USING THE WORKERS' COMPENSATION EXPERIENCE MODIFICATION FACTOR AS A GAUGE OF SAFETY

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The use of the workers' compensation experience modification factor (or EMR "rate" as it is known in the construction and energy industries), has inappropriately evolved over recent years as a measure of safety. This factor is often used as a qualifying metric to bid a project. A company may be disqualified from bidding on some projects if their modification factor is greater than 1.00. While the intention of this measure is to award contracts to companies that are safe, it may be, inadvertently, awarding them to companies who house large payrolls, instead. The experience modification factor is influenced by numerous external factors, completely unrelated to safety and many outside of the control of the employer.

A client company was bidding on a project that required a .80 modification factor. This contractor was completely injury-free for more than six years, but was disqualified from bidding on the project because they had a .85 mod factor. Under the current actuarial formula, this contractor was at their lowest possible mod. It was loss-free. It is not mathematically possible to develop low mods for smaller contractors, even those who are completely injury-free. Setting these strict experience mod factor thresholds can discriminate against smaller or midsized companies, disqualifying them from bidding on projects, despite their having an excellent safety and injury history.

Various rating organizations, such as the National Council on Compensation Insurance (NCCI), compile the injury and payroll data provided to them by workers' compensation carriers. However, it is quite common for that information to be reported incorrectly, or for it to be incomplete, resulting in a "contingent" modification factor. These errors often go undetected, leaving an employer's modification factor incorrect for years. It is common to find injuries on an experience mod worksheet that have been reported into the wrong state, or even reported into a mod factor for the wrong employer. Employers may have their policy information inadvertently blended with another employer of the same name, or have estimated payrolls included in the calculation, in lieu of the final audited payrolls. Employers have actually experienced instances in which large claims have been reported by the carrier, with only $1 reported in payroll for that employer , in order that the claim data would not be rejected by the database at the ratemaking organization. These errors illustrate the importance of auditing mod worksheets to assure their accuracy.

For employers working in any of the seventeen "net reporting" states, frequently the carrier fails to report the claims dollars net of the deductibles that the employer reimbursed back to the carrier. In addition, something as simple as changing a policy period for a workers' compensation policy more than 90 days from its original inception, can adversely impact an employer's mod factor.

Some employers do not even qualify for the development of an experience mod factor. Examples would be employers who are exiting a Professional Employment Organization (PEO), employers with minimal premiums, or relatively new, start-up companies that have not met the minimum policy period threshold to have an experience modification factor produced for their companies.

It's also important to remember that some claims are still open and the injured worker still receiving treatment, at the time the claim dollars are reported to produce the mod factor. In those cases, the full, gross "estimated" cost of the case is included in the mod calculation. In those instances, the mod factor will be developed using claims that are open and dollars that have not yet been paid by the carrier. It is not uncommon for such claims to be over-estimated and be closed at a much lower amount, after the carrier has already reported the original, higher estimate to the rating bureau, potentially causing the employer's experience modification factor to be artificially higher.

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Included in the mod factor calculation are injuries that are the result of another's negligence. If an employee, for example, is injured in a vehicular accident while working for his employer, workers' compensation benefits are typically the first to respond to the injured worker. After the case is resolved, the workers' compensation carrier may subrogate against the negligent party to recover the costs of the injury benefits they have expended. Some of these injuries are quite severe and the treatment and cases may take years to conclude. However, even though the injury was the fault of a third party, those costs are still part of calculating an employer's experience mod factor, until monies are recovered from the negligent third party.

In addition, each year, when rates change in each state, across more than 600 industries, rating bureaus also adjust the Expected Loss Rate (ELR) factor used in an employer's mod factor calculation. In addition, they may also change the "developed" ratio (D Ratio) with annual rate changes. These ELR and D factors are then used in the formulation of the final experience modification factor. Several rating bureaus apply these factors, retroactively, to previous policy years, where losses were "expected" to be higher than current trends. Both of these annual changes impact the final EMR for the employer, but are actuarial factors which an employer has no control over.

Beginning in 2013, NCCI introduced a substantial change in their actuarial formula to mod factors. In the past, the NCCI mod factor formula used the first $5,000 of each claim. This amount was considered the "primary" portion of each injury and was weighted the heaviest in calculating the final modification factor. Every dollar of a claim over the first $5,000 was considered the "excess" portion of an injury cost, so that larger, more severe claims, had weights and ballasts placed against them in the formula to stabilize or lessen their impact to the mod factor. So, prior to 2013, $5,000 per injury was the "split point" of each claim.

In 2013, NCCI doubled that amount to the first $10,000 of each injury that is considered the "primary" portion and given the greatest weight in the mod calculation. In 2014, it was raised to $13,500, and has risen nearly every year, until in 2017 and 2018 it is at $16,500 (more than triple the amount used in the mod factor calculation for more than twenty years). Employers who are working in multiple states could, simultaneously, have completely different versions of this formula applied in each state to produce their mod factor. California introduced ninety different split point levels in 2017. While all of these formula adjustments will absolutely influence an employer's EMR, it is critical to understand that they are state and industry-wide actuarial formula changes by a ratemaking organization. They were not adopted, consistently, by all rating bureaus and are in no way a reflection of an individual employer's commitment to safety, as employers have no control over such adjustments.

Other formulas are unique to only certain states. More than twenty NCCI states use the Experience Rating Adjustment Plan. In addition to the multiple split point formulas applied above, some states, using this "ERA" formula, will have 70% of all medical-only injury dollars, completely removed from the calculation of the experience mod factor. This could benefit an employer in one state, while their competitor in another state, has the full 100% of their medical injury costs included in their mod factor calculation. For 2019, California will arbitrarily remove the first $250 of each claim for their state's experience mods.

It is important to understand that mod factors are an actuarial tool, designed for insurance carriers to address premium disparities. The modification factor was never designed to be a reflection of an employer's commitment to safety. NCCI released their own article in September 2017 warning against the use of these mod factors in the pre-qualification process. Virginia passed House Bill 1108 in 2017, disallowing the use of EMRs on public project bidding. We are pleased to have recently experienced some well-informed owners, contractors and energy companies seeking more detailed information that is directly related to safety and depending less upon this unreliable number, with some having eliminated its use, completely, from their pre-qualification requirements.