Workers' Compensation Research and Evaluation Group (REG) continues to track the participation of both Texas policyholders (employers) and injured employees in certified networks created by HB 7. According to the results of a July 2012 data call with twelve of the largest workers' compensation insurance carrier groups (representing 84.5 percent of the direct workers' compensation premium written in Texas in 2011), approximately 56,344 policyholders, most of

whom are small and mid-sized employers, have agreed to participate in workers' compensation networks in exchange for premium credits that range between 1-15 percent.

While these top twelve insurance carrier groups have contracted with or established a certified network for their policyholders, usage of networks among insurance carriers varies widely. As of July 2012, only four of the twelve insurance carrier groups offering a certified network option reported that more than 25 percent of their policyholders have agreed to participate in their certified network. While certified network participation among Texas policyholders has grown considerably since 2006 (56,344 policyholders in 2012 compared to 7,500 policyholders in 2006), it remains to be seen how differences in insurance carrier marketing strategies, the concentration of high deductible policies within an insurance carrier's book of business, the level of premium credits offered for certified network participation, employer requirements to provide employee certified network notices, and the impact of the economy on insurance carrier profitability and market competition will affect the participation rates for Texas policyholders over the next biennium.

In addition to tracking the participation of Texas policyholders in certified networks, REG also tracks the number of injured employees who have been treated by certified networks through separate data calls with each certified network. As of February 1, 2012, approximately 327,373 injured employees had been treated by 27 certified networks. While the number of injuries being treated by certified networks continues to grow, the overall percentage of injuries being treated by certified networks is still relatively low. The REG estimates that approximately 35 percent of all new injuries are being treated by certified networks. Additionally, the population of injuries being treated by certified networks (roughly 32 percent) is highly concentrated in one certified network associated with the largest workers' compensation insurance carrier in Texas; however, this concentration has decreased since 2008 when roughly 70 percent of certified network claims were treated by one certified network.

Information from the annual workers' compensation network report card produced by the REG in September 2012 provides some insight into the early implementation of certified networks.¹⁷ Nine

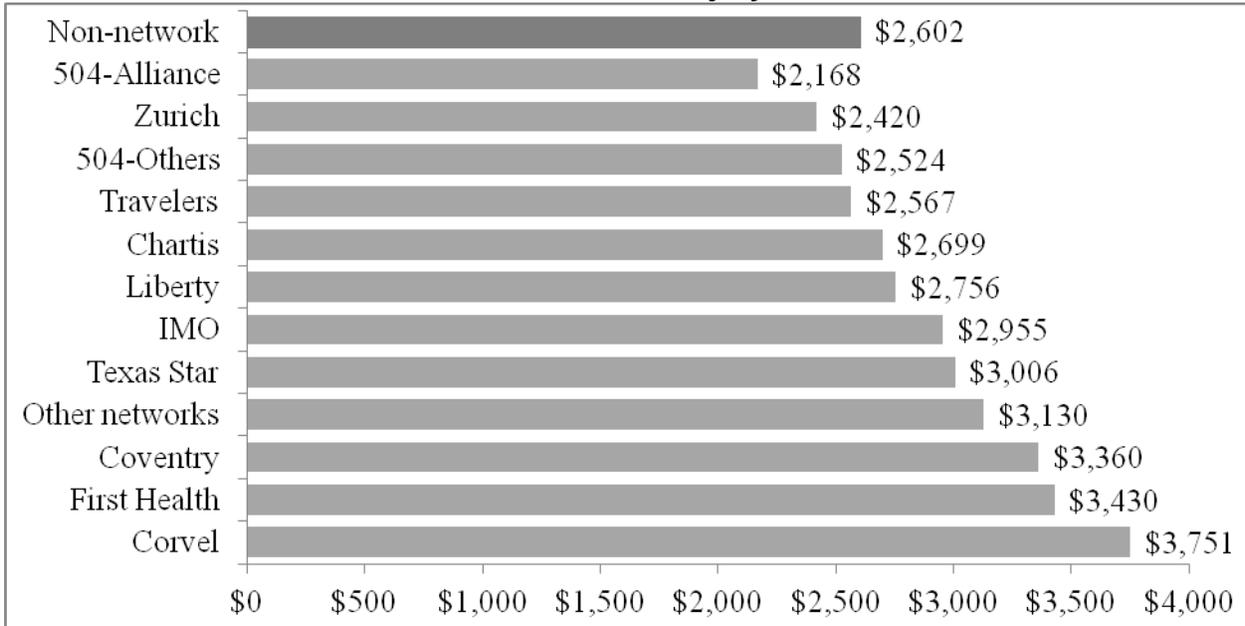
¹⁷ For more information about how individual networks compare with each other and with non-network claims on a variety of cost, utilization, access to care, satisfaction with care, return-to-work, and health outcomes measurements, see Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, *2012 Workers' Compensation Network Report Card Results*, 2012 (<http://www.tdi.state.tx.us/reports/report9.html>).

certified networks had sufficient claim volume to be compared with each other and with non-network claims. Additionally, the report card compares the outcomes of certified networks with the experiences of political subdivisions and intergovernmental risk pools that directly contract with health care providers under Chapter 504, Labor Code. In the report card, 504-Alliance represents several large pools and 504-Others represent four smaller political subdivisions. The remaining certified networks that had reported treating injured employees according to the February network data call were combined into an “other networks” category for comparison purposes.

