REPORT OF THE VIRGINIA WORKERS' COMPENSATION COMMISSION

Report of the Virginia Workers' Compensation Commission Studying House Joint Resolution 11 (HJR 11, 2022)

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

HOUSE DOCUMENT NO. 3

COMMONWEALTH OF VIRGINIA
RICHMOND
2023

COMMONWEALTH OF VIRGINIA
Workers' Compensation Commission
333 E. Franklin St., Richmond, VA 23219
877-664-2566 | workcomp.virginia.gov

Wesley G. Marshall, Commissioner
R. Ferrell Newman, Commissioner
James J. Szablewicz, Chief Deputy Commissioner
Evelyn V. McGill, Executive Director
Jason S. Quattropani, Clerk of the Commission

Robert A. Rapaport
Chairman
p. 804-205-3134
f. 804-823-6951

November 4, 2022

The Honorable Daniel W. Marshall, III
Virginia House of Delegates
Post Office Box 439
Danville, Virginia 24543

RE: Virginia Workers' Compensation Commission Report on HJR 11

Dear Delegate Marshall:

During the 2022 legislative session the Virginia House of Delegates proposed HJR 11 requesting the Virginia Workers' Compensation Commission (VWC) study the practice of charging workers' compensation premiums on bonus pay, vacation, and holiday earnings. Enclosed is the requested report for your review and consideration. This report was prepared with input and assistance from the National Council on Compensation Insurance, the Virginia Bureau of Insurance, and our agency.

Please do not hesitate to contact me with any questions or comments concerning this report.

Sincerely,

Robert A. Rapaport

RAR/nst

Enclosure

Report of the Virginia Workers' Compensation Commission
Studying House Joint Resolution 11
December 1, 2022

TO: Delegate Daniel W. Marshall, III
Patron of House Joint Resolution 11

SUMMARY AND CONCLUSIONS

During the 2022 legislative session, the Virginia House of Delegates proposed HJR 11 requesting the Workers' Compensation Commission (WCC) study the practice of charging workers' compensation premiums on bonus pay, vacations, and holidays. The WCC enlisted the National Council on Compensation Insurance (NCCI)[1] to assist in its completion of this study.

- The elimination of bonus, vacation and holiday pay from premium would necessitate a significant loss cost level ***increase*** in order to maintain loss cost[2] adequacy for Virginia's workers' compensation system.
- Any reduction in premium would have to be accompanied by a corresponding ***reduction in medical and indemnity benefits*** for Virginia's injured workers to avoid loss cost inadequacy.
- The change in the definition of payroll as described in HJR 11 would reduce the premiums for certain employers while increasing premiums for other employers. This could create a scenario in which some employers subsidize others.
- A thorough review of the Basic Manual rules concerning payroll and its components determined that none of the 38 NCCI states excludes holiday, vacation, or bonus pay as described in HJR 11. Washington, a monopolistic state and not in NCCI's jurisdiction, is the only state that does not use payroll as a premium basis. It uses hours worked.
- Premium collected could be reduced by 10.2%. Consequently, any tax revenue billed, recorded, and collected by the Commission predicated on collected premium would be reduced by that same amount. This would adversely impact the Commission's Administrative and Uninsured Employer's Funds' budget and available resources and risk insurer participation in the Virginia market if they were not allowed to collect premium that is actuarily sound and responsive to the insured exposure.
- The Virginia Workers' Compensation Commission estimates that 13% of the Commission's tax revenue is from state and local self-insured entities. (*See* footnote 7.)

---

[1] NCCI is a licensed advisory rating organization authorized to make recommended loss cost/assigned risk rate filings on behalf of workers' compensation insurance companies in Virginia. NCCI maintains the Basic Manual for Workers' Compensation and Employers Liability Insurance that contains rules, classification descriptions, rates/loss costs for each classification, and state-specific exceptions for writing workers' compensation insurance.

[2] In general, a loss cost represents a provision for losses and loss adjustment expense per $100 of payroll for each classification. Loss costs are not final rates because they do not include provisions for remaining expenses (including production expenses, profit, contingencies, etc.) of an insurer. Loss costs are the foundational factor in calculating final premium.

BACKGROUND OF PAYROLL AS PREMIUM BASIS

With one exception (Washington state), the premium basis for workers' compensation insurance is payroll (money or substitutes for money). Payroll is an effective premium basis due to three primary traits: 1) it is easily determined and verified, 2) it adjusts in concert with the covered exposure, and 3) it is not easily manipulated. The suggested change in the definition of payroll would directly conflict with these characteristics.

According to a 2022 Society of Human Resource Management (SHRM) study[3] – looking at all industries, all locations, and all organization sizes – 67% of organizations utilize Personal Time Off (PTO) versus separate classifications for both vacation and sick time. Employers would be required to adjust their existing bookkeeping processes and modify automated payroll systems to accommodate the new definition of payroll as suggested by HJR 11. This could be viewed as burdensome to the employer community, costly to their operations, and render payroll as no longer easily determined and verified.

The current definition of payroll captures the entirety of an employee's renumeration, which varies directly with the exposure to the covered loss: loss of earning due to injury. The proposed changes would disrupt this relationship and would result in either inadequate premium to cover the exposure or require the reduction of benefits to maintain the direct relationship.

And finally, an employer with a sufficiently sophisticated compensation program could be motivated to increase the proportion of bonus pay in its salaries solely to reduce workers' compensation premium. This level of artifice is not available under the current definition of payroll and undermines its ability to not be easily manipulated.

