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Understanding Experience Modifiers: Can Subrogation Really Affect Premiums?

By Gary Wickert | January 4, 2013

For many corporate personnel, the concepts of underwriting and experience ratings remain a clouded mystery, yet they directly affect the amount of insurance premiums a company will pay.

Even more mysterious though is what effect, if any, subrogation efforts have on premiums.

Everyone can agree that "to get money back" is a good thing. Whether it affects the insured's experience rating and whether or not it will ultimately lead to reduced premiums and savings for a good insurance client is another issue altogether, and remains shrouded in the hieroglyphics of modern insurance underwriting.

Understanding the correlation between the worthy goals of lower premiums and subrogation recoveries often stimulates subrogation efforts and allows corporate decision-makers an opportunity to shape subrogation opportunities which would otherwise be lost, directly affecting the company's bottom line.

The concept of experience ratings should not be a mystery. Experience ratings reward insureds who have a favorable loss history and penalize insureds who have a poor loss history.

This is accomplished by the application of a credit (a reduction) or a debit (an increase) to premiums pre-determined by the National Counsel of Compensation Insurance (NCCI). NCCI is an insurance service entity which organizes and compiles information on insurance risk and losses and, depending on the state, keeps statistics on various insureds, thereby enabling it to calculate experience modifiers for different companies and employers.

The loss history is compiled on unit statistical cards which are available to insurers and insureds alike. It is prudent for an employer to periodically check its unit statistical card in order to determine if any errors or miscalculations have been made which may detrimentally affect its premiums.

Losses are divided into primary losses and excess losses. Any losses under $5,000 are considered primary losses, while the amount of losses in excess of $5,000 is considered excess losses.

Actual and expected primary losses are calculated separately, with each state applying different weighted values and ballast values in order to arrive at an experience modifier which is intended to reflect the true condition of the insured's loss history. Experience modifiers are obtained after dividing actual losses by expected losses.

Obviously, if actual losses exceed expected losses, this is a bad thing, and the resulting modifier constitutes a debt or increase to an insured's insurance premium. If actual losses are lower than expected losses, the modifier has the opposite result.

For example, if actual losses total $150,000 and expected losses total only $100,000, the experience modifier is 1.5. The higher the experience modifier, the higher the premium is.

It is easy to see how any control the insured or insurer has over the experience modifier may directly affect the premium an insured can expect to pay in subsequent years. When a retrospective rating program (retro policy) is in effect, the effect of a good loss history is even more immediate.

Generally, an insured's loss history is reviewed and its experience rating is calculated over a three year period. The experience modifier is then issued one year after the three year period has expired. This gives the experience raters a set time during which to evaluate an insured's loss history, and an adequate period of time to digest and publish the information.

So, how does subrogation fit into all of this?

In theory, subrogation recoveries serve as a debit to actual loss totals and actual primary losses, thereby directly affecting the experience modifier. In short, one or two subrogation recoveries can mean the difference between a debt modifier and a credit modifier.

Controlling experience modifiers becomes the key for insureds interested in holding their premiums to an absolute minimum under the experience rating process. Conscientious insureds can obtain copies of experience modifier worksheets and/or unit statistical cards from the insurer and/or NCCI. The key to keeping premiums under control is to have a basic working knowledge of the experience rating process, and to do something about those aspects of experience modifiers over which the insured has some control.

Double checking the NCCI figures on the applicable worksheets aggressively seeking subrogation recoveries, maintaining an accurate record of these recoveries, and seeing to it that those recoveries find their way into the experience modifier calculations are the most significant things an insured can do to control premiums. Expected loss rates can be adjusted to reflect significant credits obtained as a result of settlements or recoveries in third-party subrogation cases. Actual incurred losses and actual primary losses should also reflect any subrogation recoveries obtained. These adjustments cannot be made, however, until recoveries are achieved. Recoveries are not achieved until subrogation potential is recognized and action is taken to make the recovery.

In the area of workers' compensation, most insureds respond to a compensable injury to one of their employees by blaming the employee and touting their own safety programs and risk management efforts.

My experience has been, after investigating thousands of work-related accidental injuries, that in 9 out of 10 such incidents, the employer believes that by placing contributory negligence on the employee and by absolving itself from any fault in connection with the loss, it is somehow protecting itself from liability. After a work-related injury, insurance professionals must immediately contact the insured and carefully explain to them how, by virtue of having workers' compensation insurance, they are immune from liability, and any assistance they can give in identifying third-party liability and subrogation potential may directly impact the premiums they pay in the future years by reducing the negative effect the loss may have on their experience modifier. By allowing and/or assisting the claimant to pursue a third-party tortfeasor, the employee's dependence on workers' compensation benefits can be drastically reduced or completely eliminated. This behavior on the part of the insured is equally self-destructive in property and casualty claims.

Corporate decision-makers and corporate counsel should make it their business to see to it that subrogation is made a priority that they are given proper credit for subrogation recoveries, and that these recoveries are reflected in experience modifiers which control how large of a premium the insured will be responsible for paying in the coming years. Loss control programs attack loss frequency and are a worthy goal in connection with any business or insurance program. However, risk management must be taken a step further.

It is the insured's responsibility to insist that subrogation potential is being investigated and is being actively and competently acted on. After a successful subrogation venture, it then becomes the insured's obligation to see to it that they are given proper credit for those subrogation recoveries, which might otherwise be lost in the rather confusing and obfuscated world of experience rating.