

Experience Modification Rates-- Are They an Accurate Measurement of Safety Performance?

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Overview

It seems an unfortunate fact that a number of good, safety-conscious construction companies are being precluded, or seriously handicapped, from bidding/winning projects due to the increasingly common practice by agencies, project owners and general contractors of using the Workers' Compensation Experience Modification Rate (EMR) as a measure of safety performance. EMR is not necessarily a correct indicator of safety performance. EMR is an insurance underwriting tool originally set up to measure an employer's workers' compensation claims experience and to adjust pricing accordingly.

Under this system, an employer with a calculated EMR of 1.00 is determined to have "average" loss experience for the governing class of their workers' compensation policy. If the factor is greater than 1.00, the employer's claim performance, in terms of frequency and/or severity, is considered worse than average. Conversely, if the calculated EMR is less than 1.00, the employer's claims performance is considered to be better than the average governing class. EMR's are also trailing indicators. They measure the previous three policy years of claim costs, excluding the most recently expired policy year. Companies may have enacted many positive changes since those dates to help improve safety and claims management systems.

Good (safe) contractors can see their EMR increase for numerous reasons unrelated to safety. These include:

- a new rate formula in California
- fewer dollars in the workers' compensation system
- payrolls down due to economy and
- workers compensation claims that are included in EMR that were unavoidable and may not reflect a "lack of safety"

Most disturbing--and this article's main theme--workers' compensation claims are being included in the EMR calculation even though the injury was brought about by factors beyond the control of the employer. As agencies, owners, general contractors and construction managers strive to evaluate contractor safety performance, using the right measurement is more important than ever.

The Issue

According to the California Workers' Compensation Rating Bureau, the formula change was predicted to have the following affects on California EMRs: -3 to +3 points for 44% of business, +4 to +10 points for

27% of business, +11 to +20 points for 4% of business.¹ Many employers have already seen an increase in EMR due solely to the formula change; even though their own loss experience has not changed.

The Workers' Compensation system has undergone considerable change in recent years. As open rating and workers' compensation reform measures have been enacted, the result has been that around 75% of the premium dollars have been taken out of the system from 2004 to 2009.² Currently, there are \$8.9 billion in workers compensation insurance premiums written in California, which is down from \$23.5B in 2004. In 1993 premiums were at today's volume of \$8.9B. Employers with similar losses and costs from year to year experienced increases in EMR as there were far fewer dollars available in the system to pay claims. Conversely, some firms had decreases in their workers' compensation claims and costs and still saw their EMR rise.

The original intent of the worker's compensation system was to protect the employer from lawsuits brought by injured employees and to provide injured employees the resources necessary to recover from their injury as much as possible. Many employers have had claims filed by employees who embellish the seriousness of an event, making it worse than it really is, or even going to the extent of filing a fraudulent workers compensation claim. Even if the insurance carrier denies these claims, because there was a claim filed, there may be some medical and/or legal or investigative costs associated with the denial.

Another problem faced by contractors that can result in EMR increases is major losses caused by third parties that are no fault of the employer. Many instances exist demonstrating that filing of workers' compensation insurance claims have nothing to do with the company's safety efforts. The examples below highlight the issues:

- ✚ An employee is seriously injured while traveling on company-related business from one project to another in a company-owned pickup truck. He is rear ended by an uninsured driver. Because there is no subrogation potential, the employer is liable for the workers' compensation bills totaling many thousands of dollars. This situation adds points to the EMR, putting the company over 1.00 and making the company ineligible or subject to additional scrutiny during the pre-qualification process.
- ✚ Two employees are involved in a fist fight in which one breaks the other's jaw. The result is a permanent damage award and this claim drives up the EMR exponentially.
- ✚ A high profile truck hits a K rail, flips over and the vehicle crushes a worker inside the K rail. The employer has an extensive safety program, exceeds MUTCD requirements and has documented training. This claim pushed the firm's EMR to over 1.00.
- ✚ Cumulative Trauma (CT) claims. If you are the unlucky last employer in a long string of employers for someone claiming CT, you could be stuck with the work comp costs. It is unlikely that the entire CT occurred during the one year working for you and was probably spread out over the previous 20 years while working for other contractors. Although in some cases apportionment may be an option, there will still be significant costs associated with the claim.
- ✚ Insurance carrier medical bill review fees are a part of the total incurred claim costs and EMR calculations. An example: if medical charges were \$50,000 and the insurance carrier has a schedule of \$30,000 for that particular medical procedure, a portion of the savings was charged as a fee —say 20% of the \$20,000 'savings'. The 20% was then added in the EMR calculation. Although this practice will not be allowed after July 2010, it will take a few years to work these "fees" out of employers EMR's.
- ✚ Many claims filed by workers are due to soft-tissue (back, arm, knee, shoulder, etc.) strains as construction projects are coming to an end and no further work is available. These claims are

very difficult to prove or disprove and such a phenomenon may not accurately reflect the management of the company's safety program.

Additionally, many times construction companies are at the mercy of the insurance carrier claim representatives to handle claims effectively. If not, the claim dollars may increase, and due to no fault of the construction firm the EMR may increase. A firm's EMR may be higher with the same claims as other contractors simply because one insurance carrier handles claims better than another.

As previously mentioned, Experience Modification Rates (EMRs) are an insurance tool to help underwriters set premiums. Not every contractor that has an EMR of over 1.00 is a 'bad' employer and for that matter, those companies under 1.00 are not necessarily good (safe) employers. The State of California recognized this fact when the State enacted their High Hazard Unit. The State defines "High Hazard Employers" as those having an EMR of 1.25 or greater, thus giving a leeway of 24 points to make up the inadequacies or inequities of the EMR grading system. The Army Corps of Engineers has recently raised their cut off level to 1.05. They raised it 5 points due to the many contractors now bidding work who have EMRs greater than 1.00.

Finally, it should be noted that relatively small/medium firms can see their EMR spike upward during the rating period as a result of one or two large claims (legitimate or not). There is no statistical "power" in the EMR measurement as applied to smaller/medium firms.

Recommendations

Perhaps a better way to measure a company's safety performance is to look at the Incident Rate (IR), Days Away, Restricted and Transfer Case Rates (used to measure effectiveness of return to work programs) over the past three to five years. Other pre-qualifiers include safety program reviews and OSHA citation histories.

If EMRs are going to be used during the pre-qualification process, they should be used with the understanding that some extenuating circumstances may be in play and ask for an explanation letter of why the EMR is over 1.00 and, if applicable, what is being done to help lower it. Possibly, a third-party professional, such as a Board Certified Safety Professional (CSP), insurance broker, or an insurance carrier could issue the explanation letter. The State of California requires firms who wish to self-insure have their safety program and OSHA records "certified" by a CSP. A similar "certification" regarding a contractor's EMR could be accepted by project owners. Perhaps averaging the EMR over a three-year period or trending the EMR could also be used.

Some will argue that the EMR formula is the same for everyone so it must be fair. The problem with that viewpoint is that some companies have been the victims of uncontrollable events, even fraud, while others have not. The WCIRB states: "The fact that one employer has a higher experience modification than another employer within the same classification does not necessarily imply that the first employer is less safe."³

In today's tough economy, there is a lot of competition for every project. A more equitable solution for those agencies, owners and GC's who want to utilize safe contractors is to allow an explanation of why the EMR is over 1.00 and, if applicable, what is being done to try to lower it.

References

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2. WCIRB, 12/31/09, report released 4/14/2010, 2004 written WC premiums=\$23.5B, 2009 premiums=\$8.9B. 1993 premiums =\$8.9B.
3. WCIRB, An overview of California's Experience Rating System.