

Washington Pension System Review

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Submitted by:

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EXECUTIVE SUMMARY

INTRODUCTION

The purpose of this study is to analyze the incidence of Total Permanent Disability (TPD) pensions in Washington State's workers' compensation program. Concerns exist at both the legislature and in the Department of Labor and Industries as there appears to have been a sharp upturn in the number of pensions awarded since late in the 1990s. This report examines the factors that may be causally related to any upsurge in such awards. Our task is to evaluate pension incidence for both the state fund and the self-insured populations, with a view towards identifying causes of the trend in both sectors, although we concentrate more on the state fund claims due to data limitations.

Interest in pensions arises both because of their costs and because of the widely held view that wherever possible injured workers should be enabled to return to productive employment. In total, TPD pension claims account for more than one-fourth of workers' compensation costs for state fund insureds in Washington. Yet total permanent disability claims do not represent a very large share of overall benefit costs in other states because the incidence of such claims is low. At least two factors account for the importance of pensions in Washington. First, it appears that Washington has a higher incidence of total permanent disability cases than do other states. Second, these benefits are adjusted annually to reflect increases in the state's average annual wage, and there is concern about the unfunded liability of the Supplemental Pension Fund. Inflation adjustments of this or similar kinds are found in 15 other state systems and represent a sizeable portion of the cost of these claims. In Washington, one-half the costs of such inflation adjustment are borne directly by the state's workers.

Our report can be summarized in five major sections which we treat as questions:

- Are the rates of TPD pension award high in Washington State?
- What factors are associated with claims that result in pensions?
- Has there been substantial growth in pensions?
- What factors are associated with the growth in pensions?
- How can the future course of pension claims be predicted?

ARE TPD PENSION RATES HIGH IN WASHINGTON STATE?

Making interstate comparisons in workers' compensation is always challenging. State laws, practices, terminology, data availability and reporting all vary. The speed with which jurisdictions close claims can vary substantially. The problem of the "long tail" of claims increases the difficulty in making certain kinds of comparisons, and this is certainly true with regard to the incidence of TPD claims. In Washington it has not been unusual for claims to remain open and active for more than 10 years before they are resolved with the award of a pension. A special challenge for comparisons is that most states allow insurers to use compromise and release settlements to close claims and terminate liability. The problem with such agreements for purposes of a comparative analysis is that there are claims that might have resulted in TPD compensation in the absence of the settlement, but they are not recorded as such in other jurisdictions.

The National Council on Compensation Insurance (NCCI) reports on the incidence of total permanent disability cases for 44 states and the District of Columbia. The number of pensions awarded per 100,000 covered employees is very high in Washington compared with other states; roughly four to eight times the 36-state average, and about two to four times as high as any other jurisdiction. Washington is also very high when evaluated in terms of TPD claims per 1,000 time-loss claims or the ratio of TPD awards to permanent partial disability awards.

Because the broad structure of workers' compensation in British Columbia is similar to Washington's approach, we regard it as a valuable source of benchmark comparison. This was especially so before some legislative changes made in B.C. after a 2002 "Core Review." Adjusting for the obvious differences in claim counts, examining the TPD experience in the two jurisdictions reinforces our conclusion that the incidence of pensions in Washington is very high, roughly two to two-and-a-half times as high as in British Columbia.

WHAT FACTORS ARE ASSOCIATED WITH CLAIMS THAT RESULT IN PENSIONS?

A Structural Source of Pensions in the Washington System

In terms of TPD pensions, we believe that Washington's approach is almost unique in a very significant way. Only one other state, Nevada, provides compensation in basically the same way as Washington does for total permanent disability.

First, Washington is different from most of the other states in that its workers' compensation program does not allow for compromise and release agreements for indemnity benefits to decisively close claims. We believe that only eight states either do not allow such agreements or place important limits on their use (See Table 1). While 19 states including Washington pay PPD benefits for unscheduled injuries or illnesses solely on the basis of the extent of medically determined impairment resulting from the injury or illness, only six of these limit lump-sum settlements.

