WORKERS' COMPENSATION SELF-INSURANCE:

AVOIDING THE PRICING PITFALLS

By Glenn Backus

SMART SHOPPER

You have just concluded a rigorous RFP process and selected a third-party administrator (TPA) at a very good price, or so you thought. At the end of the three-year agreement, your average cost per claim is still increasing at a steady rate. But you have just negotiated a hefty reduction in the fee per claim you're paying. The medical network, utilization review and pharmacy vendors are all showing much improved savings. At the end of the day, your experience modifier (e-mod) has not improved at all and still remains at an unacceptable level. Average costs per claim are actually increasing. Does this sound familiar?

The industry, using the RFP and spreadsheets, has done a good job holding unallocated expenses steady over the past 10 years. As a result, the claim fee now covers approximately sixty percent of a TPA's expenses. TPAs are still faced with ever-increasing benefit costs, investments in technology to keep pace with regulatory changes, and the overall rise in expenses facing businesses today. The problem will be exacerbated with a graying workforce leading to escalating personnel costs related to a competitive environment for qualified personnel.

WHERE TO BEGIN?

You decide that it makes financial sense for your entity to self-insure and you decide to hire a TPA. So, how do you make sure you're getting a good deal? The first step is developing an understanding of allocated vs. unallocated expenses. Unallocated expenses (according to IRMI) are defined as all external, internal and administrative claims-handling expenses, including determination of coverage, that are not included in allocated loss adjustment expenses (ALAE). In a typical TPA contract, the most common unallocated loss adjustment expenses (ULAE) are claim fees, though administration and system fees are common as well.

Example: In a typical TPA contract, ULAE =

- TPA 1 Workers' Compensation Claim Fee
  - Indemnity = $995
  - Medical Only = $130
- TPA 2 WC Claim Fee
  - Indemnity = $1200
  - Medical Only = $150

As you can see, there is a big difference between the fee charged for an indemnity claim versus a medical-only claim. Therefore, to make sure that you're paying the proper fee, entities need to make sure the TPA follows the industry definition of indemnity and medical-only claims. Some TPAs may use a liberal definition to classify a higher portion of claims as indemnity, resulting in a higher overall fee.

For example, the statutory definition of an indemnity claim is defined as: if a claim has incurred or paid (on closed claims) indemnity or legal, the file will be charged as a lost-time claim. All other claims are charged as Medical Only. However, some TPAs may classify a claim as an indemnity claim if: ❶ indemnity is paid or incurred, or ❷ a claim incurs only medical charges but remains open more than 90 days, or ❸ medical charges exceed a certain dollar amount ($2500). When reviewing RFP responses, looking at two TPAs, one that follows the statutory definition, the other that follows a more liberal definition, how might this impact the bottom line?

	TPA 1	RATE	TPA2	RATE
CLAIM COUNTS	1,000		1,000	
INDEMNITY	250	$995	440	$1,200
MEDICAL ONLY	750	$130	560	$150
COST				
INDEMNITY	$248,750		$528,000	
MEDICAL ONLY	$ 97,500		$ 84,000	
TOTAL COST	$346,250		$612,000	

As you can see, the results can be dramatic. The savvy consultant you hired to lead the RFP selection has done a good job of pointing out the definition pitfall. Your spreadsheet will clearly indicate that TPA 1 is your best choice. Let's continue to peel back the onion by looking at allocated expenses.

Borrowing from IRMI again, allocated expenses are defined as: *loss adjustment expenses that are assignable or allocable to specific claims*. Fees paid to outside attorneys, experts and

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investigators used to defend claims are examples of ALAE. Municipalities typically entrust their TPAs to select vendors as needed to administrate the claims.

One common example of an allocated expense is bill review, which is used to re-price medical bills to fee schedule or usual, customary and reasonable (UCR). Some TPAs may use bill review as an additional source of revenue.

Example: Bill Review (ALAE)

Assumptions

- 1000 claims: 250 Lost Time (LT); 750 Medical Only (MO)
- 10 invoices per LT claim; 3 invoices per MO claim
- 45% savings
- Avg fee per bill: LT = $600; MO = $300

	TPA 1	TPA2
RATES	20% savings	$8.50/bill
INVOICES	N/A	4,750
MEDICAL PAID	$2,175,000	N/A
BILL REVIEW FEE	$195,750	$40,375
TOTAL FEE	$542,000	$652,375

Now comparing the two TPAs, TPA 1 still has an advantage (albeit much smaller), but we're not finished.

Some TPAs have also hired their own nurses to perform telephonic case management and utilization review. This has also become an important source of revenue for TPAs. While most TPAs do a very good job in the managed care sector, be aware that sometimes the emphasis is on revenue, which can lead to an overutilization of managed care services.

Example: Telephonic Case Management (ALAE)

	TPA 1	TPA2
COUNTS	1,000	1,000
LOST TIME	250	440
MEDICAL ONLY	750	560
RATES	$95/hr	$200/mo
UTILIZATION (LT)	50%	25%
UTILIZATION (MO)	6%	6%
DURATION (LT)	8 hrs/mo (3 mos)	3 months
DURATION (MO)	2 hrs/mo (1 mo)	1 month
TOTAL TELEPHONIC CASE MANAGEMENT	$261,460	$71,600
TOTAL FEES	$803,460	$723,975

Once all costs have been identified and defined, TPA2 has now become the best choice for the municipality—and we're still not finished! The entity must remain ever diligent in making sure that all business partners comply with established service and financial standards. Reporting mechanisms must be in place until a level of trust has been established. Even then, as President Reagan stated so succinctly, "Trust, but verify."

WHAT CAN YOU DO ABOUT IT?

First and foremost, demand full disclosure. Insist that all pricing—allocated and unallocated—remain fully transparent. Retain the opportunity to contract with vendors directly. Make sure allocated expenses as a percent of total paid fall below 10 percent (typically 5–8 percent). Pay your TPA a fair fee up front, preferably a flat, fixed fee. Audit all business partners frequently by a disinterested third party. And, most importantly, develop a relationship with your business partners. All play a key role in the success of your workers' comp program. All are entrusted with the care of a very valuable asset—your employees.

When a self-insured entity hires a TPA to manage their claims program, the entity, in essence, hands their checkbook (and a high degree of trust) over to the TPA. The TPA then is also given the authority to hire other vendors necessary to administer the claim. Make sure they have your best interests at heart and don't forget to "trust but verify." ■

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