



Tonry Topics

THE COST OF WORKERS' COMPENSATION CLAIMS

A customer recently asked how much his workers' compensation claims cost him in increased premium. You might be surprised at the answer (he was).

Experience Rating Basics

In Massachusetts, workers' compensation risks are eligible for experience rating when, according to the Massachusetts Workers Compensation and Employers Liability Insurance Manual, "subject premium, as defined by the Massachusetts Statistical Plan, in the last year or last two years of the experience period produced a premium of at least \$11,000. If more than two years, an average annual subject premium of at least \$5,500 is required."

Experience rating compares the actual losses for a given risk during the experience rating period to the expected losses. Expected losses are a function of the audited payrolls by class for the experience rating period. The experience rating period is the three complete years prior to the effective date of the policy. If the risk's anniversary rating date is 10/1/07, for instance, the risk's experience factors and rates effective 10/1/07 would be based on audited payrolls and actual claims, including reserves, for the policy years effective 10/01/05, 10/01/04 and 10/01/03.

A Real Example

For the 2006 policy year, our customer paid workers' compensation premium of \$148,018, which included an experience modification factor of 1.13 and an ARAP of 1.21. During the experience rating period of policy years 2002, 2003 and 2004, there were 10 claims below \$5,000 totaling \$13,099 and three claims greater than \$5,000 totaling \$270,290.

We recalculated the experience factors and the premium for the 2006 policy year as if there were no claims at all during the experience rating period. Under this scenario, the experience mod. for 2006 would have been .81 and there would

not have been an ARAP surcharge. The premium would have been \$89,038. So the simple answer to our customer's question is that the claims they had resulted in a premium increase of \$58,980 or 66%.

Digging a little deeper reveals some interesting scenarios. Instead of having no claims during the experience rating period, let's assume there was one claim for \$5,000. The premium in this case would have been \$92,177. In other words, one \$5,000 claim would have increased the premium by \$3,139 for the year in question.

This is a good point to remind you that the experience rating period is three years and that any claim affects the experience factors and premium for three years. Under the second scenario, it's likely that the insured would more than pay back the \$5,000 claim in increased premiums.

The third scenario we looked at eliminated the claims below \$5,000 but kept the three larger claims totaling \$270,290. Under this scenario, the premium would have been \$124,206. For this policy period, the insured paid an additional \$35,168 in premium because of the three larger claims totaling \$270,290.

The fourth scenario eliminates the three larger claims but keeps the 10 claims below \$5,000 totaling \$13,099. In this case, the premium would have been \$97,310 or an increase in premium of \$8,272 for this one year.

To further make the point that the insured ends up paying for small claims, we examined a fifth scenario that added three \$2,500 claims to the actual loss history. Adding \$7,500 in claims increased the premium by \$14,016 from \$148,018 to \$162,034.

The following table summarizes the different scenarios above.

Scenario	Claims < \$5,000	Claims > \$5,000	Mod / ARAP	Premium
Actual	\$13,099	\$270,290	1.13 / 1.21	\$148,018
1	\$0	\$0	.81 / 1.0	\$89,038
2	\$5,000	\$0	.84 / 1.0	\$92,177
3	\$0	\$270,290	1.06 / 1.08	\$124,206
4	\$13,099	\$0	.89 / 1.0	\$97,310
5	\$20,599	\$270,290	1.17 / 1.28	\$162,034

Small Claims and Frequency

There are many factors included in the experience calculation, and claims will affect each risk differently. This is only one example, but I have seen similar results when reviewing experience calculations with customers. It is safe to say that small claims and frequency affect the experience factors and the resulting premium for all risks to a significant degree. It is not unusual to have an actual scenario where the insured ends up more than paying back small claims in increased premium.

Premium is, of course, only one cost of workers' compensation claims. The "human" element and the loss of productivity are also significant costs. Eliminating or reducing workers' compensation claims has a direct and indirect relationship to controlling costs.

For additional information, please contact your account handler at (617) 773-9200. Albert J. Tonry & Co., Inc., Crown Colony Office Park, 300 Congress Street, Quincy, MA 02169. www.tonry.com