Of these six jurisdictions only Washington and Nevada compensate total permanent disability based on (medical) impairment (for conditions specified in the statute) **or** for work disability. In Washington the worker is totally disabled for the purposes of a pension when the injury or disease permanently incapacitates the worker from obtaining and performing any work at any gainful occupation. As a result, the opportunity to return to work is central to the pension award decision, aside from those specific conditions listed in the statute which account for relatively few cases annually.

Table 1 Arrangements for Permanent Disability Compensation among State Workers' Compensation Systems

Limits on lump-sum settlements for indemnity benefits for permanent disability	Permanent partial disability benefits based solely on impairment (unscheduled injuries)	Total permanent disability benefits paid only for conditions listed in the statute	Total permanent disability benefits paid based on impairments listed in statute or on incapacity from performing work
Delaware	X	X	
Indiana	X		
Nevada	X		X
New Mexico		X	
Tennessee			
Texas	X	X	
Washington	X		X
West Virginia	X		

For explanatory notes, see Chapter 6 of the report.
 SOURCE: Barth and Niss (WCRI, 1999)

Thus, among the states where permanent partial disability compensation is based on the degree of impairment, and where the use of lump-sum settlements for indemnity benefits is limited by law or practice, only Washington and Nevada use criteria other than the degree of impairment to evaluate and award total permanent disability pensions. Even where a work-related injury causes a severe economic hardship, the law requires that only the degree of (medically determined) impairment be considered in the awarding of permanent partial disability

benefits. However, the impairment benefit may bear very little relationship to the actual degree of work disability. If it appears evident that the permanent partial disability benefit inadequately compensates for the work disability that the worker has experienced, the system has no flexibility to remedy this. The result of this combination of factors places the worker and the state fund or the self-insured employer in a position where the only possible source of additional compensation is the TPD pension.

The Characteristics of Pension Claims

This study undertook a detailed review of a random sample of over 900 workers' compensation claim files, drawn from both the state fund and self-insureds, and including both those that culminated in pensions and others that did not. Our aim was to gain a detailed understanding of the claims management and pensioning processes, and to observe any differences from before and after the upswing in pension awards. It enabled us to obtain data elements that were not available in the Department's data warehouse. It allowed us to achieve a qualitative understanding of trends and patterns as well as a consistent quantitative measurement of factors affecting pensioning.

We took two different years, 1997 and 2002, comparing the total permanent disability claims awarded in those years, as well as selecting a comparison population from time-loss claims in each of those time periods. This way it would be possible to compare characteristics of pensions awarded in the two time periods, and also compare pension claims to non-pension claims in the two years. In choosing 1997 we are close to the beginning of potential changes in claims and pension adjudication, but we are confident that the choice of 1997 still allows for some significant "before and after" comparisons between the two time periods.

Obtaining a suitable comparison group was difficult. Ideally we sought a group of claims that had a high probability of TPD by virtue of their characteristics, but had not received a TPD award by the time of our analysis. The selection of self-insured claims was conducted in a similar fashion, but the data on time-loss-only claims among the self-insured were very incomplete. We believe that we have a representative selection of self-insured claims for review, but we are not satisfied with the quality of the time-loss data among the self insured. Our analysis of self-insured claims is also limited by the small sample numbers. Because of these data limitations, our analysis of self-insured claims is also limited.

The claim file review allowed us to consider many different variables. Very succinctly, comparing state fund pension cases in 2002 with those awarded in 1997, we found the following to be significant differences between the two years. The 2002 pension claims show a slightly higher age at injury, and a lower proportion married; they also show a lower number of hospital admissions and surgical procedures than 1997 pensions. They are more likely to demonstrate opioid use, to have preexisting conditions, and to be from economically distressed counties. They are less likely to show any return to work than 1997 pension claims.

State fund comparison time-loss claims from 2002 are less likely than 1997 claims to involve back injury, have much lower hospital admission rates, and fewer surgical procedures. They are older at injury and are more likely to have at least a high school education. They show less opioid use, are much less likely to have used a pain clinic, and have significantly less psychological involvement. They are also less likely to have preexisting conditions, far less likely to be a reopened case, and are less likely to show a return-to-work attempt. They are more likely to have had their claim contested by their employer, but are far less likely to have been involved in an appeal to the BIIA.

