How to Avoid the Workers' Comp Cost Cycle

By
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With few exceptions, Workers' Compensation insurance rates are in decline across the country. Although rates are certainly an important component of Workers Compensation insurance costs, there are other considerations companies must address during a declining rate environment.

As a starting point, it's important to have a basic understanding of the Workers' Compensation insurance price cycle, Experience Rating, as well as some history of this coverage's market.

The Workers' Compensation price cycle repeats over and over again in an historically predictable pattern:

- Workers' Compensation rates rise, often with double digit increases.
- Rising rates precipitate a public outcry from business leaders that triggers legislative reforms.
- Over the short term, these reforms create attractive market conditions for insurance companies to increase their competitive efforts for market share, a situation that produces price wars.
- With rates declining, businesses "shop for the best deal."
- Insurance is purchased for a lower price and complacency sets in as employers lose their focus on injury prevention and cost containment.
- Claim costs do not fall in relation to the reduced rates, so employers suffer from an increase in their Experience Modification Factor.
- Legislative reforms are either eroded or prove to be ineffective in addressing the real cost drivers, such as medical inflation and abuses in the system.
- Insurance companies' profits grind down and the "low-ball deals" go away.

• Employers are left with fewer choices, higher Experience Modification Factors, and higher costs.

• Inevitably, a renewed public outcry starts the cycle over again.

Historically, a decline in Workers' Compensation rates is just a calm before the next storm. Usually businesses will pay back all of their "savings," and then some, as the cycle moves to the next phase.

Relying exclusively on legislative reforms and the insurance marketplace for stable cost reduction is a fool's errand. While reforms can help in the short term, companies with a business objective to drive down Workers' Compensation costs in the long term must take a more proactive approach.

1. The first step is to understand that Workers' Compensation insurance functions like a credit line. Employers are typically financing injury costs through their Workers' Compensation policies. To understand this concept, it's necessary to have a working understanding of how the Experience Rating Plan works, since it produces an Experience Modification Factor that is applied to almost all Workers' Comp policies.

The Experience Rating Plan is an integral component of the final cost of Workers' Compensation insurance. While the underlying concepts are complex, we can simplify their application.

In effect, the Experience Rating Plan is a method for tailoring the cost of insurance to the individual characteristics of an employer. It gives employers the opportunity to manage their own expenses through measurable and meaningful cost saving programs. However, the Plan cuts both ways and high injury costs are translated into higher insurance costs.

Actual payroll and loss data for the individual employer are analyzed over a period of time. Usually, the latest available three years of data are compared to similar types of businesses to calculate the Experience Modification Factor.

In general, an employer with better than average injury expenses receives a credit, thus reducing the premium. On the other hand, employers with worse than average injury costs will carry a debit rating, and pay more.

What does the Experience Rating Plan have to do with the price cycle? Due to the inner workings of the Plan, it is more difficult for employers to lower their Experience Modification Factor during a declining rate cycle.

The Plan expects that if rates go down, so should injury costs. So, if injury costs don't track downward consistent with the rate decreases, then the Experience Modification Factor goes up. An increase in the Experience Mod can, and often does, wipe out any savings from the rate reduction. *Employers may actually find their total Workers' Comp costs going up even though premium rates are going down.*

2. To avoid cost increases during a period of rate decreases, it is critical for employers to be vigilant and proactive in reducing injury expenses. Ultimately, an employer's injury costs have a far greater impact on the company's eventual net cost than reforms and rate decreases. This fact shifts the responsibility of cost reduction from governmental bodies, insurance companies, and the marketplace directly to the employer.

But employers often feel helpless in managing injury costs. Unaware of processes that can dramatically improve outcomes, many view the Workers' Comp system as out of control. It often takes an act of faith before discovering that the strategies and methods for controlling Workers' Comp costs will work.

Employers should approach the objective of reducing injury costs in much the same manner as they already do for their other business imperatives. Once knowing what to do, the tougher part is getting proven processes implemented and embedded into every day business practices. This task, like so many others, is an ongoing process and not a one-time event.

Reducing injury costs can be broken down into two primary categories: what to do before an injury occurs and what to do after an injury occurs. One of the major mistakes employers make is to hand over too much responsibility to the insurance company in managing injury costs. Insurance companies are neither positioned nor capable of doing this job alone, primarily since their involvement is usually after-the-fact. Employer involvement is essential, and begins before an injury occurs.

The key steps employers must take *before* an injury occurs include:

- Select and train an Injury Coordinator
- Establish a Return-To-Work Program
- Hire a person who is fit for the job
- Establish a relationship and get commitments from your Primary Care Physician
- Train supervisors on what to do and say when an injury occurs
- Address human resource issues before an injury occurs

Steps to take after an injury occurs include:

• Follow a written, repeatable, step-by-step process

• Return the injured employee to work as soon as medically possible even if in a modified work capacity

• Maintain positive communication with the employee and the doctor

• If an employee is not recovering according to expectations, address additional underlying causes of the disability

It is often said, "The best injury is the one that never happens." Employers are keenly aware that maintaining a safe workplace is the foundation of prevention. However, too many businesses rely entirely on traditional loss control engineering and fail to take the secondary steps indicated above. *The majority of injuries occur from unsafe acts, not unsafe conditions*. Safe conditions are required, but inspecting and addressing conditions alone will not bring desired results.

In summary, the most effective way to drive down Workers' Compensation costs over the long term is for employers, medical professionals, and employees to make the right decisions and do the right things at the right time.

Practical and proven methods are available. Awareness, knowledge, and possibly a dose of faith are the initial steps. No government entity, insurance company, or even the free market system will ever produce more beneficial long-term results.

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