



Business Insurance & Worker Compensation Conference
May 2018
Chicago, IL

Premium-It's Not Just About Price.

I. Nothing happens until someone buys something

The Science and the Art of Premium Calculations

There are many factors involved in the determination of insurance premium for workers compensation. Some are based on the review of big data obtained by insurance companies, state agencies and national rating bureaus.

Other contributors include medical costs of a geographical area, the current state of the economy and recent legal rulings pertinent to worker compensation cases in the state the policy is written.

However, as the underwriters are human, at least for now, they have memories that can rival an elephant. Past experience with a particular account or type of risk can cloud the thinking of an underwriter as they consider a risk. Many have equated underwriting with gambling as some decisions are based as much on “gut feelings” than raw data.

Tools used when determining Premium

Manual Work Comp premium is determined using three factors—type of risk, payrolls and the rates filed by the carrier in a specific state.

Risks are assigned a class code by the National Council on Compensation Insurance (NCCI) based upon the job functions or risk factors. There are 800 different codes and they are reviewed and revised as new types of employment are developed. Though in today's world, they are having a tough time keeping up!

Payroll of employees would seem straight forward but that can be tricky if employees do many functions for an employer. Payrolls are audited after the conclusion of the policy period to account for

the fluctuation of payrolls, number of employees and their job duties. Construction, manufacturing and transportation risks can have huge swings in payrolls due to economic changes. The recent recession caused an already soft market to suffer some of the worst results since 9/11.

Rates are given to each class code by each class code by each state each year Rates are determined by using data on medical costs, claims experience, current legislative and legal interpretations and whether a state wants to steal businesses from their neighboring states. They can even be determined by a candidate for Governor who is running for election and needs a platform to campaign that appeals to the voters.

State rating bureaus or the NCCI can recommend rate filings but as each state determined its own insurance laws and rates, they are subject to the whims of politics. Rate decreases are normally welcomed more than rate increases.

When the sins of the past come back to life

Another important factor in determining premium is how safe or lucky an employer has been when it comes to on the job accidents.

Don't forget in all of this discussion of premiums, the MOST important thing is the health and safety of employees. Worker compensation came into existence to protect employees from a pledge from employers to take care of injured employees in exchange for not suing employers when accidents did happen. Employers who are unsafe or are in high risk occupations pay more in premiums and those who are in safer occupations or have no losses pay less. Simple enough.....and yet is it??

The quickest and simplest way to know if an employer is a safe is to review the experience modification worksheet or EMOD. This form is at once a snapshot of the past claims experience of an employer and the world's worst algebra problem. As each risk has some inherent exposures that no amount of safety programs can eliminate, the EMOD formula has built in weights to give credits and debits as necessary to create a number that an underwriter can use to determine if a risk deserves premium relief or needs to cost more to cover potential future exposures.

A more hand on review of an employer's claims history as well as onsite loss control visits on larger and more complex risks will give the underwriter the information needed to come up with a number that a carrier can cover anticipated losses and still make an underwriting profit.

II. The Good, the Bad and the Really Ugly

What this country needs is a really good 5 cent cigar

When the economy is good and folks are working, the workers compensation insurance industry is as exciting as it gets. As this is the coverage every employer must carry, when more folks are working,

the more insurance coverage is needed. The best case scenario is new construction, more products being built domestically and those products along with others shipped in from other places being transported throughout the country. Public infrastructure projects as well as the increasing need for healthcare facilities for aging baby boomers continue to swell the employment rolls. However as the employment of “yesteryear” evolves into the gig economy, co-working spaces and bitcoin miners, the need for workers compensation coverage remains.

The Court of Unintended Consequences

A rule to live by when working on any case is never make case law and never, ever make bad case law! Case law—good or bad, which depends on the eyes of the beholder, can dispute the workers compensation system and premiums faster than a recession and massive layoffs. When former California Governor Schwarzenegger signed SB 899 into law in 2004, he put into action a series of events that kept the workers compensation market in a soft market cycle that lasted for nearly 10 years. How could one state cause such a ripple effect?? California accounts for 20 Billion in written workers compensation premium every year. It can change the direction of the entire marketplace and create a black hole for the rest of the country.

Another state that can move the needle is Florida. When the ruling came in from the Florida Supreme Court on the Castellanos v. Next Door Co. in April 2016 on the handling of workers compensation legal fees charged by attorneys, carriers with legacy claims and exposures in that state now had to reserve for an exposure they had not had to consider when underwriting the risk originally. That ruling not only affected current and future cases, but was retroactive! There is no possible way an underwriter can know when a retroactive court ruling will come into play while considering a risk today sitting on their desk.

