

To: Clients

From: Sam Celly

Sub: **Workers' Compensation & Mod-Ratio, and How Litigation is Adding to Our Claims**

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Introduction: Workers' Compensation (WC) insurance costs are increasing more than other costs to the dealership and much faster than inflation. In this newsletter, we explain:

- How WC Insurance Premium is calculated based on payroll
- Premium calculation is based on risks of the worker, i.e., the office worker has lower premium compared to an auto mechanic due to hazards on the job
- How employers with greater injury rates have a higher Experience Modifier (ex-mod)
- How higher ex-mod results in higher premiums
- How WC rates have climbed over the years
- How Medical Indemnity has more than doubled over the last 15 years
- How ALAE per Indemnity Claim has tripled over the last 15 years

Background: The workers' compensation insurance is mandatory in the United States and many other countries as well. The objective of WC insurance is to provide medical treatment and disability benefits to employees injured during the course of employment. While the cost of premiums are borne by the employer alone, the employer benefits by receiving immunity from employee lawsuits that may arise on a theory of negligence, etc.

Cost Containment: The insurance premiums are a significant cost to the employer, and a prevailing trend on the part of employers is to contain insurance costs. The premiums are based on the severity and frequency of injuries and as such, a reduction in injuries reduces insurance costs. The base insurance rate is a function of the employees' job duties, number of employees, their payroll, and a modifier used to calculate the premium. The modifier is based on the losses incurred by the employer. The losses incurred by the employer are calculated based on the claims paid by the insurance companies for injuries occurring at the workplace.

Calculating Costs: In order to calculate the premium for employers situated in California, the payroll data and losses incurred for a 3-year period are taken into account. The year immediately preceding the year for which the insurance is required is usually ignored. For example, if the premium is to be calculated for a policy beginning January 1, 2015, the injuries occurring in 2011, 2012, and 2013 will be considered, while the 2014 injuries are ignored. Such calculations reflect a trend over a broader period rather than taking one year into account, which may disproportionately impact the insurance rates.

Cost Savings: To illustrate the insurance premium calculations (may vary based on the difference in the injury rate), hypothetical calculations were made for two employers, Employers I and II, both having the same identical payroll. Table A shows the payroll data for each type of employees. Table B illustrates the excessive injuries of Employer I and Employer II. Employer II has four more injuries than Employer I, resulting in a total loss of \$282,500 instead of a total loss of \$45,004 during the same period. While the insurance company pays these losses, the difference for the two premiums is \$174,570 for the year 2015. A savings of \$174,570 with

fewer injuries for Employer I (see Table C) offer a competitive advantage. The fact that injuries affect the premium rate for three consecutive insurance years shows how important monitoring injuries at the workplace are. Investing in time, training, and equipment for employees in order to reduce workplace injuries can be a worthwhile scenario, especially with a significant return in the scenario above.

Table A: Payroll Data (Employer I & II)

Employee	Annual Salary	No. of Empl.	Salary '11	Salary '12	Salary '13
Clerical/Office Staff (code 8810)	\$ 30,000.00	20	\$ 600,000.00	\$ 600,000.00	\$ 600,000.00
Sales Staff (Code 8748)	\$ 50,000.00	20	\$ 1,000,000.00	\$ 1,000,000.00	\$ 1,000,000.00
Technicians (Code 8391)	\$ 40,000.00	50	\$ 2,000,000.00	\$ 2,000,000.00	\$ 2,000,000.00
Total		90	\$ 3,600,000.00	\$ 3,600,000.00	\$ 3,600,000.00

