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Experience Modification Rate: 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
- 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 44% of business, +4 to +10 points for 27% of business, +11 to +20 points for 4% of business. 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**. 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 a claim filed, there may be some medical and/or legal or other investigative costs associated with the denial.

Another problem faced by contractors and can result in EMR increases are 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 pick up 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 fistfight 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 (Jersey barrier), flips over and the vehicle crushes a worker inside the K rail. The employer has an extensive safety program, exceeds traffic safety (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 in California 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 and inequities of the EMR grading system. According to recent WCIRB statistics, there were 11,632 California companies with EMRs over 1.25. This does not include self-insured groups, which I am told could add another 2,000 companies to this total. The Army Corps of Engineers, at one facility, has recently raised their EMR pre qualification requirements to 1.05 due to many contractors bidding work who have EMRs greater than the previous EMR pre-qualification requirement of 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 assessments, OSHA citation histories and actual project site observations if possible. Project risk assessments focusing on "leading indicators" will be useful in determining contractor loss probability. A much more accurate tool than simply relaying on a firm's EMR.

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, under 1.00 for that matter, and why it is either over 1.00 or under 1.00 and what is being done or has been done to help lower it. Possibly, a third party professional, such as a Board Certified Safety Professional (CSP) or construction safety professionals from an insurance broker or carrier, or independent 3rd party, 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. Some Municipalities and Public Works entities also require program "certification" 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."

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.

Examples of EMR Action Plans

1). Company No. 1: A 35-year-old contractor. They had an EMR of 1.86 in the year 2006 and had not had an under 1.00 EMR in 20 years. They are now at 1.12 and poised to go under 1.00 in 2014. They are a 500-employee contractor covering entire state of California with 6 area offices. They install under ground fiber optics, communication cables and utilities. After a thorough study of the losses within the EMR period, it was determined that the number of lost time days was excessive, especially with the incidents that were not severe. A return to work program was immediately started and the number of lost work days dramatically decreased and two years later when the last year of the new EMR period was added in, the EMR points were reduced by seven EMR points. Following the return to work program implementation, a thorough safety program audit was conducted and recommendations offered to senior management were: a) the incentive program should be scrapped and revised to incorporate pro-active safety involvement not only by the craft workers but their foremen, supervisors and divisional vice presidents; b) area vice presidents would be required to attend and participate in the craft worker monthly safety meetings which were held off site at local restaurants for an early dinner safety / training meeting; c) a new safety orientation and disciplinary program introduced. The entire EMR reduction program (with a written action plan with completion dates and assigned accountability) was presented by the CEO to all area VP's that safety would be a part of their overall performance reviews and bonus calculation.

2). Company B: A national environmental remediation company with rapid growth in past 7 years and a 1,000 employee base. EMR was 1.39 in 2008 and currently at 1.01 poised to go under 1.00 in 2014. After CEO was informed that several potential bids were rejected because of "excessive EMR" and insurance premiums were 39% over expected rates, an EMR reduction action plan was quickly established with this full support. He informed us to work with safety director and president him a formal EMR Action Plan and he would handle the rest. Our plan included:

a). An EMR explanation letter from Aon risk control and one from claims. These two letters would be included with bids to explain why the EMR was over one. There were four "questionable" claims that caused the EMR to go over 1.0;

b) they made a change at the top of their EH&S department and hired a safety professional. The CEO required division vice presidents to become actively involved in the safety program and held them accountable. They established a fit for duty/ return to work program which included not only injure workers coming back to work but for workers coming back off medical leave and desiring to come back to work this enabled local project management teams to evaluate the condition of workers prior to starting work at specific projects;

c) annual goals were established pertaining to hiring practices, orientation and training and performance.