It is not only court rulings that can change the rules midstream. Individual states insurance departments or their states Work Comp industrial boards or commissions can also make determinations that can change the game. The Illinois Industrial Commission nearly undermined their own medical reimbursement fee schedule law at the end of 2017 when they considered increasing the medical fee rates of some of the most used CPT codes in the state. Those medical rates were used to determine the work comp premium rates for 2018, which resulted in an 11% DECREASE!! The Indiana Work Comp Board ruled that the law that capped Hospital Fees at 200% of Medicare didn't apply to ambulatory surgical centers—most of which are owned by hospitals. So the law intended to help lower costs was undermined by the very group who worked to get it passed. Want to guess where employees are sent to for surgeries??

OK, Houston, we've had a problem here

The recent recession started as this author began her switch from 20 plus years as a multi-state work comp claims adjuster to a national work comp broker in 2008. Employers began laying off employees or just closing down altogether as the stock market crashed and credit lines disappeared. What that means for work comp premiums is they have to be refunded to the employers because they are based on payroll. At the time of the recession, the work comp market was in an extended “soft” market cycle. So pricing was suppressed as carriers tried to remain competitive. Unfortunately, when

that happens, carriers lose money because medical costs aren't getting any cheaper. Couple that on fewer premium dollars due to lower payrolls and you create the soft market. Again, when rates are set 12 months prior and policies are issued, you can't come back hat in hand midterm to get more money until the next policy period. However, after "the summer(s) of recovery" began, carriers got scared and many just stopped writing work comp business. That is when the market started to harden. And those carriers who weren't scared to write work comp business started printing money.

This is an easy example of the difference between the soft market and the hard market. Say a risk would normally be written at \$40,000. But during a soft market, carriers fight each other to write it at \$20,000. Then the market hardens and only one carrier will even consider this risk and their price is \$60,000. And no one ever seems to save that \$20,000 that they saved during the soft market for when the market goes hard.

III. No Good Deed Goes Unpunished

A Gig is not just for horses anymore

A direct outcome of the recent recession was the "gig economy". Unemployed and underemployed folks needed ways to make money and "side hustles" began to outpace full time employment. Package delivery, errand running and human conveyance done by the use of an app on a smartphone began to blur the lines of the employee/employer relationship. At first, those utilizing the gig economy liked the autonomy of setting their own hours and such. But when those they did work for started demanding certain requirements like an employer without the benefits, the rub started. And, of course, the courts got involved as folks started suing to be recognized as employees.

Uber used the excuse of them being a "technology company not a transportation company" which began to ring stale to judges' ears as the lawsuits when drivers got hurt at work. As when FedEx drivers became employees in certain states due to rulings by the courts, Uber drivers used the same argument. The kicker this time is Uber drivers were competing against long standing taxi drivers—many of which paid thousands of dollars for fees and licenses to transport folks while Uber drivers opened up an app on their phone and their new "gig" started. And those drivers either carried work comp coverage on their own or through their companies while Uber drivers did not.

In the states where gig employees are being looked at as not subcontractors but employees, underwriting these types of risks and employees has not quite caught up with the industry. (As an industry, insurance is not one to embrace change quickly or well). The whole sense of who has control makes carriers leery of offering coverage until the lines are more clearly drawn. But as soon as they can figure out a way to rate it, they will offer coverage as the marketplace demands it.

My Fraud is bigger than your Fraud

No discussion on work comp premium can be complete without discussing the misclassification of employees. While the general public thinks that an injured employee might be faking their injury because they saw them mowing their grass or shopping at Target or Walmart, the really big fraud is committed by employers and insurance agents who intentionally put employees into wrong class codes to get better pricing. As the industry moves from human underwriters to online, metrics driven rating platforms, these fraudulent practices will get worse not better. When no one checks to confirm that the roofing company isn't rating their employees as office workers and paying folks under the table in cash, then the entire marketplace suffers. And if fraud causes carriers to lose money, they will either raise their prices for certain classes of business by using pricing tools that can force employers to move their businesses to other states or just close shop. And if employers can't get workers compensation coverage, they can't employ workers.

If the phrase from The Lion King—The Circle Of Life—just popped into your head, you now understand.