In general, differences have begun to emerge among individual networks. As Figure 18 shows, with the exception of the 504-Alliance, 504-Others, Travelers, and Zurich, the average medical cost per claim for the other certified networks was higher than non-network claims. Medical cost differences between network and non-network claims appear to be driven primarily by higher hospital fees, higher pharmacy utilization and higher utilization of certain physical medicine services and diagnostic tests than non-network claims with similar types of injuries.

While claims by injured employees treated outside of networks in 2012 experienced a 12 percent increase in average cost over 2011 (most likely due to the statutory elimination of informal and voluntary network discounts from the TDI-DWC fee guidelines in January 2011), most networks had either decreases or lower increases in average costs than non-network claims. The average medical costs per claim for several networks are still higher than the average costs for non-network claims; however, the differences in costs appear to be narrowing between the two groups as a whole.

Figure 19: Average Medical Cost per Claim, Network and Non-Network Claims, 6 Months Post Injury

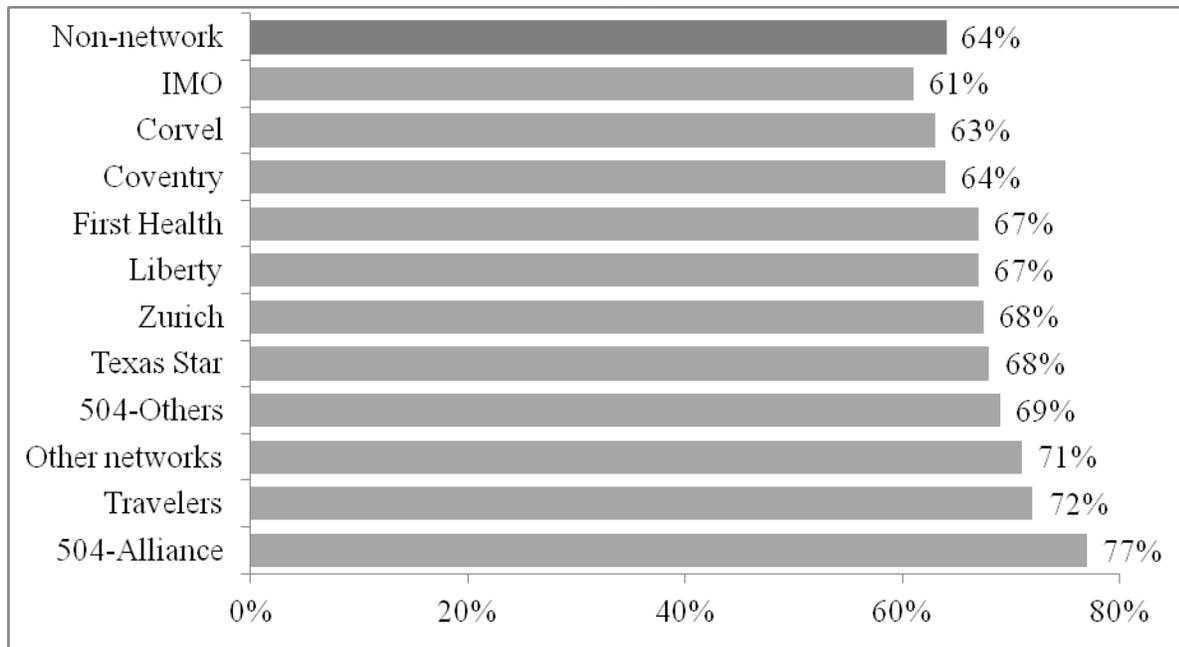


Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.
 Note: The figures presented above are adjusted for injury type and type of claim differences that may exist between the groups.

Generally, injured employees who received medical care in certified networks had better perceptions regarding access to care and satisfaction with care than non-network injured employees (see Figure 20). It should be noted that this is the first year that the general perceptions of employees being treated in certified networks are better than non-network injured employees. The results also reflect continued improvements since the REG first surveyed injured employees in 2005 (before the implementation of certified networks) who reported choosing a doctor recommended to them by their employer or insurance carrier.¹⁸

¹⁸ For a summary of the 2005 injured worker survey findings, see *Biennial Report of the Texas Department of Insurance to the 80th Legislature: Division of Workers' Compensation*, which can be viewed at <http://www.tdi.state.tx.us/reports/report9.html>.