<u>Best Practices for EMR Reduction Plan</u>

1. Develop Executive Summary of Workers Compensation losses that make up the current EMR. i.e. 2013 EMR are all WC losses from policy years 2009, 2010, 2011. Make an easy to understand graph showing total losses and incurred costs for those years. Then additional graphs / charts showing trending, the primary losses each year that contributed the most to the EMR.
2. Provide Senior management with WC insurance costs and then compare with company's current EMR and compare with "what if" scenario's – i.e. if EMR was at parity of 1.00 WC insurance premium's could be $1,000,000, .75 = $750,000, 1.25 = $1,250,000.
3. Show how not only is EMR costing dollar-per-dollar more in WC per year, it is hampering the firm's ability obtaining new work. Actual examples work best. I.e. we were not invited to bid a particular $10,000,000 project due to our EMR of 1.42 being over owner's maximum EMR rate of 1.25.
4. Finally, show how excessive EMR places the firm in Cal OSHA's "high hazard unit". This unit is fully funded by "fines" (based on payroll) paid by all firms with EMR's over 1.25 in California. The high Hazard Unit then tracks those firms. Many owners do not want the extra oversight and attention brought by the high Hazard Unit. And, as a peer pressure, the Cal-OSHA Reporter, when reporting on those firms who were cited / fined by Cal OSHA (public information) the firm's EMR is posted along with alleged Cal OSHA citations.
5. Once this is clearly is understood by Senior Management you are ready to present your EMR reduction plan. Very rarely do we see senior management ignore the above data and continue to run "business as usual". Although one firm comes to mind that mentioned that they were too busy with new work and were making too much money to worry about the EMR and WC insurance costs. Plus we were informed; the EMR is never a big deal with the owners we work for. Their EMR was 1.90 and premium, adjusted 90% increase, was $2.1M per year.
6. EMR Reduction Plan following Senior Management buy in (caution – do not proceed without Senior Management buy-in – you are setting up for failure.

A. Immediately establish a Return-to-work program for injured workers. Your insurance carrier and broker will help in this. RTW will help control the Temporary Disability (TD) payments. In California TD is over $1,000 per week for maximum wage earners tax free.
B. Establish / upgrade the Supervisor's Accident / Incident / Near-miss Investigation process and documentation. This is critical for obtaining accurate internal data so informed decisions can be made regarding RTW, safety management systems and causations factors. It will provide you with "who is managing" (foremen, supervisors) and who is following prescribed safety protocols. Corrective actions then immediately implemented where possible.
C. Conduct a detailed safety management system audit (use a 3rd party if possible, usually your insurance carrier and / or insurance broker will do this as part of their services). Audit will include detailed safety and claim management review and field observations. Unannounced field observations are critical in looking at "leading indicators". A safety professional with a sharp eye will be able to offer great insight into what needs to be improved at the project site or location. I.e. a lack of mechanical materials handling devices along with poor material handling techniques may lead to increased back / soft tissue WC claims.
D. Continue to champion the EMR reduction program and find someone else in your organization who shares your passion. The higher up the line management system you can find your Champion the quicker and better the results.
E. Tie the EMR reduction goals into existing safety / claims management protocols and management accountability systems. Use it help measure performance, KFI's, Bonus payouts and Insurance charge back to profit centers. You can break out each profit center EMR "weight" and charge back accordingly. I.e. Company has 5 Regions – adjustments can be made on Insurance charge back to each profit center based on EMR weight. Region #1 contributes 50% to EMR -- thus the added insurance costs are charged back to Region #1 which is 30% in this example.
F. Be careful with setting specific reduction goals and time frames. Changes in EMR formulas, an unexpected large non-safety WC claim (i.e. an older salesperson on business trip steps off curb at airport and breaks both legs and will never return to work) and a deduction in payroll will make specific EMR goals difficult to predict. We have noted though, with PPE (Patient, Persistent Effort), the EMR will come down through management best practices. It may take 3 to 5 years but once it comes down and management sees the other tangible and intangible benefits that come along with fewer incidents and increased profits, the safety and claims management systems should fully supported at all levels of management.

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* WCIRB 1/1/10 Pure Premium Rate Filings. www.wcirb.org

* WCIRB, 12/31/09, report released 4/14/2010, 2004 written WC premiums=$23.5B, 2009 premiums=$8.9B. 1993 premiums =$8.9B.