Self-insured pension claims from 2002 are less likely than those from 1997 to involve back injuries and less likely to be female. Fewer of them had prior claims, but they are much more likely to have had a contested claim. Fewer of these 2002 pension claims show appeals. Comparison time-loss claims from 2002 are quite similar to those from 1997. They involve fewer back injuries, are slightly older, and less likely to show opioid use. There were no significant differences in the number with prior claims or return-to-work attempts. There was also no difference in the number whose claims were contested by the employer.

There were major differences between our two multivariate estimates that presumably indicate changes in Washington's workers' compensation system between 1997 and 2002. The largest increases in estimated effects were found in psychological conditions, agricultural employment, and preexisting conditions. Other variables that showed rising influence on the likelihood of pensions in 2002 included opioid drug use, reopened claims, and claims from economically distressed areas. These all seem to be consistent with what we heard from knowledgeable observers in Washington. In addition, the effect of the number of VR activities and prior PPD award both became less negative from 1997 to 2002.

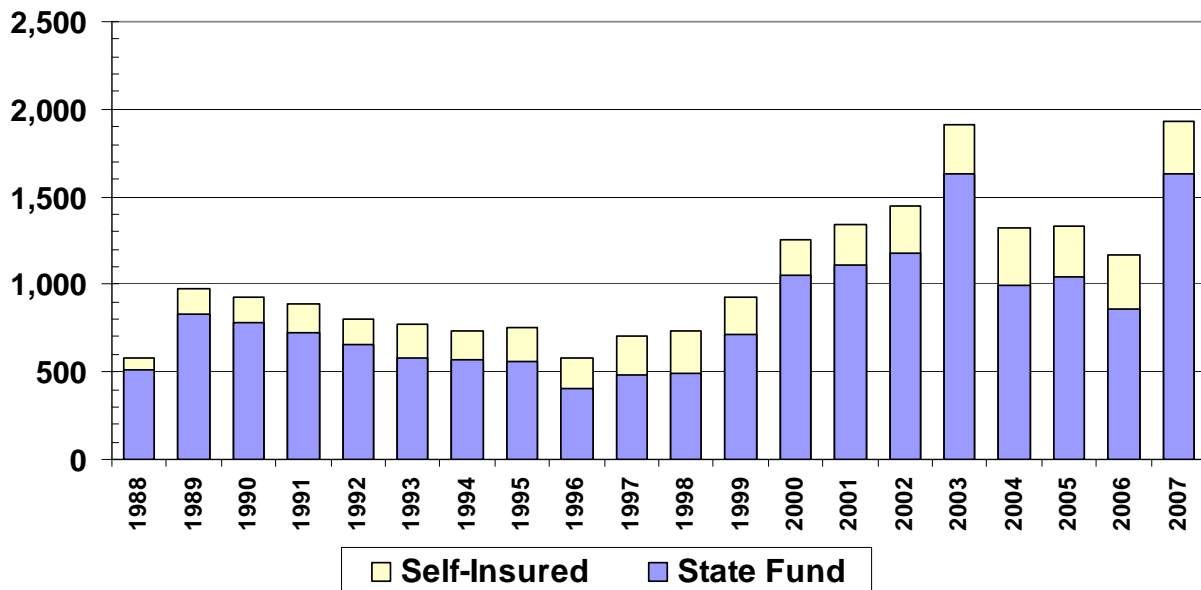
Among those variables that declined in influence between 1997 and 2002 were gender, marital status, age at injury, and less than high school education. Thus the demographic characteristics of the injured worker seemed to be less important in 2002. In addition, the influence of pre-injury earnings, use of pain clinics, and legal representation were all less positive than they had been in 1997. Small declines were recorded for employer contested claims, prior claims, and the number of medical procedures. No change was seen in the effect of employer accommodation, the number of independent medical examinations, or self-insured status of the employer.

HAS THERE BEEN SUBSTANTIAL GROWTH IN PENSIONS?

