**Standardized Regulatory Impact Assessment (SRIA) (REVISED)**
**Proposed Return-to-Work Program Regulations**

The proposed regulations are intended to provide supplemental payments to injured workers whose permanent disability benefits are disproportionately low in comparison to their earning loss.

Need for Proposed Regulations

California's workers' compensation system covers virtually all workers and employers. In addition to providing medical treatment to injured workers and temporary disability benefits, the system provides $1.8 to $2.9 billion in permanent disability benefits every year. In 2004 the Legislature passed a major reform of workers' compensation permanent disability benefits, Senate Bill 899. After evaluating the effects of that reform, which reduced permanent disability benefits by more than 50%, the Legislature revisited permanent disability benefits in 2012. In passing Senate Bill 863 (Statutes of 2012, Chapter 363), the Legislature increased permanent disability benefits by 30% and created a $120 million return-to-work program to be administered by the Department of Industrial Relations.

The authorizing statute, Labor Code section 139.48, specifies how employers will pay the additional assessment. Employers are already being assessed for this purpose and the funds are being held in the non-General Funds of the Workers' Compensation Administration Revolving Fund, with the expectation that $120 million each year will be disbursed to qualifying workers.

However, the statute also requires the Department to adopt regulations for determining eligibility for supplemental payments from the fund, and these regulations will allow DIR to provide the benefits intended by the Legislature. The benefit amount is set so that with the expected number of qualifying workers the total cost of the program will be $120 million a year and the proposed regulations allow the Director to adjust the amount of the benefit based on actual experience.

Current Regulations on Injured Workers

Workers who have a work-related injury that causes permanent disability receive compensation based on the percentage assigned to the disability. This percentage reflects how much function is impaired (Labor Code 4658). For injuries in 2013, payments for injuries ranged from $690 for a 1% disability to $260,202.50 for a 99% disability. Workers who are not able to return to their at-injury employment and whose employer does not offer modified work receive a Supplemental Job Displacement Benefit (SJDB) of $6,000 (Labor Code 4658.7).

The SJDB provides a voucher that can be used to pay for job training as well as some computer-related expenses intended to assist in the return to work.

## Proposed Regulations

Pursuant to Labor Code 139.48, DIR is to establish eligibility criteria for one-time supplemental payments to those workers whose permanent disability benefit is disproportionately low compared to their wage loss. For example, a worker with a 10% disability who cannot return to work would receive $6957.50 in permanent disability benefits and a $6000 SJDB, but may have had a wage loss of $45,000 per year.

These proposed regulations provide injured workers who are not able to return to their at-injury employment, and who apply, with a one-time $5,000 supplemental payment in addition to the $6,000 voucher. This is the same criteria as for the SJDB, except the additional one-time payment is not automatic. As the supplemental payment was intended to target workers that face disproportionate wage losses, DIR has assumed that only those workers who qualify for the SJDB suffer disproportionate wage losses.

Individuals will be able to apply for the supplemental payment on-line or at Workers' Compensation Appeals Board offices throughout the state. Individuals will fill out a simple application and provide a copy of the SJDB voucher. The application only requires identifying information, not evidence of disproportionate wage loss, as this would be complex to define and administer. This would allow the program to be administered by DIR without imposing additional obligations on employers or insurance carriers.

To implement these SB 863 changes, DIR proposes to add sections 25101 to 25111 to Subchapter 8 of article 1 of title 8, California Code of Regulations.

## Stakeholders' Inputs to Proposed Regulations

The Director was required to determine eligibility for the Return-to-Work Supplement to target those workers whose permanent disability was disproportionate to their wage loss. The eligibility criteria have to balance the tradeoff between offering a benefit to more workers and offering qualifying workers a higher benefit, as well as the administrative costs of various options.

In looking at possible eligibility criteria for the Return-to-Work supplement the Director considered the concerns of stakeholders. The insurance industry and employers did not want additional obligations and did not want to be required to administer a new benefit. Injured workers wanted a simple, easy to navigate, system. All parties were interested in a speedy and efficient delivery of the benefit.

