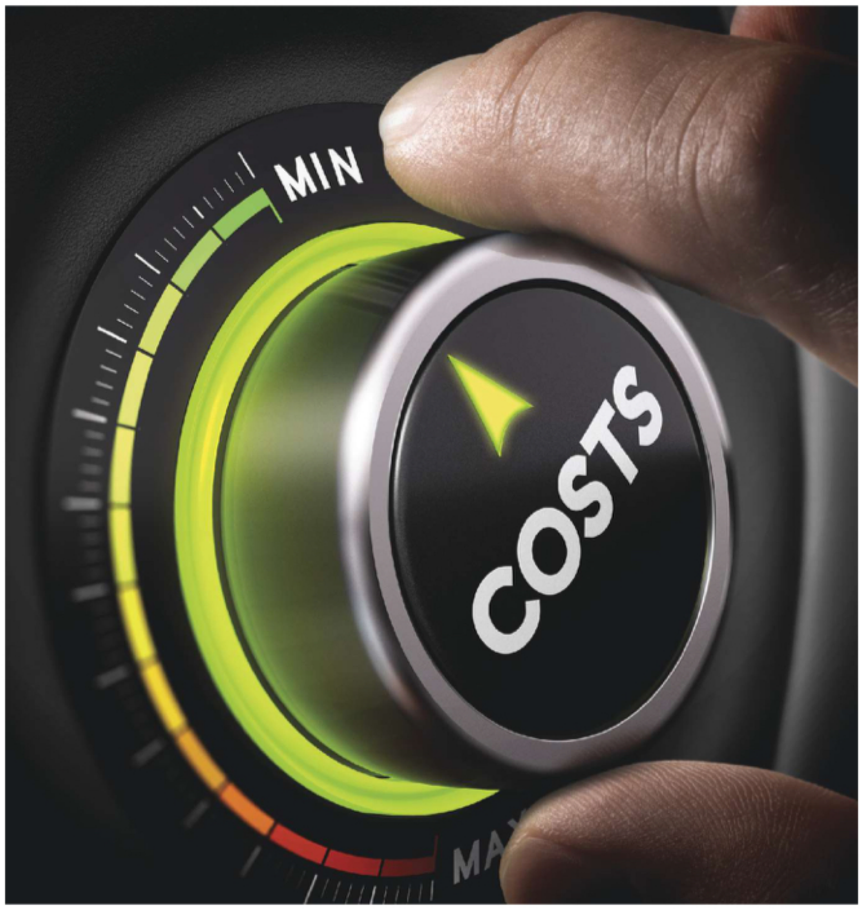
Road To Recovery

Understanding the Effect of Experience Modifiers

By Gary L. Wickert



It is said that good judgment comes with experience but experience comes from bad judgment. That pithy aphorism generally is true in life but particularly so when a company sees significantly increased workers' compensation insurance premiums following a serious claim. The same is true even if the claim was not the employer's fault. Is it fair? Of course not, but neither is workers' compensation.

Over a century ago, our society and the legal community that reflects it determined that the risk of employee injury and death should fall to the mom and pop trying to run a profitable business. We saddled employers with potentially unlimited liability in the case of medical expenses and lost-wage replacement benefits when an employee is injured. In exchange, we give the employer immunity from a lawsuit by the employee and grant the employer (or its workers' compensation carrier) the right to reimbursement should the employee make a large tort recovery from a tortfeasor (a third party other than the employer) responsible for the injury.

The sad trend today, unfortunately, is bad judgment shown by insurance companies and self-insured employers that do not aggressively strive to recognize and pursue third-party reimbursement for the benefits they have paid. Successful subrogation assists in avoiding a potential, significant increase to what is already one of the most expensive overhead items in starting up or running a small business—workers' compensation insurance premiums. Understanding how and why a company can save itself money in the future is using good judgment.

Workers' compensation insurance and underwriting is not always logical. How can a company that did nothing to contribute to an employee's injury be on the hook for increased insurance premiums just because an employee was klutzy or worse? For many corporate personnel, the concepts of underwriting and experience ratings remain a mystery, yet they directly affect the amount of insurance premiums a company pays. Even more mysterious is what effect, if any, subrogation efforts have on premiums. Everyone can agree that getting money back is a good thing. Whether or not it affects the insured's experience rating or will lead to reduced premiums for an in-

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surance client is another issue altogether and remains shrouded in the hieroglyphics of modern insurance underwriting. Understanding the correlation between the goals of lower premiums and subrogation recoveries often stimulates subrogation efforts and allows corporate decision-makers an opportunity to shape subrogation opportunities that would otherwise be lost, which directly affects the company's bottom line.

The concept of experience ratings shouldn't be a mystery. Experience ratings reward insureds that have a favorable loss history and penalize insureds that do not. This is accomplished by the application of a credit (a reduction) or a debit (an increase) to premiums predetermined by the National Council of Compensation Insurance (NCCI). NCCI is an insurance service entity that organizes and compiles information on insurance risks and losses and, depending on the state, keeps statistics on various insureds, thereby enabling it to calculate experience modifiers for companies and employers. The loss history is compiled on unit statistical cards that are available to insurers and insureds. It is prudent for an employer to periodically check its unit statistical card to determine if any errors or miscalculations have been made that 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 that is intended to reflect the true condition of the insured's loss history.

Experience modifiers are obtained after dividing actual losses by expected losses. If actual losses exceed expected losses, this is obviously a bad thing, and the resulting modifier constitutes a debit, 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

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 debit modifier and a credit modifier.

Controlling experience modifiers becomes the key for insureds interested in holding their premiums to a 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 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 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 primary losses should also reflect any subrogation recoveries obtained. However, these adjustments cannot be made 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,

blaming the employee and touting their own safety programs and risk management efforts. This behavior on the part of the insured is equally self-destructive in property and casualty claims. My experience after investigating thousands of work-related accidental injuries is that, in nine out of 10 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 protected 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 that any assistance they can give in identifying third-party liability and subrogation potential may directly impact the premiums they pay in the future by reducing the negative effect the loss may have on their experience modifier. By allowing or assisting the claimant to pursue a third-party tortfeasor, the employee's dependence on workers' compensation benefits can be reduced drastically or completely eliminated.

Corporate decision-makers and corporate counsel should make it their business to see that subrogation is made a priority, they are given proper credit for subrogation recoveries, and those recoveries are reflected in experience modifiers that 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 actively and competently acted on. After a successful subrogation venture, it then becomes the insured's obligation to see that they are given proper credit for those subrogation recoveries, which might otherwise be lost in the confusing and obfuscated world of experience rating. ■

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1.5. The higher the experience modifier, the higher the premium. It is easy to see

most insureds respond to a compensable injury to one of their employees by

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