Managing Workers' Comp:
The Workers' Comp Perfect Storm

BY DAVID R. LENG

Hang on to your wallets. Employers already are seeing the tip of a very nasty iceberg as the insurance industry feels itself reelin' and rockin' on a number of different fronts, all adding up to the "perfect storm."

Combined ratios for workers compensation are hitting upwards of 112 percent. This means the insurance industry isn't making any profits on workers' compensation this year as every dollar coming in is going out at $1.09. This is worse than 2011, when it was $1.02 going out.

The workers' compensation combined ratio hit 118 percent in 2010, the worst since 122 percent in 2000 and 2011 is expected to finish even higher. This means insurance companies not only didn't make any profits on workers' comp last year, but the ship is taking on water faster than they can bail it out. For every dollar of premium they receive, they are spending $1.18.

For the first time in decades, we are seeing more employee injuries, with an upswing in the severity of claims. This has caused a surge in medical costs and an alarming trend towards injured employees staying out of work longer as more employers abandon return-to-work programs due to the financial constraints as a result of a poor economy.

Investment yields have plummeted. Treasury yields once hovering around 5 percent back in 2007 are now below 1 percent or lower, which means insurance company underwriting losses cannot be offset by investment income.

Insurance companies are seeing return on equity drop to 7.5 percent from a high of 15.9 percent in 1979. Shareholders, and your 401k, aren't happy about that.

Now for the bad news

In 2011, the global insurance community was hammered by three of the top 11 natural catastrophes of all time: the New Zealand earthquakes, the tornadoes that ravished our nation's mid-section and the staggering Japanese undersea earthquake and subsequent tsunamis. The financial aftershocks – insurance payouts totaling a staggering $61.3 billion – are just now starting to hit reinsurance costs.

If, as an employer, you are wondering how an earthquake a half a world away can impact the 2012 workers' compensation premiums for your widget factory in Iowa City, think "Butterfly Effect" to the nth degree. Your insurer or excess company may be local, but reinsurers are global.

The re-insurers lost money, the self-insured programs lost money and just about everybody took a hit. As a result, no matter what type of coverage you have, you're going to be exposed to increases if you haven't already experienced it.

You may even think you can seek shelter from the storm by getting a dozen quotes. However, shopping has never helped an employer reduce injuries, discover and correct errors, return an employee to work, reduce their experience modifier, find the right doctor to treat an employee, keep an attorney out of the system, find an agent who is an expert at workers' compensation or improve how their insurance company sees their business.

What can you do about it?

Remember, the basic tenet of insurance is a financial transfer of a risk for an amount of money. What drives your rates and increases your premiums is what the underwriters perceive as the risk. Simply put, the more the risk underwriters perceive, the more you pay in rates. In the world of workers' compensation, perception most definitely is reality. And the reality of the situation is if you don't get your company's risk under control, you're going to pay for the oversight.

All risks are different and not locked into a certain profession or occupation. It's true that a retail grocer will have lower rates than an electrical contractor, but it's false to

believe all electricians get hit by the same rate. For electrical contractors, the rates are proportionate to the risk. The electrical contractor who has 5 percent or more of his employees involved in incidents a year, lets injured employees sit at home and does not have a true safety program in place will pay higher rates than the electrician that goes years without incident, brings injured employees back on transitional duty and focuses on having a formal, effective safety program in place that goes far beyond just OSHA compliance.

It never ceases to amaze me how many employers say they have a safety program and a safety culture, yet continue to experience an above-industry-average frequency and are hemorrhaging money to pay for injuries via higher premiums.

What you can do to keep insurance costs as low as possible is improve your company's risk profile, whether it's using PEPs, offering educational courses, limiting your physical exposure to potential accidents or monitoring the behavior of your employees. You then need to address risks in order of potential severity by implementing the proper policies and procedures for each risk. After doing so, you must convey to the underwriters why you now are a better risk and what you are doing differently today than you were last year if you expect to see your rates go down.

Your experience modification factor also is a driver of the risk perception bus, so work to control it. An experience modifier that's out of control – anything in the 1.002 to 1.8 ranges – gives the impression of an unsafe company with poor quality control and a lack of safety procedures. This also will come back to bite you in the wallet as a higher experience modifier drives you to a higher premium. Experience modifiers also can be used as a screening tool to prevent you from obtaining a job or contract, particularly in private sector jobs and contractors.

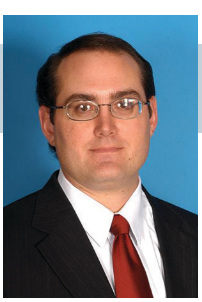
It's critical to prove to the underwriters that you're committed to improving your potential risk by concentrating on getting your incident frequency down, even if it's simply by implementing drug testing and screening, doing some tool box talks, keeping minutes of safety and committee meetings and stepping up the HR process to keep from hiring a walking workers' compensation claim. It's all about being able to convey to underwriters that you have a better risk profile today than yesterday.

Risk managers

Consider hiring a certified risk manager (CRM- or ARM-designated) and not simply a loss-control/safety person. Make certain it's someone who both can steer and direct your company towards improving your all-important risk profile. This is important as many people, particularly those in the insurance industry, incorrectly use the terms risk management and loss control interchangeably. Loss control is only part of an effective risk management ongoing process; so a loss control person should not be called a risk manager, which occurs quite frequently, unless they are a fully trained risk manager.

It's what you don't see, or pay attention to, that will come back to cause your ship to sink. Think of the Titanic: the impact below the water line, what could not be seen, is what sunk the ship. Having standard policies and procedures in place are useless if someone is sacrificing safety or productivity for a better result. The Titanic had superb navigational charts in place, but it was all for nothing because someone was trying to make record time crossing the Atlantic.

You can't control natural disasters – or insurance company profits – and what's done is done. But you can control your company, your employees and potential financial fallout by adopting the correct risk management measures today. By righting your own ship, you may avoid the risk of sinking as this big storm continues to intensify, which I have no doubt it will.



This article by David Leng appeared in *EHS Today, Tire Business, Food Forum, Northeast Oil & Gas*, and *Grocery Headquarters*, among others.

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