Figure 1 shows the number of TPD pensions awarded annually over the past two decades in Washington. It is evident that a sizeable upturn began in the mid 1990s and continued at least through 2003 along with a considerable jump in awards in 2007. Also, although pensions awarded in 2004 and 2005 fell from the previous peak in 2003, the number of pensions awarded in those years were higher than levels reached before 2000. The figure makes it clear that this upturn was more characteristic of state fund claims than of self-insured claims, although self-insured pensions rose substantially also. Perhaps the most remarkable thing about the growth in pension awards, at least among state fund employers, is that it occurred in the face of a steadily declining number of workers' compensation claims for time-loss benefits since reaching a peak in 1990–91.

We are persuaded that pension awards have been growing over time though the rate of increase may have been somewhat less dramatic than it initially appears to be. Consider that in the five years 1988–1992, there were an average of 682 pensions awarded per year; or that in 1989 to 1991 under a previous push to close claims at L&I, there were 735 pensions awarded per year. Then consider that in the years 1993–1998 there were only 499 pensions awarded per year. The 1989–91 spike was likely accounted for by the “Yes-We-Can” push, and that was followed by a decline in pensions from 1993 to 1998, with an inventory buildup that was then pared down over the next few years. This view would suggest that a portion of the jump in pensions after 1998 actually was a pipeline or inventory adjustment linked to the decline in the average number of pensions awarded in the 1993–98 years.

Figure 1 Number of TPD Pensions Awarded by Fiscal Year



SOURCE: L&I Research and Data Services

If we consider the years 1999 to 2006, the average number of awards is indeed higher than the 1989–91 baseline. That is hardly surprising in the light of time-loss claims that began to increase after 1982 and peaked in 1990. Claims from this peak period were the raw material for pensions in the late 1990s and going forward. From 1998 to 2001 the median length of time for pension awards made in those years was eight years from date of injury. That the number of pensions is correlated with the number of time-loss cases with a lag of six to 10 years is both intuitive and indisputable.

Based on the peak of time-loss claims in 1990, pensions would have been growing for that reason alone in the late 1990s and early 2000s, even aside from the working down of the excess inventory that built up from 1993–1998. There was indeed an upsurge in pensions around 1999, at least for the state fund. But the view of the size of the upswing must necessarily be shaped by the baseline used to measure it. There is little doubt that there has been a continuing increase in the ratio of active or open claims to all compensable claims from the mid 1990s to the present. As duration continues to increase, the raw material for future pensions does as well.

Aside from the issues of a claims inventory adjustment and of the lag from the peak years for time-loss claims to the awarding of pensions, one other factor adds to the puzzle. Beginning early in the 2000's the median time from claim origination to allowance fell from approximately eight years to about six years. That is equivalent to saying that claims that once would have

remained in open or active status for some additional years were now pensioned earlier, boosting the number of pensions that L&I awarded. Had this change in practice or policy not occurred, it is likely that the pension counts would have been lower in the mid 2000s, though very likely most of these would have become pensions a few years later.

We conclude that the growth of pensions was not due solely to the inventory adjustment resulting from claims management processes in the agency. The rate of pension awards relative to lagged time-loss claims has also grown. And there has been continuing growth in the proportion of time-loss claims that remain open or active, both for relatively short durations and for long ones, suggesting that the agency is encountering difficulty in closing claims as quickly as they have in the past.

WHAT FACTORS ARE ASSOCIATED WITH THE GROWTH IN PENSIONS?

Major Cause: Claims Management Practices

In our view one of the factors that led to the upsurge in pensions was the result of three conditions that occurred in combination. These conditions are:

- a build-up of open (or active) long-duration time-loss claims;
- a high probability that a long-duration time-loss claim will evolve into a pension case; and
- a concerted push to clear out the long duration time-loss claims.

In 1998 about one in seven open claims at L&I had been open for at least six years; many of them were a good deal older. This proportion began to decline slowly thereafter, yet one in every eight time-loss claims that were open had been open for six or more years in 2001. Each year from 1996 to 1999 there were close to 6,000 open time-loss claims that had been open for six or more years. This is compared to a range of 600 to 1,000 pension awards per year.

A large share of the pensions awarded in any year goes to claims where the work accident occurred 10 or more years previously. In 2000 a high water mark was reached as over 38 percent of the pensions awarded that year went to claims that had been open for 10 or more years. The number of these 10-year-old or older cases that were pensioned peaked in 2002 and 2003.