Figure 20: GETTING NEEDED CARE
percent of injured employees who reported no problem getting: a personal doctor they like · to see a specialist · necessary tests or treatment · timely approvals for care

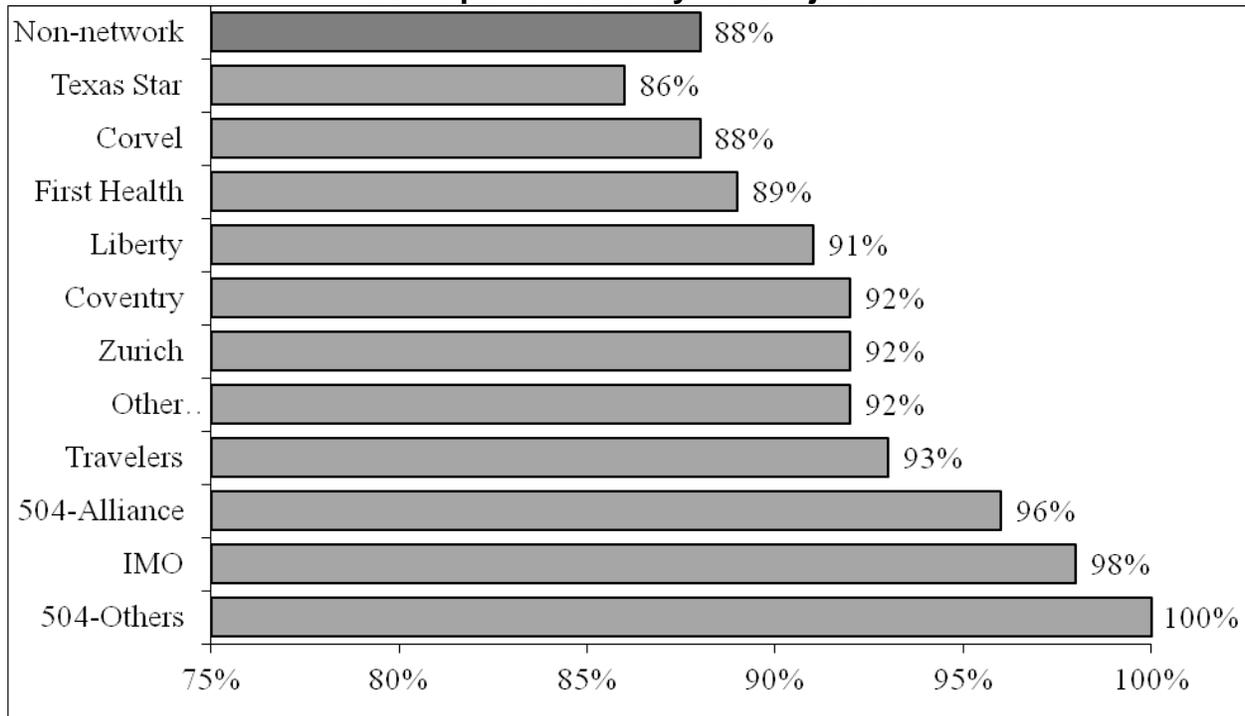


Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.

Note: The figures presented above are adjusted for injury type, type of claim, race/ethnicity, gender, age, education, age of injury at the time of the survey, insurance coverage, and self-rated health differences that may exist between the groups.

In addition to medical costs and access to care perceptions, certified networks also continue to show improvements on return-to-work outcomes. As Figure 21 indicates, most networks reported a higher percentage of their employees than non-network employees who said that they had returned to work at some point after their injury. These improved return-to-work outcomes have obvious implications for reducing income benefits costs. However, it is important to note that the income benefit cost data currently collected by TDI-DWC is somewhat limited since it collects data when benefits are initiated, changed or terminated, instead of transaction-level income benefit payments so calculating income benefit savings is difficult. In order to more accurately estimate the impact of certified networks on income benefit costs, additional data will be required.

Figure 21: RETURN TO WORK
percent of injured employees who indicated that they had returned to work at
some point after they were injured



Source: Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, 2012.
 Note: The figures presented above are adjusted for injury type, type of claim, race/ethnicity, gender, age, education, age of injury at the time of the survey, insurance coverage, and self-rated health differences that may exist between the groups.