Table B: Injury Data & Losses Pain Per Injury

Year	Claim #	Employer I		Employer II	
		Type of Injury	Incurred Losses	Type of Injury	Incurred Losses
2011	1	Cut Finger	1	Back Injury	\$ 50,000.00
2011	2	Cut Finger	1	Back Injury	\$ 7,500.00
2011	3	Broken Finger	\$ 10,000.00	Broken Finger	\$ 10,000.00
2011	4	Cut Finger	1	Elbow Sprain	\$ 5,000.00
2011	5	Head Injury	\$ 5,000.00	Head Injury	\$ 5,000.00
2012	6	Arm Rash	1	Fatality*	\$ 175,000.00
2013	7	Back Injury/Cum. Trauma	\$ 25,000.00	Back Injury/Cum Trauma	\$ 25,000.00
2013	8	Arm Rash	\$ 5,000.00	Arm Rash	\$ 5,000.00
Total			\$ 45,004.00		\$ 282,500.00

*Death benefits are statutorily limited in certain states. For California, death benefits are capped at \$320,000.

Table C: Estimated Premium Costs

	Premium Based on Employee Count & Payroll	Experience Modification	Total Premiums for 2015
Employer I	\$ 264,500.00	85	\$ 224,825.00
Employer II	\$ 264,500.00	151	\$ 399,395.00

Note 1: The wages and employee count for the employees in Table A are fictitious and have been used merely to illustrate the calculations.

Note 2: The Experience Modification in Table C uses California rates and formulas calculated on July 27, 2015 for a policy beginning Jan. 1, 2015. Calculations for other states may vary.

Note 3: The premiums listed in Table C are before the underwriter's "risk adjustment" debits or credits or premium discounts (if any are offered by the WC carrier).

Note 4: The issue now is that Cumulative Trauma has replaced psych disorders, which were common in the past. Psych is not a ratable disability whereas Cumulative Trauma is and hence, more lucrative to plaintiff counsel.

Questions You Want To Ask, But Are Afraid To

- What is the overall industry average charge rate per \$100 of payroll?
 1/1/1998 to 12/31/1998 = \$2.33
 1/1/2005 to 6/1/2005 = \$4.96
 1/1/2014 to 9/1/2014 = \$2.93
- What is the average attorney involvement in Workers' Compensation Claims?
 All Claims = 11.6%
 Lost Time Claims = 38%, LA County = 46%
 Permanent Disability Claims = 80%, LA County = 83.8%
- What percentage of all Paid Indemnity Claim Cost in the CWCI sample had Attorney Involvement?
 Per the CWCI:

Attorneys were involved in 38.1% of all indemnity claims. Attorneys were involved in 82% of all claims paid out, i.e., \$6.26 billion of the \$7.6 billion paid.

4. What is the projected Ultimate Medical per Indemnity Claim?
Per the WCIRB:
1998 = \$22,375
2005 = \$31,787
2013 = \$47,354

5. What is the projected Ultimate Allocated Loss Adjustment Expense (ALAE) per Indemnity Claim?
Per the CWIRB:
1998 = \$3,989
2005 = \$6,139
2013 = \$11,768

6. What is the Projected Ultimate Total Loss and ALAE per Indemnity Claim in Workers' Compensation?
Per the WCIRB:
1998 = \$47,539
2005 = \$56,767
2013 = \$85,373

DISCLAIMER: Employers must consult with their WC Insurance brokers for a better understanding of their WC premiums and safety consultants for matters related to safety. Terry Cressman contributed towards premium estimates and John Kallas of Smart Comp contributed with the numbers published by the California Workers Compensation Insurance Rating Bureau (WCIRB) in the *Questions You Want to Ask* section of the newsletter. The contents of this newsletter are for informational purposes only and not to be considered as legal advice. The premium numbers are for discussion purposes and actual numbers for ex-mod and premium calculations may vary on a case by case basis. The article was authored by Sam Celly of Celly Services, Inc. who has been helping automobile dealers comply with EPA & OSHA regulations since 1987. Sam received his BE (1984) and MS (1986) in Chemical Engineering followed by a J.D. from Southwestern University School of Law (1997). Our newsletters can be accessed at www.epaoshablog.com. Your comments/questions are always welcome. Please send them to sam@cellyservices.com.