Workers' Compensation: What Factors Affect My Premium?

Throughout its first quarter-century of operation, the hallmarks of AMRRP's success have included its commitment to consistent underwriting practices, innovative loss control programs, and superior claims handling. To support these focuses, AMRRP has remained committed to ongoing Member education about how the Pool's underwriting philosophy, loss control efforts and claim results interact to affect Member premiums. Municipal leaders' solid understanding of industry practices and challenges enable them to better analyze the shortfalls of competitors' offers of coverage and service at temporarily reduced premiums compared to the long-term stability and benefits of AMRRP membership.

To that end, it's important for Members to know as much as possible about the factors affecting AMRRP's workers' compensation underwriting process. The financial aspects of the workers' compensation system are based on a complex, ever-changing mix of calculations and figures that is far more involved than just estimating lost work time payments and medical bills. The following are just some of the factors and pressures faced when calculating workers' compensation premiums and rates:

Effects of Recession

Arizona municipalities have long been burdened with the task of operating under reduced federal, state, and local budgets. As a result, many cities and towns have elected to adopt a four-day work week, furloughs, or layoffs. Since workers' compensation premiums are partially based on payroll dollars spent, these practices likely resulted in decreased work comp premium. According to the National Council on Compensation Insurance (NCCI) which collects workers' compensation and workplace injury statistics, analyzes industry trends, and makes insurance rate recommendations, nearly $900 million was spent on work comp premiums in Arizona in 2007; by 2011, that figure had dropped to $544 million. While that may initially seem favorable to municipalities, statistics show while premium dollars are decreasing, claim dollars are not. NCCI data shows in 2010, for every dollar received for work comp premium, $1.32 was spent on claims. This may be due to a smaller number of employees being forced to perform the same work as the previously larger workforce, often resulting in an increase of on-the-job injuries. Regardless of cause, that overage has to be paid—at the cost of diminishing Member surplus and a decreased likelihood of annual dividends. Because of these factors, the AMRRP loss control staff works diligently to assist Members who want to ensure a safe workplace, knowing that reduced workplace accidents will lead to improved workers' compensation rates.

Arizona's High Medical Costs

In Arizona, medical costs account for the vast majority of workers' compensation dollars spent. On average, 71 percent of all Arizona work comp dollars are spent on medical costs, compared with 62 percent regionally (Arizona, Colorado, New Mexico, Nevada, and Utah) and

59 percent nationwide. Why are Arizona's medical costs so high? A number of factors contribute, including:

- Prices- The costs of medical services are going up. While municipal officials have found creative ways to lower payroll on a reduced budget, accidents are up, so we as a state are spending more on medical costs.
- Utilization- The number of treatments per claim is up from previous years. Injured workers are following the treatment advice of their doctors, possibly due to more mature workers becoming injured.
- Aging workforce- Americans are working far longer than in the past. This could result in higher work comp dollars being spent to care for older workers.
- Rising prevalence of obesity- Americans are among the heaviest in the world, and medical costs to care for diabetes; joint, muscle, and bone deterioration; and respiratory issues are at an all-time high.
- Inability to make full/final settlements- Arizona law allows an injured employee to reopen an old case if their old injury requires additional treatment. Older employees and advances in medical technology make this a costly benefit.

While inflation of medical costs is not altogether avoidable, municipalities that invest in the health of their employees can see a decrease in sick and/or injured employees—translating to lower medical dollars spent. The Wellness Council of America (WELCOA) contends that since Americans are working longer, the workplace is the ideal place to foster health and wellness practices. An AMRRP Loss Control consultant can help you start a program to help your employees lead happy, healthy lives.

NCCI/Experience Modifiers

In addition to payroll dollars, workers' compensation premiums are also based on prior claims which collectively make up a Member's loss experience. Although AMRRP is not an NCCI subscriber, to calculate this loss experience into claim and premium data, AMRRP staff uses NCCI licensed software to compute an experience modifier, or "e-mod" for each Member. Using complex algorithms, NCCI's software compares the actual workers' compensation claim experience of an entity with what would be expected from an entity of like characteristics- for instance, a city of similar size and population. A value, or e-mod, is assigned to each entity based on its unique workers' compensation experience as compared to the average:

- An e-mod of 0.99 or lower = Better, or less, claim experience
- An e-mod of 1.00 = Average claim experience
- An e-mod of 1.01 or higher = Worse, or more, claim experience

Once an e-mod is assigned, it is applied to the premium, which consequently, will fluctuate up or down depending on the insured's prior workers' compensation claim history. For example, if three different cities each had a base premium of $100,000, each city's e-mod would affect its premiums as follows:

	Premium	e-mod	Payment
City A	$100,000	0.80	$80,000
City B	$100,000	1.00	$100,000
City C	$100,000	1.20	$120,000

A large portion of the formula is based on primary and excess losses. To determine primary losses, NCCI caps all work comp claims at $10,000. Any dollar amount over the initial $10,000 allowance is recorded as an excess loss. For example:

- $4,000 claim = $4,000 primary loss / $0 excess loss
- $10,000 claim = $10,000 primary loss / $0 excess loss
- $15,000 claim = $10,000 primary loss / $5,000 excess loss

Primary losses are used to measure claim frequency, while excess losses are used to measure claim severity. When calculating an e-mod, more weight is given to the primary losses. A municipality that has many small, primary losses poses a greater insurance risk than a municipality that has an occasional severe excess loss.

Primary losses are currently capped at $10,000, however, that cap will be changing in the near future. Effective January 1, 2014, it will increase to $13,500; in 2015, the cap will increase yet again, to $15,000 per claim.

What does this mean for Members? Starting with the July 2013 policy renewal, the dollar values of the more heavily weighted primary losses will increase. While the increased value of primary losses will be somewhat offset by a decreased value in excess losses, for Members with a high claim frequency, this will mean increased e-mods. Members with few claims may see no change, or may even see a decrease.

The Pool has several Members that have elected to decline reimbursement from AMRRP for temporary partial and temporary total disability (TTD) payments. Any amount AMRRP pays in temporary partial or temporary total disability benefits goes into the e-mod calculation at 100 percent, while “medical only” claims are valued at 30 percent. For example:

	Medical Benefits Paid	Temporary Total Disability Paid	$ amount submitted for e-mod calculation
Claim A	$3,000	$100	$3,100
Claim B	$3,000	$0	$900

Another option for Members is the AMRRP Work Comp Deductible Program, which may also help Members save on their workers’ compensation premium. To explore more options AMRRP has to offer, contact Ed Bantel at (602) 368-6618 or ebantel@berkleyrisk.com.