

5 Common Mistakes to Avoid with Claims Reserves

Why are Claims Reserves so Important?

Accurate claims reserves are crucial for both organizations and insurers to maintain financial stability when dealing with workers' compensation claims. For organizations, precise reserves allow for effective budgeting and financial planning, preventing unexpected spikes in expenses that could strain resources. Additionally, accurate reserves help insurers properly allocate funds, ensuring they can meet their obligations to injured workers without compromising their overall financial health. This transparency and reliability instill confidence in stakeholders and contribute to a stable and sustainable workers' compensation system.

Many businesses assume they have a good strategy when reserves are established, but they may not fully understand how claims reserves are developed and the impact of having inaccurate reserve amounts.

Establishing Claims Reserves

Establishing claims reserves for workers' compensation involves a careful and systematic process. At the onset of a workers' compensation claim, a claims adjuster will be responsible for establishing the initial allocation for the corresponding claims reserve. The challenge occurs as the claims adjuster must make their determination in the early stages of the claim, often prior to the ill or injured employee receiving a precise diagnosis, treatment plan and without the benefit of diagnostic studies. Armed with the information available following their initial investigation, which includes making three-point contacts in order to formulate an initial analysis of compensability, the adjuster makes an informed estimate regarding the anticipated claim expense and subsequent reserve amount. The goal is for the initial reserve amount to be as accurate as possible, with minimal adjustments necessary. This can be difficult to do, especially since most jurisdictions have tight deadlines as to when to accept or deny a claim.

Potential Claim Costs

The claims adjuster may estimate the initial expenses for each of the categories below based on information from the employee's latest medical reports, as well as analyze past claims involving similar illnesses or injuries to deduce costs. As new information related to the claim emerges, the adjuster may either increase or decrease the initial reserve amount based on all available information and the probable outcome of the claim itself. Examples include: the medical prognosis changes and the treatment plan now includes surgical intervention; the employee seeks legal representation; or, the employee has successfully returned to work and has been discharged from care.

The following costs contribute to determining the reserve amount:

- **Medical**—This category refers to expected expenses for the ill or injured employee's medical diagnosis and treatment. Such costs may include those of hospital or physician visits, diagnostic testing, specialist care, prescriptions, physical therapy appointments and any transportation necessary for obtaining treatment.

• **Indemnity**—This category consists of anticipated costs related to the ill or injured employee's ability to return to work and if they have any permanent impairment as a result of their industrial injury. Benefits can be temporary or permanent and are designed to replace their salary or hourly wage, subject to state minimums and maximums, and their ability to compete in the open labor market following the illness or injury. Depending on the severity of their condition, the employee may be entitled to permanent disability or vocational rehabilitation benefits. If the employee is fatally ill or injured, their family may be entitled to death and dependent benefits. Indemnity benefits can also include full and final settlements, where applicable.

• **Expense**—This category pertains to a wide range of assumed claim costs. In particular, this may include legal expenses such as defense attorney payments, discovery, court costs and state filing fees, along with medical management expenses like triage nurse charges and nurse case manager costs. This category also includes cost containment programs such as bill review and utilization review. It further takes into consideration any vendor expenses associated with establishing a basis to accept or deny the claim and mitigating the loss exposures.

Common Mistakes to Avoid

When establishing workers' compensation claim reserves, several common mistakes can occur leading to inaccurate reserve amounts, potentially causing financial challenges and disrupting the claims management process. Understanding how to avoid these three common errors can significantly reduce potential exposure.

1. Underestimating Future Claim Costs

Underestimating the future costs associated with a workers' compensation claim is a significant mistake. This can happen when claims adjusters base their initial reserve amount on limited information or fail to account for ongoing medical treatment, rehabilitation or even potential legal expenses. Failing to anticipate these costs can result in reserve amounts that are insufficient to cover the actual costs of the claim, leading to financial strain for both the insurer and the organization.

2. Neglecting Claim Progress and Updates

Failing to regularly review and update claims reserves as new information becomes available is a critical mistake. The status of a workers' compensation claim can change over time, with the employee's condition improving or deteriorating, treatment plans evolving or legal actions affecting the claim. It is imperative that the claims adjuster adhere to best practices with respect to reserving and to review the allocations at regularly scheduled intervals to determine appropriateness, including any time the exposure changes. If these updates aren't reflected in the reserves, it can lead to inaccurate financial planning and potential financial instability.

3. Lack of Data-driven Analysis

Relying on outdated assumptions rather than utilizing data-driven analysis is a common mistake. Modern technologies and analytical tools can provide valuable insights into claims trends, allowing for more accurate reserve calculations. Ignoring these resources may result in reserves that don't align with the actual costs of claims, potentially leading to financial challenges down the line, especially if the benefits are due for the rest of the injured worker's life expectancy.

4. Lack of Communication and Collaboration

Insufficient communication and collaboration among key stakeholders in the claims process, such as the insurer, claims adjuster, medical providers, legal representatives and the injured employee can lead to inaccurate claims reserves. Effective collaboration ensures that all pertinent information is considered when establishing the reserve amount. The following steps can help organizations ensure their reserves are appropriate:

Communicate with all parties. Frequent communication with all parties involved in the claim process, including the insurer, the ill or injured employee and the medical provider is essential to maintaining the most accurate reserves

during the life of the claim. Reserve adjustments need to be based on all available information and need to be made timely, as soon as the exposure is known. This also holds true when a claim is ready to close. When no additional benefits are due, the claim should be closed and the outstanding reserves should be reduced to what has been paid to date.

Conduct routine reviews. Work with your claim representatives to engage in routine, organizational claim reviews. This can shed light on typical claims costs and allow for an analysis of whether current reserve amounts provided adequate funding for the most probable outcome of the claim.

5. Lack of Documentation and Transparency

Insufficient record-keeping regarding the rationale behind reserve calculations can lead to confusion and disputes. Transparent documentation is crucial for justifying reserve amounts to stakeholders and regulatory authorities. This includes the use of detailed reserve worksheets as well as statutory and regulatory guidelines.

Watch for Red Flags

Keep an eye out for potential reserve issues throughout the claim process:

Claim inconsistencies—This problem can occur when an employee has several treatment steps ahead of them, but the claim reserve is nearly depleted. Alternatively, an employee may be close to full recovery, but the claim reserve still has significant funds leftover. The reserves should reflect the exposure and there should be adequate file documentation to justify the current financials.

Stair-stepping concerns—Stair stepping occurs when there are insufficient reserves to cover an immediate payment and the claims examiner puts up enough money to manage the loss in the short term. This leads to an inaccurate assessment of the actual exposure and more than likely requires a larger increase at a time when the claim should already be fully developed.

Small incremental increases over the life of the claim weakens the financial stability of the insurer.

Major reserve changes—This problem can occur when the claim reserve needs to be adjusted by 10% or more. While this issue isn't always a red flag, it could be indicative of a larger problem if such adjustments happen right before a claim closes or don't coincide with the latest claim information. Many times, the adjuster negotiates and enters into a settlement agreement without having that range reflected in the current reserve. There should be an established internal and external communication protocol with respect to formal requests to raise reserves and settle claims.

Addressing these common mistakes involves improving communication, utilizing comprehensive data and analysis, and staying vigilant in regularly reviewing and adjusting claims reserves based on the most up-to-date information. By doing so, insurers and organizations can enhance the accuracy of claims reserves, effectively manage costs and ensure financial stability in the face of workers' compensation claims.

Contact Information

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