At the request of the Director, RAND performed a study entitled Identifying Permanently Disabled Workers with Disproportionate Earnings Loss for Supplemental Payments, RAND, which was published in February 2014. This study, as discussed below, looked at the distribution of wage losses across permanently disabled workers. The Director had previous experience with RAND studies of the California workers' compensation system and the RAND studies had proven reliable and accurate descriptions of the benefit system. The Director relied primarily on the RAND study in developing these proposed regulations as well as the Department's own experience with permanent disability payments.

DIR conducted meetings with stakeholders concerning the proposed regulations including a meeting for stakeholders held in Oakland on April 4, 2014, which included representative of labor, injured workers and their attorneys, the insurance industry and employers.

Based on the feedback received, the Director has developed regulations that prioritize a simple and efficient method of determining eligibility and making payments over a more burdensome method that would have targeted workers with disproportionate wage losses more tightly.

Analysis of Proposed Regulations

The Return-to-Work Supplement program is funded by an assessment on workers' compensation premium which all employers pay, and this generates $120 million a year to fund the supplemental payments.

These regulations are expected to help up to 40% of the approximately 60,000 workers who have a work injury causing permanent disability annually. Payments to these workers are not restricted, and will be available for meeting ongoing living expenses as well as job search and training expenses.

Table 1 shows how the amount of the benefit could vary depending on how many individuals seek the SJBD. The current usage rate for the SJDB could be used to determine benefit eligibility. If this were the case this might suggest that 20.2% would be the maximum number of workers we would expect to be eligible for this program. On the other hand, a previous vocational rehabilitation program (similar eligibility requirements, but offered cash benefits), had approximately a 40% utilization rate. The Director chose to set the amount of the benefit based on a higher take-up rate for the SJDB. There are approximately 60,000 workers who receive permanent disability benefits in the workers' compensation system each year. A 40% take-up rate would mean that approximately 24,000 would be eligible for the return-to-work supplement. The SJDB provides $6,000 to eligible workers and this return-to-work supplement would provide an additional $5,000.

Table 1: Workers and Supplemental Payments

| Eligibility Criterion | Take up Rate | Number of RTW Workers | RTW Payment/Worker |
|---|---|---|---|
| Workers receiving SJDB (60,000) | 40.4% | 24,240 | $4,950 |
| Workers receiving SJDB (60,000) | 20.2% | 12,120 | $9,901 |
| Workers receiving SJDB w/ above-average decline in earnings | N.A. | 10,290 | $11,662 |

As shown in Table 1, the amount of the Return-to-Work supplement is based on the expected number of eligible applicants. That number is based on the expectation that the percentage of injured workers who receive the SJBD would be as high as the percentage of injured workers who took advantage of vocational rehabilitation benefits before those benefits were discontinued. The rate of usage of vocational rehabilitation benefits was approximately 40%. The current usage for the SJDB is lower, approximately 20.2%. Because the Return-to-Work supplement will provide additional funds, the Director expects that the usage rate for this benefit will be more like the usage rate for vocational rehabilitation, which provided an ongoing payment. Because the Return-to-Work supplement is based on an estimate concerning SJDB usage as well as studies about wage loss, the regulations provide that the Director may change the amount of the benefit based on additional studies or changes in the eligibility rate. This will prevent the fund from being exhausted, or alternatively from accumulating funds that the Legislature intended be distributed to injured workers.

Because the Return-to-Work supplement is only paid to those injured workers whose date of injury is on or after January 1, 2013, the actual number of workers eligible for the Return-to-Work supplement depends on how many injured workers are unable to return to their at-injury employment after a period of temporary disability and continued medical treatment until the injured worker reaches maximum medical improvement. The usage rate for the SJDB for 2015 is expected to provide a first look at the group of workers who would be eligible on an annual basis for the Return-to-Work supplement. Information about that usage rate will be available in 2017 and after reviewing that information and actual experience the Director intends to adjust the Return-to-Work supplement if necessary to reflect the actual usage of the SJDB for post January 1, 2013 injuries. Actual applications for injuries on or after 2013 will also provide a basis for the Director making adjustments if needed before 2017.