The data suggest that there is a continuing problem with long-duration claims in Washington. The percent of compensable claims from each calendar accident year that are active five years after the injury year began to rise in 1996, increasing nearly 60 percent by 2002. This

growth of long-duration time-loss claims provides the base for pension growth in the future. Additionally, the linkage between long-duration cases and the increasing probability that this results in pensions seems incontrovertible.

Steps to shorten average duration have been taken at various points for more than two decades at L&I. One such major push was made in 1998 when money was made available to fund 24 additional Claim Managers, with the proviso that time-loss duration be reduced by five percent by June 30, 2000 and an additional 2.5 percent by June 30, 2001. This added considerably to the workloads of the Pension Adjudicators, both because of the increased number of pension determinations that were needed to be made by them, and because the average experience level of the Claims Managers was less due to the presence of newly acquired staff.

We conclude that the concerted push to reduce time loss and close claims during the period from 1998 to 2001 contributed to a lumpiness in the year-to-year number of pensions awarded, thereby precipitating a portion of the increase in the number of pensions awarded.¹ This administrative action accounts for a significant share of the pension growth. However, the administrative push and the resulting upsurge of pensions were built upon a foundation of increasing durations. This push to resolve claims also led to some decisions by the agency that disappointed some claimants and fostered an increased number of appeals.

Major Cause: Poor Labor Market Conditions

Difficulty in the labor market is likely to increase the probability that an injured worker cannot return to employment and the earnings level that existed before the injury or illness. That difficulty may be the result of economic weakness in the injured worker's community or region, and/or it may result from personal characteristics that contribute to difficulty in finding and retaining employment, except perhaps when the labor market is very strong. We believe the evidence shows that labor market conditions have played a significant role in the pension upsurge in Washington.

Labor markets that provide substantial job opportunities reduce some of the barriers that injured workers face in seeking and retaining employment. Such labor markets also cause employers to have a greater need to reemploy their injured workers. Strong labor markets also tend to generate wages that encourage workers to return to and to remain in employment. Since

¹ Not only do such special efforts contribute to year-to-year volatility, there is considerable variation in the number of pensions awarded on a quarter-to-quarter basis. This seems particularly pronounced since 2000.

the early 1990s the labor market in Washington has been weak, though some geographic areas have been strong for most years. Not surprisingly, those with the least education or other disadvantages have been disproportionately at risk for having their work injuries evolve into pensions.

Other Possible Causes of the Increase in Pensions

There is no doubt that a worker's age is associated with receiving a pension. It is also true that Washington's population, and likely its labor force, have grown older in recent years. Did this contribute to the growth in pensions? Our analysis finds that the aging of the workforce is not a significant contributor to the year-to-year growth in pensions. Age undoubtedly has an impact on pension likelihood but not on short-term swings. The impact of age does manifest itself over longer periods of time and it has likely had some effect when viewed over the period of a decade or more. As the state's labor force continues to age, it will tend to raise the rate of pensioning.

Back injuries are often the focus of concern in workers' compensation studies because of their frequency, their cost, and the difficult diagnostic, etiological and treatment issues they present. From 1993 to 2004, accepted back or spinal injury claims fell by 29 percent in Washington and the number of denied claims over the same period fell by 48 percent. When we examined the proportion of back or spinal injury claims that were accepted as a proportion of all time-loss claims in each accident year, the rate fell over the 12 years, albeit slightly.

Could changing treatment for back injuries be responsible for the upsurge in pensions? It was suggested to us that increased use of lumbar fusion surgery in Washington State, especially with intervertebral cage devices, may have made a significant contribution to the increase in pension awards. The data on such procedures lead us to conclude that this type of surgery could not have been responsible for more than a small percent of the increased number and rate of pensions during calendar years 1996 to 2003.

By contrast, claims with psychological involvement have clearly increased and may have played a role in the increasing number of pensions. However, the rates of increase are not sufficient to account for a major share of the increase in pensions during the period under question. These medical conditions often develop after another disabling injury has occurred. They may be the result of disability as much as the cause. We identify this factor as one that warrants some further attention.

