STRATEGIES FOR MANAGING WORKERS' COMPENSATION EXPERIENCE MODIFICATION FACTORS

Introduction

The National Council on Compensation Insurance (NCCI) recently announced its plan to modify how a company's Experience Modification Rating (EMR) is calculated beginning in 2013. Understanding how EMRs are calculated and strategies for managing associated risk factors is critical to the success of most companies.

It is becoming increasingly common for companies with workers' compensation Experience Modification Rating (EMR) greater than 1.00 to be prohibited from bidding on new or renewal contracts. The EMR has become one of several critical benchmarking metrics used to determine if a bidding company offers a competitive advantage through sustainable safe and efficient operations. In these tough times, contractors, manufacturers and service providers cannot afford to be shut out from any business opportunities. It is this competitive environment that makes it critical for companies to know and understand how to manage their EMR.

The EMR can serve as a good lagging indicator of how effective a company's safety and claim management programs are. An EMR of 1.0 represents the "average" mark for a company's specific industry class. EMRs greater than 1.0 represent a historical performance worse than the industry average, and less than 1.0 represents a performance better than the industry average. It is important to keep this performance benchmark in mind when establishing company goals and objectives. Would a company be satisfied if other aspects of their business, such as production, quality, sales goals or customer satisfaction, were graded as below average for performance? Probably not.

Understanding the EMR Calculation

Understanding how an EMR is calculated is the first step in developing strategies to help manage it. Effectively managing the factors that influence an EMR can positively impact a company's bottom line through increased productivity, improved quality, reduced employee injuries, and reduced claim costs.

EMRs for companies with operations in multiple states are generally calculated by the National Council on Compensation Insurance (NCCI) with the exception of a few states. These so called "exception" states generally have their own rating bureaus.

Basically, the EMR calculation is the comparison of a company's actual losses, over a three year period, to the expected losses for companies of similar size and classification. The following metrics are used to calculate a company's EMR:

Workers' Compensation (WC) Payroll Class Codes

It is important to understand the definitions of the payroll classification codes used to calculate workers' compensation premiums. Incorrect codes can lead to errors in the calculation of a company's experience modification factor. A class code is a four-digit code assigned to differentiate between the various job duties or scope of work performed by employees. Each of these class codes is then assigned a rate per $100 of payroll. The assigned rates vary by class code based on the risk of injury assigned to each classification. For example, an office worker has a lower risk of injury compared to a welder; hence, the rate assigned to the office worker would be lower than that of the welder. The class codes are from your past audits and are reported by your insurance carriers.

Claim Loss Cost History

Workers' compensation claims are categorized into primary losses and excess losses based on a $5000 split point.

- Primary Losses are the first $5,000 of any claim. These losses carry the heaviest weight in determining the experience modification factor because claim frequency is more predictable than claim cost or severity.
- Excess Losses are amounts over $5,000. These losses are also used in determining the experience modification factor. They are capped at maximum values that vary by state.

Experienced Rating Adjustment (ERA)

One of the more common questions posed by companies is whether or not they should pay small medical bills versus reporting them under a first dollar workers' compensation program. The idea behind this philosophy is that claim frequency impacts the EMR equation greater than cost or severity.

To alleviate this concern an Experience Rating Adjustment (ERA) is incorporated into the EMR calculation. The ERA reduces "Medical-Only" claim costs by 70%, before they are used in the calculation for states where ERA is approved. Also, the expected loss rate and discount ratio, used to calculate expected losses, is also adjusted to reflect a 70% reduction in medical-only claims.

Because of the ERA there is really no incentive not to report medical-only claims in states where ERA is approved. In 2012, ERA approved states include: Alabama, Arkansas, Arizona, Connecticut, District of Columbia, Florida, Hawaii, Iowa, Idaho, Illinois, Indiana, Kansas, Kentucky, Maine, Maryland, Michigan, Minnesota, Missouri, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Carolina, Oklahoma, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia, West Virginia and Wisconsin.

Time Periods

The experience period includes three prior years of data, excluding the most recent year. For example, the current year EMR would use data from the policies effective in years -4, -3, and -2. The data from policy year -1 policy would not enter the experience period until the next policy year +1, when the data from the policy year -4 would drop out.