Impact on California Individuals and Business Enterprises

The pool of individuals who would be directly affected by the regulations would be those individuals who were injured at work and cannot return to their previous place of employment. They will be directly impacted in that they can apply for the Return-to-Work Supplement. The Director estimates that this would be approximately 24,000 individuals out of the pool of 60,000 injured workers who receive permanent partial disability benefits. The impact would be on a state-wide basis and the supplement is not limited to workers in a particular industry. The supplement will almost double the amount of the SJDB and will be available to spend as the worker feels most appropriate.

The pool of businesses that will be directly affected would be those that are required to provide workers' compensation benefits. This is approximately 860,000 employers. Those employers have experienced and will continue to experience some increase in their assessment for the Workers' Compensation Administration Revolving Fund which is funded primarily by assessments on employers, per Labor Code 62.5(f)(1).

There will be some differentiation in the impact by industry because the assessment will be proportional to workers' compensation insurance costs. The distribution of permanent disability claims that include a voucher shows that the incidents of claims are higher in manufacturing and construction with 34.4% of the total claims. This compares to a low of .2% in public administration and agriculture. Claims in retail and health account for 18.9%. The average charged rate for premium varies by year by in 2013 was $2.96 per $100 of payroll. This rate however varies based on the claims experience by industry. In construction the amount would be $7.90 while in retail $5.87 and $.73 in information and professional services. The assessment is approximately .06% of premium.

There will be a relatively small impact of the assessment on premium costs but there could be some small decrease on investment by employers to offset this cost, directing money to premium payment rather than expansion of operations. There may, on the other hand, be incentives to increase spending on safety related investments to reduce exposure to industrial accidents and increased premium costs.

There will be indirect effects on businesses in California that will benefit from the increased spending that will follow from providing the supplement to injured workers. Given the job and wage losses in this group, it is expected that most of the supplement will be spent. It is expected that the spending will be spread over the major categories of personal consumption, although there may be more spending on goods and services related to a job search.

The economy as a whole will experience an induced benefit because of the purchases and investments made by those who sell goods or services to those who receive the supplement.

Because DIR will administer the benefit it is not expected that insurance carriers of self-insured employers will have any changed administrative costs because of this supplement. In addition, it is not expected that workers will have expenses due to a need for assistance in applying for this benefit.

Creation of Jobs, New Businesses, and Investment

Although the injection of $120 million into the economy annually is significant, the impact of the $120 million will be offset by the increase in the assessment to employers to pay for the supplement. Under the proposed regulations the $120 million will be going to workers who have significant wage loss, and therefore DIR expects that all, or almost all, of the supplement will be spent as received on basic items. This increased spending would lead to the creation of jobs. The assessment on employers however would mean that those employers would have less money to spend on hiring or business expansion. These increases in spending by workers would be offset by this reduction in spending by businesses. Virtually all the resources involved are endogenous to the system and virtually none are exogenous. Since this employer cost will likely be passed on to all workers in the form of fewer jobs in the future, or lower wage growth over time, it is also a transfer from workers who do not experience a serious injury at work to seriously injured workers. We would expect that the net job impacts would be negative. The output impacts will also be negative, since all the costs are local (felt by firms paying assessments in California), while we can expect that while there will be consumer spending by the injured workers, those injured workers will only buy a certain proportion of goods made in California, likely around two-thirds based on Department of Finance assumptions. With higher costs of $120 million, a multiplier of 2, and a leakage rate of one-third, the costs are $240 million and the benefits from the spending will be $160 million so the loss will be roughly $80 million in aggregate. This loss would decrease to the extent that injured workers spend this money locally on locally produced products.

It is not expected that the supplement will have any substantial effect on capital investments, equipment, structures or real estate. DIR will be administering the distribution of the funds within existing budget constraints (estimated to be $5 million) so the administrative aspects of the regulation, the application and eligibility determination would not have an effect on the economy.

Competitive Advantages and Incentives to Innovate

These regulations will provide incentives to innovate for California businesses, as firms that face higher assessments will have an incentive to reduce their injury rates. There may be some competitive disadvantage due to the fact that the assessments are proportional to existing insurance rates, and so businesses with higher insurance rates will see their costs rise more. These are likely to be firms concentrated in manufacturing and construction, making them relatively less competitive.

Benefits of the Proposed Regulations, Impacts
on Health, Safety, Welfare, or Environment.