The use of opioids to treat the disabled has also grown considerably over the period we considered in this study. It is difficult to sort out the causal relationship between the use of these medications and long-term disability and pensions. Is their continuing use a function of the degree of pain and impairment for the worker? What is cause and what is effect? Even if this treatment is responsible for increasing the numbers of pensions, our analysis suggests that it could not be a major cause of these cases.

In seeking to explain the upsurge in pension awards beginning in the late 1990s, we also ruled out some sources that theoretically could be responsible. Among those factors that were investigated, but did not prove to be strongly related to the upsurge were the following: an increase in the number and/or the severity of occupational injuries and illnesses, changes in the legal environment in which workers' compensation cases are evaluated, including certain judicial decisions (e.g. Leeper 1994) operation of the Vocational Rehabilitation (VR) program, and appeals to the BIIA by injured workers. None of these factors appear to be causally involved in the increase in TPD pensions.

HOW CAN THE FUTURE COURSE OF PENSION CLAIMS BE PREDICTED?

We used information from the L&I data warehouse to estimate a model that would predict pension receipt among claims that had already received between three and 10 years of time-loss payments. Our model predicted the probability that these claims would be granted a pension in the following six years based upon their characteristics. The data included such factors as time-loss duration, age at injury, gender, county of injury, industry of employment, PPD receipt, Social Security offset status, number of appeals, vocational rehabilitation plan development, hospital admissions, surgical procedures, opioid prescriptions, neck and back conditions, psychological treatment, and prior claim status.

In our predictive model, the most important determining factor in the likelihood of pension is the length of time from the date of the injury. Each additional year of time loss since injury increases the odds of a pension by 30 percent. Age at injury was also a very significant factor. Each additional year beyond the mean is associated with a nine percent increase in the odds of pension, holding other factors constant. Translating this to predicted probabilities, a worker who is less than 30 years old and has between 3 and 10 years of time loss has a 15 percent predicted probability of pensioning, while a worker with the same characteristics, but between 60 and 65 years of age has a 78 percent predicted probability of TPD.

Claims from economically distressed areas had a 16 percent increased likelihood of TPD, holding all other factors constant. Claims with psychological treatment within the first three years of injury had a 40 percent increased chance of pension outcome. Accepted back and neck conditions (as defined by ICD-9 codes) were associated with a 30 percent increase in the odds of pension over other conditions. Claims with opioid use showed a 21 percent greater likelihood of pensioning.

A case with a vocational rehabilitation plan approved is 56 percent less likely to receive a pension than a case without such a plan, other things equal. This estimate does not mean that VR treatment will reduce the likelihood of pension by 56 percent, but it does indicate that claims selected for VR referral that proceed to VR plan approval are much less likely to end up as pension claims.

If a worker's benefits are offset due to Social Security payments, the worker is more than twice as likely to receive a pension. Receiving a permanent partial disability (PPD) award within the first three years of a claim lowers the probability of pension by 17 percent, holding all other factors constant. Appeals to the BIIA are associated with an increased likelihood of TPD by 10 percent.

Industry of employment can be an important factor. In this model we included agriculture and construction as two major industries tending to have seasonal employment and relatively high workers' compensation claim incidence. Our model estimates that an agricultural worker was 25 percent more likely to receive a TPD than other workers, but that construction workers were not statistically different from other workers with regard to TPD benefit receipt.

Our model correctly predicts pension outcomes approximately 70 percent of the time based upon the available variables. Our predicted pension probability is somewhat lower than the ultimate probability of pension predicted by L&I Actuarial Services for claims three or more years old. But it is important to note that our pension probability model misses many of those likely to be identified by the actuarial models, especially claims that get awarded pensions more than 10 years from date of injury. The actuarial models use a different method, employing projections of ultimate counts based on the number of active claims and past claim closure rates rather than individual claim characteristics, and their numbers are not directly comparable to ours.

In essence, actuarial methods use a “macro” or systems approach, while our model uses a “micro” or individual approach. In addition, our model only explains a portion of the overall variation in pension rates due to its restricted range and limited variable set. Our model is not meant to be a substitute for the methods or the estimates of the actuarial staff at L&I. The value to the Department of Labor and Industries of our model is that it could be used to identify cases with a high probability of pension so that a claim management intervention could be applied earlier in the claim to reduce the probability of pension award.