Changes to EMR Calculations

The NCCI recently obtained regulatory approval to update the $5,000 split point, which was set over 20 years ago. According to NCCI, the average cost of a claim has nearly tripled over that 20 year time period. The new EMR split point will be revised to $15,000 to account for this inflation. This filing will be a graduated change over a three-year period ($10,000/$13,500/$15,000) beginning in 2013.

Looking at the example below, starting in 2013, that $10,000 lost time claim will have the full $10,000 "primary" portion of the claim count **fully** against the MOD factor calculation.

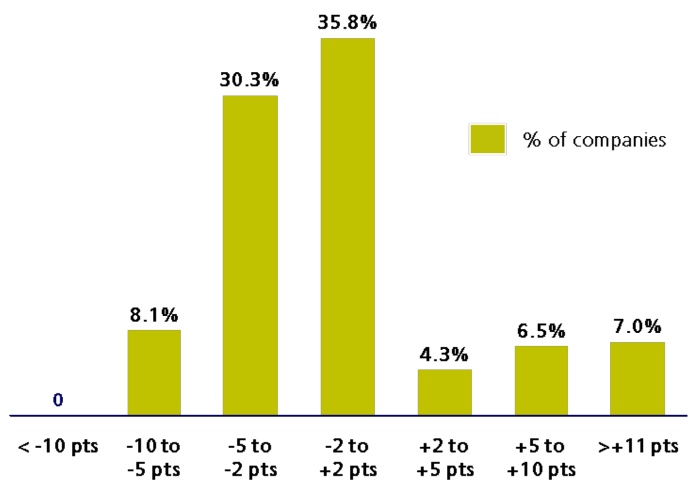
Example of NCCI Mod Split Point Increase[1]

Split Point		Current $5,000 Split Point	Year 1 $10,000 Split Point	Year 2 $13,500 Split Point	Year 3 $15,000 Split Point
$5,000 Claim	**Primary**	$5,000	$5,000	$5,000	$5,000
	Excess	$0	$0	$0	$0
$10,000 Claim	**Primary**	$5,000	$10,000	$10,000	$10,000
	Excess	$5,000	$0	$0	$0
$15,000 Claim	**Primary**	$5,000	$10,000	$13,500	$15,000
	Excess	$10,000	$5,000	$1,500	$0
$20,000 Claim	**Primary**	$5,000	$10,000	$13,500	$15,000
	Excess	$15,000	$10,000	$6,500	$5,000

[1] NCCI I - Introduction to Proposed Experience Rating Plan Changes Item E-1402—Webinar on Demand

The impact of this change to individual companies will vary. The fewer claims a company has in excess of the current $5,000 split point will help to contain the EMR under the new program. The idea behind this is that the fewer claims that fall under the new higher $15,000 split point, the better the EMR results. These claims would then be considered "Primary Losses" and carry a heavier weight in determining the EMR factor because claim frequency is a more predictable indicator than claim severity. In theory, companies with EMRs less than 1.0 should expect to see lower mod factors at the higher split points. In turn, companies with EMRs greater than 1.0 should expect to see even higher mod factors at higher split points.

Projected first year mod changes[2]



Six Strategies for Managing Workers' Compensation Experience Modification Factors

Focusing on the strategies that will reduce a company's EMR can also help to make a company more efficient, as well as more attractive to both new customers and insurance carriers. Here are examples of six basic strategies that can help a company manage its EMR:

1. Establish a "Zero Accident" Commitment

The single most effective strategy for managing an EMR is to prevent work-related injuries from occurring.

Many industries have benefited from establishing "zero-defect" quality control programs for production processes; preventing work-related injuries should merit the same commitment. Safety is seldom thought of in those terms. Yet, most successful companies establish some form of production, quality and growth performance goals. Management meetings are held and reports are developed to track the progress toward attaining these goals. For most companies, safety performance and accident frequency are relative terms. Only when a company can benchmark or compare its own accident experience with previous years or against industry benchmarks can meaningful zero accident goals be established.