The regulations will allow DIR to provide payments to injured workers who are most in need of supplemental assistance, thus benefitting the overall welfare of the state. These workers will have additional funds to use in seeking new employment and to the extent they are successful in finding jobs the overall economy and welfare of the state will benefit. Workers with permanent disability who are able to return to the work force will have better long term outcomes than those who do not return to work. Moreover, firms will pay lower assessments if they make their workplace safer. These firms will be incentivized for safety innovations.

There will thus be some incentives for employers to be more conscious of worker safety as this supplement will increase the cost of permanently disabling injuries, thus any steps taken by employers to prevent on-the-job injuries will be beneficial. These regulations will not have an impact on the environment either positively or negatively.

Alternatives Considered

Two alternatives to the proposed regulation were considered. They vary by eligibility and are described below.

Alternative One

Alternative One limits eligibility to those workers whose wage loss was 30% greater than the average wage loss for someone with the same disability. While all injured workers suffer a wage loss following an industrial injury resulting in permanent disability, many workers suffered a significantly greater wage loss than average.

Alternative One has two drawbacks. First, the targeting would not have been very precise. The distribution of earnings decline was such that most of those who had a greater than 30% average decline essentially were the same group that suffered a near complete earnings loss. The RAND study showed that even limiting the benefit to those at the 67th percentile of earnings loss was essentially an almost 90% decline in earnings. Such a skewed distribution makes the selection of a threshold percentage somewhat arbitrary. Moreover, this alternative would provide no benefit to some workers who did have greater than average earnings loss.

Second, this alternative would have been difficult to administer. Workers would have been required to document actual earnings loss. The DIR staff would have had to review tax returns and other documents. Moreover, the Department could have had to determine actual wage loss on an annual basis for all workers in order to determine this benefit and this would not have been practical. It would also have led to uncertainty about who would actually qualify for the benefit because it would not be certain what level of earnings loss would turn out to be 30% greater than average. This method would have required postponing payment of the supplement for two to four years in order to be able to compare wage loss over some reasonable period of time post-injury.

Under Alternative One, the spending would remain at $120 million and the effect on the assessment would be the approximately the same although there would be some increase in the assessment due to increased administrative costs which are estimated would be about $20 million under this alternative. The amount available for each eligible worker would be approximately $6,000 rather than $5,000 and the number of workers eligible would be approximately 20,000 rather than 24,000. Under this alternative, the loss would likely be over $90 million.

Alternative Two

Alternative Two considers eligibility based on receiving a Supplemental Job Displacement Benefit (SJDB) under Labor Code section 4658.7 and having an above average earnings loss.

The vast majority of workers who receive the SJDB fall into the group of workers who experience a disproportionate wage loss compared to the permanent disability benefit. The RAND study found that for those workers who do not return to their at-injury employer earnings loss is significant. The problem these regulations address is not confined to a few outliers. Of those workers who are unable to return to their at-injury job, a vast majority have a greater than average earnings loss compared to all injured workers who receive permanent disability payments.

This alternative would be somewhat simpler to administer because the Department would not need to determine a level of earnings loss that would trigger eligibility. The Department would still need to determine average earnings loss and most significantly would have to make an individualized assessment of a workers claimed earnings loss. This would involve review of tax and other documents.

Alternative Two, which would limit eligibility to those workers who receive the SJDB and have a higher than average wage loss would also involve increased administrative costs similar to Alternative One, but perhaps a bit lower, perhaps as low as $15 million.  The number of workers eligible would also be approximately 20,000 rather than 24,000 as under the proposed regulation.

Alternatives One and Two would identify those workers with the largest earnings loss.  However, actual earnings loss is problematic to measure and could have adverse effects on a worker's motivation to return to work.  Tying benefits to actual earnings loss can have an adverse work incentive.  A worker might voluntarily defer a return to work in order to qualify for benefits.

Moreover, any alternative basing eligibility on actual earnings loss would require that the payment of the benefit be delayed until the actual earnings loss over time could be measured.  In addition this would require much greater administrative costs as the Department would need to collect individual data about wage loss, either from tax records or some other source and then determine through some kind of hearing process whether the wage loss was due to the disability or had some other cause, such as returning to school, or voluntarily leaving the work force.