WORKERS' COMP CLAIMS: THE EFFECT OF LOSS EXPERIENCE ON YOUR PREMIUMS AND YOUR PROFITS.

Workers' compensation (WC) is "on-the-job" insurance for injured workers. It provides benefits to employees for work-related injuries and illnesses. WC laws vary from state to state, but all are designed to protect the employee and employer if a workplace injury does occur.

THE TWO COSTS OF WORK-RELATED INJURIES

You can look at WC costs as you would an iceberg. At the tip of the iceberg are all of the direct costs, covered by WC insurance:

DIRECT COSTS

Costs related to the injury that are covered by workers' compensation insurance include:

- Medical costs associated with the injury (treatment, surgery, medications, therapy/rehab)
- Compensation costs (wages from lost time work, disability benefits, survivor/death benefits)

Beneath these costs are many more hidden ones that can actually exceed the costs you're insured against:

INDIRECT COSTS

Costs related to the injury that aren't covered by workers' compensation insurance aren't easily measured, but estimated by OSHA to have a cost ratio range of 1:1 to 1:4[1] for each direct dollar spent. They include:

- Costs to other employees:
  - Assisting injured
  - Decreased productivity
- Supervision/management costs:
  - Damage control through PR and media
  - OSHA liaison
  - Coordinate shortened workforce
- Company costs:
  - Replacement worker
  - Overtime pay
  - Damage to work
  - Damage to equipment
  - Schedule or production delay
  - OSHA inspection
  - Claims management
  - Investigate, report, follow-up

HOW LOSS EXPERIENCE FACTORS IN: THE E-MOD

"E-Mod" is a calculated factor used for adjusting WC premiums. It's based on loss experience from the past three policy years, not including the expiring year.

Calculating your E-Mod.

Your losses are compared to average losses of similar business classes. The final factor provides for a premium reduction (for low losses) or increases (for high losses).

Adjustments depend upon the frequency and cost of the claims. Costs will include:

- Money paid
- Money in reserve

2012 2013 2014 2015 2016
E-Mod

Indemnity claims vs. medical-only claims. The E-Mod is largely influenced by the cost and frequency of indemnity (or lost time) claims. These involve payments for missed wages and disability benefits. The cost and frequency of medical-only claims also factor in to the E-Mod calculation. However, for those states that have adopted ERA (Experience Rating Adjustment), indemnity claims are more heavily weighted.[2]

HOW INJURIES CAN AFFECT YOUR BOTTOM LINE

The table below details various costs and factors related to WC injuries for three fictitious, competing companies. Each fall within the same business class, with the same jobs, employee count, payroll, etc. Therefore, each company has the same manual premium of $200,000 (premium before the E-Mod is applied).

COMPANY	E-MOD	MODIFIED PREMIUM	AVERAGE ANNUAL LOSS HISTORY	COST RATIO RANGE	ANNUAL AVERAGE INDIRECT COSTS	TOTAL ANNUAL AVERAGE COSTS
A	0.75	$150,000	$5,000 (5 injuries)	1:3	$15,000	$165,000
B	1.00	$200,000	$95,000 (5 injuries)	1:3	$285,000	$485,000
C	1.50	$300,000	$190,000 (10 injuries)	1:3	$570,000	$870,000

WHICH COMPANY IS YOURS MOST LIKE? A, B OR C?

See how costs affect premium in the cases below.

COMPANY A	COMPANY B	COMPANY C
Direct Costs: Company A has a lower E-Mod than both Company B and Company C. This difference is a reflection of Company A's good loss performance, with a low frequency of claims that are all medical-only. Their performance is then reflected in their *modified premium* (the manual premium with a credit E-Mod applied).	**Direct Costs:** Company B had no change in its modified premium, reflecting an average performance for their business class. Note that Company B has the same loss frequency as Company A, but the cost of those claims on average is significantly higher due to indemnity claims. So Company B has an E-Mod of 1.00 and no credit is given to their manual premium of $200,000.	**Direct Costs:** Company C averages multiple losses with a high number of indemnity claims, significantly raising its E-Mod, which is reflected in its much higher premium.
Indirect Costs: When using a conservative indirect cost factor of 3, Company A shows that the five medical-only claims averaged per year could potentially cost the company an additional $15,000 in "hidden" indirect costs.	**Indirect Costs:** While averaging the same frequency of claims as Company A, Company B has had a few more costly indemnity claims that increase its average claim costs (and therefore the potential indirect costs) dramatically. As you can see, this also impacts the E-Mod.	**Indirect Costs:** Because of high frequency of claims with multiple costly indemnity claims, Company C has a very high indirect cost potential, especially when comparing to the other two companies.

HOW DIRECT AND INDIRECT COSTS CAN IMPACT YOUR BOTTOM LINE

Continuing with the same three companies, this table shows how direct and indirect costs actually impact the bottom line. The table uses a 10% net profit margin to reflect the revenue needed to offset the costs. It then breaks down the required revenue by showing how many production units would be needed to earn that revenue if each is sold at $50.00. As before, we've assumed that each company has the same product, making the same profit margin for ease of comparison.

COMPANY	COST TYPE	COSTS	REVENUE OFFSET W/10% PROFIT	TOTAL COSTS	TOTAL REVENUE OFFSET	PRODUCTION UNITS EA. SOLD @ $50
A	Mod. Premium Indirect Costs	$150,000 $15,000	$1.5 Million $150,000	$165,000	$1.65 Million	33,000 Units
B	Mod. Premium Indirect Costs	$200,000 $285,000	$2 Million $2.85 Million	$485,000	$4.85 Million	97,000 Units
C	Mod. Premium Indirect Costs	$300,000 $570,000	$3 Million $5.7 Million	$870,000	$8.7 Million	174,000 Units

What follows is a comparison of how each company fares cost-wise, based on the revenue and production required to offset WC indirect costs.

COMPANY A	COMPANY B	COMPANY C
Company A needs to sell 33,000 units to pay for the WC premium and cover the potential indirect costs associated with injuries. However, its overall advantage over the competition is obvious.	For this company, controlling injury frequency is overridden by the costly indemnity claims that drive the E-Mod and raise the potential indirect costs exponentially. This all leads to having to sell almost three times the units of Company A to compensate for the injury costs.	Competing against even an average company such as Company B's profits is going to be tough for Company C. The reasons are obvious: high levels of indemnity claim frequency, which would mean selling nearly double the production units of Company B – and over five times as much as Company A.

[1] osha.gov/dcsp/smallbusiness/safetypays/estimator.html

[2] Those that have not approved ERA are: California, Colorado, Delaware, Massachusets, Missouri, New Jersey, New York, North Dakota, Oregon, Ohio, Pennsylvania, Washingto and Wyoming