

Understanding the Details of Group Retrospective Rating A New Workers' Comp. Rating Option

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For the first time, the Ohio Bureau of Workers Compensation (BWC) has established rules allowing qualifying associations to sponsor group retrospective rating plans, otherwise known as group retro. The benefit to participants is a premium refund based on the overall performance of the group. Group retro is not right for every employer but there are a number of employers as well as certain industries that will benefit significantly from this rating option. This year employers were not provided a great amount of time to become familiar with this option because the BWC rules were established only a short time before the start of the 2009 policy year. This article will help those who already have a basic understanding of Ohio's workers' compensation system to become more familiar with the details of this new rating option.

Group retro is right for an employer when they pay significantly more in premium during a year than is paid out by the BWC for the injuries that occur during that same year. The money paid out by the BWC for injuries includes medical expenses, indemnity and award payments to the worker as well as the reserves that are set by the BWC to account for the future cost of the claim. These expenses begin accumulating directly after a workplace injury occurs. The current premium an employer pays to BWC is essentially calculated based upon the money paid out for injuries that occurred between two to five years ago rather than the injuries that occurred recently or even one year ago. This concept is integral to understanding the potential benefits of group retro.

Group retro members will still pay premium based upon their individual past but will realize a refund if the group pays considerably more in premium during a year than is paid out by the BWC for the injuries that occur for all group members during that same year. Stated another way, the group retro rating option basically compares the collective premium paid by group participants during the policy year they participate to the total dollars paid by BWC for member injuries that occur during the same policy year. If the collective premium is considerably less than the collective injury costs paid out, group members divide up a refund. Each member's portion of the refund is determined by their percent contribution to the group premium pool.

The theory behind the pooling of employers to spread risk is a sound insurance principle. However, the complexities of an Ohio group retro plan must be thoroughly evaluated and understood to minimize the risk of an assessment while maximizing the refund potential. Employers should be very cautious about joining a group retro plan unless they are confident that the association sponsor and the selected Third Party Administrator (TPA) are fully aware of and can simply explain the risk versus reward. For instance, there are considerably more details regarding how the group's injury costs are actually calculated and compared to the collective premium of the group members.

Participating employers may receive up to three premium adjustments (refunds or assessments) for the one year they participate. These adjustments will occur for three years after the participation year. If total injury costs exceed premium paid, the group members receive an assessment, which is the equivalent of an additional premium bill. Assessments are limited to a percentage of the original premium. This percentage is selected by the group sponsor and can range from 5% to 100%. The more risk of paying an assessment accepted by the group members the greater the refund potential. To realize the full refund potential, the participating group members must control their injury frequency and severity.

Here is an example of an employer that would benefit from group retro. A construction company is expected to pay \$200,000 in workers' compensation premium for the policy year beginning July 1, 2009. Due to their claims that occurred two to five year ago, the employer did not qualify for a classic group rating program. BWC determines the employer's 2009 policy year premium rates by a calculation that evaluates the cost of the employer's claims that occurred between 2004 and 2007. Analysis of the employer's data shows that during the calendar years from 2004 to 2007, the average incurred loss amount for injuries during one of those years was \$65,000. The estimated annual premium (\$200,000) is approximately three times the amount of claim cost being incurred for injuries in an average year (\$65,000). The surplus of premium over incurred losses is even greater when the 2008 injury data is evaluated. Due to aggressive safety program efforts and proper claims management, in 2008 only \$35,000 in claim losses was incurred by this employer. Early projections for the 2010 policy year put this employer's projected premium at \$180,000. If the employer continues to avoid new claims and control the ones they do have into 2010, there would obviously be a large surplus of premium paid over the incurred losses. If the employer continues this improved performance, they would re-qualify for a classic group rating program where their premium will be reduced significantly. However, there is typically a multi-year time lag and performance must be sustained for several years in a row before the employer would re-qualify for a classic group rating plan. In the meantime, a group of individual employers experiencing similar circumstances would surely benefit each other by participating in a group retro program.