Start by reviewing prior insurance company loss runs and OSHA logs. Become aware of your industry's loss leaders and benchmark against them. Track information such

[2] NCCI I - Introduction to Proposed Experience Rating Plan Changes Item E-1402—Webinar on Demand

incident rates, DART rates, length of disability and duration of transitional duty, and compare these results to industry averages.

Next, analyze when and where these injuries occur and focus safety efforts accordingly. Focus efforts on reducing the frequency of injuries that are claim cost drivers such as strains and sprains, slip/falls, falls from elevations, caught in equipment, struck by and vehicle-related incidents.

Zero accident performance goals must be supported at the same level as other key company performance goals in order to be effective in reducing accidents, improving safe behaviors, decreasing production defects or controlling production costs. Attempting to change culture and impact safety performance outside of accepted performance measures and methods commonly results in failure. To be effective, a zero accident commitment must be integrated into every aspect of a company's culture. Although this may sound extreme, it actually reflects a "common sense" approach.

2. Implement an Effective Return-To-Work Program

The second most effective strategy for managing a company's EMR is the implementation of an effective Return-to-Work program (RTW).

Most state workers' compensation laws allow for a set number of days to elapse before mandated workers' compensation wage-replacement benefits are triggered. This so called "waiting period" is the days right after an injury where an effective RTW program can have the most significant impact on mitigating claim costs and managing EMRs.

An effective RTW program is one that takes advantage of this window of opportunity by actively trying to get injured employees back to work within the waiting period. Every time the RTW program accomplishes this, the company avoids triggering the workers' compensation wage-replacement benefit. Returning employees back to work in this time frame categorizes the injury as a "medical-only" claim and takes advantage of the 70% ERA claim cost reduction.

Medical-only claims do not have as much of an impact on the experience modification as indemnity claims. Only 30 percent of the actual primary and excess portions of a medical-only claim is included in the EMR calculation. As a result, medical-only claims are reduced by 70 percent.

The impact an effective RTW program can have on the EMR can be very significant, not to mention the cost saving benefits on both the direct and indirect costs of an injury as well. Even if you are unable to return an injured worker to employment within the waiting period, effective RTW programs can still be successful in reducing overall injury and claim costs and improving employee morale.

3. Look for Opportunities in Employee Selection and Training Programs

Effective employee selection and training is a critical function for any successful company. How safely and efficiently new hires perform their jobs is also a major contributing factor in managing a company's EMR. This is because lower wages, typically associated with new hires, can be offset by higher claim costs if injured. This scenario can negatively impact a company's EMR for several years if not managed correctly.

Less experienced workers account for a disproportionately large portion of lost time claims, according to loss data reported to the U.S. Bureau of Labor Statistics, as interpreted by NCCI, as well as Zurich's own claim data. Contributing factors to this trend can include; inexperience, newly acquired skill sets, new physical job demands, new job-specific training requirements, unrecognized hazards, unfamiliar surroundings, and careless or reckless efforts to complete tasks on time.

Companies that rely on traditional employee selection and on-the-job training techniques can be in for a surprise when it comes to managing their EMR. Quite simply, many traditional employee selection and training tools and methods can fall far short of effectively managing risk factors that can contribute to EMR performance.

Some key strategies that can help minimize the potential negative impact and increased costs associated with employee selection and training can include:

- Job Analysis - A thorough job analysis for each position, including physical job demands, can help to prevent lost time injuries and facilitate Return-to-Work. Plus, when used in tandem with detailed job descriptions, they can support a variety of other loss prevention and claim mitigation programs making them one of the more useful tools for managing health and safety and a company's EMR.

- Pre-placement and Post-offer Testing Strategies - A strong pre-placement and post-offer testing strategy can help place the right people in the right jobs. By properly implementing key strategies, a company can protect their EMR in addition to other benefits, which can include: reduced work place injuries; established benchmarks for return-to-work; increased productivity; increased employee retention; reduced turnover costs (hiring, training, etc.).

- Orientation and Training - A critical step in reducing workers' compensation losses for both new and existing employees is an effective employee orientation and training program. Employee training is the foundation of any effective safety and health program because it is the vehicle to provide information and develop skills needed by employees to maintain a safe working environment. Effective safety training can help to establish a company's safety culture by promoting safe work practices, policies and procedures. Unfortunately, it is not uncommon for seasoned employees to negatively influence learned safe work practices of new hires. Thus, it is equally important that seasoned employees be properly trained and embrace the importance of workplace safety, which will ultimately lead to an effective safety culture. It is also important to train all managers and supervisors in their roles and responsibilities, making sure they understand the cost of claims and their effect on the goals and philosophy of the company.