Concluding Remarks

Since the passage of HB 2600 in 2001 and HB 7 in 2005, the workers' compensation system has changed significantly and continues to show signs of progress. Early indications show that the HB 2600 and HB 7 reforms have helped to stabilize claims costs, improve return-to-work rates, and improve injured employee outcomes such as access to and satisfaction with medical care. The number of medical fee and income benefit disputes filed with TDI-DWC is down and non-fatal occupational injury and illness rates as well as workers' compensation claim frequency continues to decline. These improvements in system outcomes have helped reduce workers' compensation insurance costs in Texas since 2005, which has resulted in more employers participating in the workers' compensation system in Texas. However, the impact that certified workers' compensation health care networks have had on the system as a whole is unclear and needs further monitoring. The REG will continue to evaluate and compare the outcomes of certified networks with each other

and with non-network claims to determine if certified networks have more of a long-term impact on cost and outcomes.

As a result of the system improvements made by previous reforms and given the completion of the TDI-DWC's Sunset Review process last session, significant legislative reforms are not needed at this time. TDI-DWC's focus over the next two years will be to continue monitoring the implementation of previous legislative reforms; work towards improving electronic communications with system participants; enforce existing laws and rules; improve data collection; fine tune dispute resolution processes; and review outdated rules and forms to improve system efficiency. With the support of the legislature and the hard work of TDI-DWC staff and system participants, the Texas workers' compensation system has become a system to watch by other states. Given the importance and the comprehensiveness of the Sunset recommendations regarding TDI-DWC that were recently implemented and the relative health of the Texas workers' compensation system, TDI-DWC is only recommending one legislative change for consideration by the 83rd Legislature - to clarify the Labor Code provision regarding the misuse of TDI's and TDI-DWC's name.

WORKERS' COMPENSATION LEGISLATIVE RECOMMENDATION Clarify Labor Code Provision to Say That TDI's and TDI-DWC's Name May Not Be Used in a Deceptive Manner

BACKGROUND: In 2005, the Texas Legislature passed HB 7 (79th Legislature, Regular Session), which added a new Labor Code Section 419.002, which prohibits the misuse of TDI-DWC's name and logo, the name and initials of TDI, and any combination of the words "Texas" and "Workers' Compensation" by a person offering or performing workers' compensation services in this state. HB 7 also set up civil and administrative penalties for the violation of this statutory provision and TDI-DWC rules and gave the attorney general or a district attorney the authority to take legal action to enjoin or restrain a violation or threatened violation under certain circumstances. These provisions were added to the statute in response to situations where medical clinics were setting up shop in buildings that also housed the field offices for the former Texas Workers' Compensation Commission – TWCC (TDI-DWC's predecessor) and using similar names, such as "Texas Workers' Compensation Clinic" in conjunction with the use of state seal. This created confusion for injured employees who visited these clinics and were often sent to specific attorneys for legal advice on their claims thinking that they were receiving assistance from the State of Texas.

Section 419.002 is currently being challenged in federal court on constitutional grounds. This lawsuit makes the claim that the statute on its face violates the plaintiff's rights to free expression under the First Amendment to the U.S. Constitution as well as violates the Fifth Amendment's prohibition of takings and the Fourteenth Amendment's guarantee of equal protection and due process. A federal district court dismissed the plaintiff's Fifth and Fourteenth Amendment claims and declined to consider the plaintiff's First Amendment facial challenge. The plaintiff appealed and on October 30, 2012, the Fifth Circuit United States Court of Appeals upheld the district court's dismissal of the plaintiff's Fifth and Fourteenth Amendment claims and remanded the plaintiff's First Amendment facial challenge back to district court to permit the parties to more fully develop the record on this issue (*see Gibson v. Tex. Dep't of Ins. – Div. of Workers' Comp.*, No. 11-11136, 2012 U.S. App. LEXIS 22375 (5th Cir. Tex. Oct. 30, 2012)). The Appeals Court also affirmed the district court's ruling that the regulation at issue is content-neutral and does not amount to a prior restraint.

TDI-DWC proposes new Labor Code Section 419.001 and amendments to Labor Code Section 419.002 to address potential "as applied" constitutional issues that may currently exist with the current statute. These changes are meant to clarify the existing statute so that it aligns with the way the Division has applied these requirements in individual cases – to prohibit the use of the agency's name, certain terms and state symbols when it is being used in a deceptive manner. A similar amendment to TDI-DWC's Sunset bill was unanimously passed by the House of Representatives last session without controversy; however, the amendment was removed by the Senate in order to preserve only Sunset recommendations in the final version of TDI-DWC's Sunset bill - HB 2605.

RECOMMENDATION:

- Create new Labor Code Section 419.001 and clarify existing Labor Code Section 419.002 to say that the use of TDI-DWC's name, TDI's name, and other terms and state symbols is prohibited if they are used in a "deceptive manner" in an effort to create a false impression that something is endorsed, approved, sponsored, authorized or associated with TDI-DWC, TDI, or the State of Texas.