IMPACT ON REGULATORY AGENCY

An annual assessment on workers' compensation premiums collected by insurance companies and on a calculated premium for self-insured employers based upon payroll is the Commission's primary source of revenue. This includes tax revenue from the imputed premiums of self-insured entities that do not purchase commercial insurance. The assessment rates for 2022 are 2.4% for the Administrative Fund and 0.10% for the Uninsured Employer's Fund for a total assessment rate of 2.5%.

The following NCCI actuarial analysis indicates at least a 10.2% reduction in workers' compensation premium could result from the changes suggested in HJR 11. This would reduce the funding to the agencies by that same amount. The reduction in revenue to the regulatory agencies does not have a corresponding reduction in their duties, function, or scope of mission.

[3] 2022 Society of Human Resource Management Employee Benefits Survey.

ACTUARIAL ANALYSIS

The following actuarial analysis, prepared by NCCI, is an application of statistical and other mathematical techniques to evaluate the potential impact of the questions posed by HJR 11.

> **Currently, workers' compensation premiums for standard classifications in Virginia are calculated based on the total payroll of the insured. If a legislative bill were enacted that resulted in the exclusion of bonuses, vacation time, and holiday time from the total payroll base used to calculate the premium for each insured, the total payroll used in the determination of premium in the Commonwealth would be reduced.**
>
> **Benefit costs in Virginia are a function of the average weekly wages (AWW) of injured workers. (*See* definition of average weekly wage, Virginia Code § 65.2-101.) Under § 60.2-229 of the Code of Virginia, wages are defined as "all renumeration paid, or which should have been paid, for personal services, including commissions, bonuses, tips, back pay, dismissal pay, severance pay and any other payments made by an employer to an employee during his employment and thereafter and the cash value of all renumeration payable in any medium other than cash." "The reason for calculating the average weekly wage is to approximate the *economic loss* suffered by an employee or his[/her] beneficiaries when there is a loss of earning capacity due to a work-related injury or death." *Bosworth v. 7-Up Distributing Co.* 4 Va. App. 161, 163 (1987). For purposes of this analysis, NCCI assumed that only the payroll calculation used in the determination of WC premiums would be impacted by the changes outlined in HJR 11 and therefore any changes resulting from the proposal and enactment of such changes would have no impact on benefits payable in Virginia.**
>
> **All else being equal, if WC premium volume declines (due to a change in how payroll is determined) and benefits are unchanged, this would create a premium shortfall in terms of collecting sufficient funds to cover the cost of benefits to injured workers and maintain overall loss cost adequacy. As a result, loss costs would need to increase to account for this premium shortage and to maintain loss cost adequacy. This increase to the loss cost level would be revenue neutral.**
>
> **NCCI is unable to precisely quantify the potential impact of this change on loss costs due to the uncertainty regarding both the amount of bonus, vacation time, and holiday time currently being included in the payroll and the amount that would be excluded[4] if the changes outlined in HJR 11 are enacted. It is anticipated, though, that any potential loss cost level increase—to maintain loss cost adequacy—may be**

[4] There could also be some uncertainty in the determination of payroll for employers with a consolidated sick leave and vacation time plan. Please see the Additional Considerations section for more details.

significant.[5] **According to the Bureau of Labor Statistics,**[6] **on a countrywide basis, non-production bonuses, vacation time, and holiday time for private industry workers**[7] **represent approximately 2.8%, 4.7%, and 2.7%, respectively, of the employers' cost of employee compensation.**[8] **Should the distribution of compensation for the Virginia workforce be similar to the countrywide distribution, payroll used in the determination of WC premium could decrease at least**[9] **as much as 10.2% (= 2.8% + 4.7% + 2.7%) if the changes outlined in HJR 11 were ultimately enacted.**

Additionally, if the changes outlined in HJR 11 are ultimately enacted, there may be some material indirect effects, potentially resulting in some employers subsidizing others. Examples of possible indirect effects include:

- **The exclusion of bonus, vacation time, and holiday time from the definition of payroll may reduce premium collected from companies that pay large bonuses, while increasing premium collected from companies that pay no bonuses or smaller bonuses.**
- **Loss costs for individual class codes may be impacted differently (e.g., different industry compensation structures) with the ultimate impact not being initially determinable.**
- **Employers could be incentivized to reduce base salary and increase bonus pay, with no change to overall employee compensation, which would directly decrease their WC premium.**

Additional Considerations

- **HJR 11 only specifically mentions excluding bonuses, holiday time, and vacation time in the calculation of payroll. However, there could be uncertainty in the determination of payroll for employers with a consolidated sick leave and vacation time plan, who cannot differentiate between the two types of days out of work for reporting purposes. For example, if only vacation days are excluded from payroll and sick leave remains included, employers that have a consolidated sick leave and vacation plan could be incentivized to**

---

[5] Significant is defined in this context to be an impact on overall system costs greater than +5.0 %. Note that this increase to the loss cost level would be revenue neutral.

[6] United States Bureau of Labor Statistics, Employer Costs for Employee Compensation – December 2021. Economic News Release, March 2022. https://www.bls.gov/news.release/pdf/ecec.pdf

[7] Note that these percentages do not include state and local government employees, who are often self-insured and therefore are not required to report data to NCCI.

[8] Since WC premiums are a basis of the employers' cost of employee compensation, costs associated with insurance, retirement, social security, Medicare, federal and state unemployment insurance, as well as workers' compensation insurance were backed out of the overall percentages for these components.

[9] BLS data does not specifically break out production bonuses (only non-production bonuses). It is unclear what percentage production bonuses represents of the overall employee compensation. To the extent that production bonuses represent a material percentage, the overall impact to payroll could be greater than 10.2%.