4. Report Claims Promptly

The prompt reporting of employee injury claims can be one of the most effective tools in controlling workers' compensation costs, impacting EMR calculations. Delays in claim reporting can lead to delays in appropriate medical treatment, which can impact the cost of medical care, recovery time, wage replacement and return-to-work opportunities. For example, the longer a strain injury goes unreported and medical treatment is delayed, the worse the injury can become, resulting in more costly types of medical treatments and longer recovery times.

The benefits of prompt claim reporting can include:

- Enhances claim adjustors' ability to make prompt contact with the injured worker and provide appropriate medical management

- Decreases the likelihood of fraud by preserving investigative facts that may affect compensability

- Facilitates medical case management opportunities that can help to reduce medical and lost time costs

- Provides for the timely delivery of benefits -- a key concern to injured employees

5. Establish a Medical Provider Relationship

According to the NCCI Research Brief, "Medical Services by Size of Claim 2011 Update," medical costs represent almost 60% of workers' compensation claim costs. Identifying and utilizing appropriate network medical providers is another critical step in controlling medical costs that influence the EMR.

It is very important to have the right medical provider making the right treatment at the right time. Occupational medical providers tend to have a better understanding of treatment protocols for work-related injuries, local workers' compensation laws and RTW philosophies.

It is also important to ensure that selected medical providers participate in the workers' compensation carrier's provider network. Provider networks can help to control medical and pharmacy costs at the point of service through negotiated lower rates, depending on jurisdictions. Utilization of over 1.2 M providers accessible through Zurich C.a.r.e.® Directory Online contributed to total medical savings in excess of $528M or 47% in 2010.

Once a company identifies a medical provider, it needs to invest the resources to educate the provider on their claim management and RTW program goals and objectives. Inviting providers to the facility so they gain a better understanding of what employees do on a day-to-day basis is a good first step. Developing performance standards, such as minimizing lag time by treating injured workers on the same day, communicating with carrier claims adjusters and case managers, and taking advantage of return-to-work opportunities, can go a long way in helping to mitigate claim expenses.

The final step with establishing a good provider relationship is making sure employees get to the right provider. About two-thirds of the states allow for some level of employer choice of medical provider, and a few other states allow employees to choose from a panel or network established either by the employer or by the state. Effective employee and supervisory training on company claim management and RTW program protocols are essential. It should be noted that regulations do not prohibit employers from suggesting medical provider options to employees in employee-choice states.

Whenever possible, accompany the injured employee to the medical provider for their initial visit and ensure the provider has enough information to make a good assessment. If a company representative cannot be present, make the sure employee has appropriate information communicating your concern for the employee and reminding the provider of the company's commitment to a return-to-work program and willingness to accommodate work restrictions.

6. Correct Workers' Compensation Class Coding

It is important to understand the definitions of the payroll classification codes used to calculate workers' compensation premiums. Incorrect codes can also lead to errors in the calculation of a company's experience modification factor. Unfortunately, class code errors are not an uncommon problem, which usually occurs during preparation for policy renewal where payroll projections are made. When projected payroll and actual payroll are relatively close and yet there is a large additional premium developed from an audit, one of two things generally have happened.

- The auditor made a mistake in the classification of employees, or
- The company made a mistake in projecting payrolls or determining the workers' compensation class code.

The bottom line is that by understanding specific workers' compensation class code definitions and rules, and ensuring that the renewal process includes reliable payroll forecasting and proper classification of employees, there will be much less of a chance for large additional premium being developed from the audit.

Conclusion

There are obvious quantifiable direct cost savings that can be realized by managing strategies resulting in a strong EMR. There are several other benefits to effectively managing a company's EMR as well. The indirect costs associated with employee injuries can result in lost productivity, market share and profits. By implementing strategies to reduce the frequency of injuries and minimize their costs, a company can impact their bottom line and improve their marketplace competitive advantage.

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