With a basic understanding of the program structure and the type of employers that would benefit, more detail regarding how retro groups actually functions will benefit employers seriously considering this rating option. Rather than simply comparing annual injury costs to annual premium expense, the BWC actually uses a few additional factors to calculate what is know as a **“group retro premium”**. It is the **group retro premium** that is actually compared to the total collected premium from all of the group retro participants to determine if a refund or assessment is due.

The **group retro premium** is calculated according to the equation provided to the right (see Figure 1). Breaking the equation into its parts, makes it is easier to understand. To begin, focus on the

$$\text{Group Retro Premium} = \left(\text{Standard Premium} \times \text{Basic Premium Factor} \right) + \text{Developed Incurred Losses}$$

Figure 1

first part of the equation between the parentheses. The **standard premium** is the actual collected premium paid (without BWC administrative costs and assessments) by all the group retro program members. The **basic premium factor** accounts for insurance costs, surplus costs, and a per claim cap and is determined from a BWC table. This table supplies a percentage that is based on the group's total amount of **standard premium** as well as the amount of risk the group sponsor selects.

For example, if the group is very large, having \$10,000,000 in **standard premium** and the group takes a high risk of paying an additional \$7,000,000 in assessments (170% risk), the **basic premium factor** would be at the minimum of 17%. Therefore, the first part of the **group retro premium** calculation (**standard premium x basic premium factor**) would be 17% of the \$10,000,000 **standard premium** or **\$1,700,000**. If the group was very small, having \$1,000,000 in **standard premium** and the group takes the lowest risk of paying an addition \$50,000 in assessments (105% risk), the **basic premium factor** would be 48.1%. Consequently, the first part of the **group retro premium** calculation would be 48.1% of the \$1,000,000 **standard premium** or **\$481,000**. Notice that the bigger the group and the higher the risk accepted, the lower the initial portion of the **group retro premium** becomes as a percentage.

The BWC's table of **basic premium factors** range between 17.0% and 48.1% depending upon the size of the group and the degree of risk assumed as selected by the sponsor. Keep in mind, to realize a refund the **group retro premium** must be less than the **standard premium**. Therefore, the amount of refund possible is greater as this basic premium factor is lower. However, in exchange for this portion of the calculation being lower, the group takes on a greater financial risk. Group retro is a risk / reward program. This risk is best controlled by a thorough evaluation of each group participant's claims experience, premium history and their safety program and a commitment of each group member to adopt effective claims management protocols.

The second part of the **group retro premium** is the calculation of **developed incurred losses** (see Figure 1). This second portion of the calculation is based on the incurred losses for injuries occurring within the group during the policy year. The **developed incurred losses** for injuries must account for the fact that the total dollar amount of an injury will become more accurate over time and may likely increase. This is a well established insurance industry trend that results from a number of factors including reactivation of dormant claims and claims that may be incurred but not reported for a substantial period. In Ohio, claims can be reported up to two years after the date of injury.

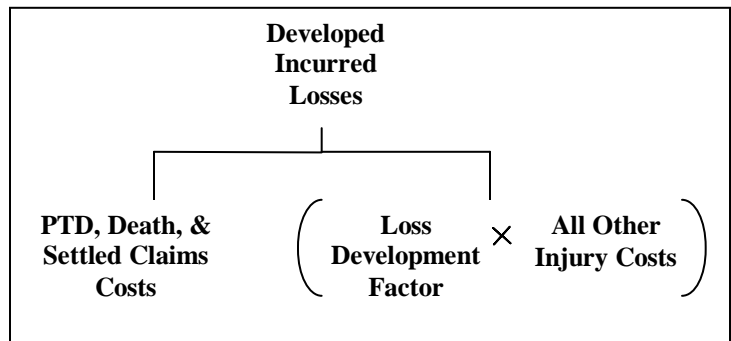


Figure 2

Developed incurred losses are made up of two segments (see Figure 2). The first segment is the incurred losses for permanent total disability (PTD), death, and settled claims that occurred during the group retro year. The future cost of these claims will not need to be developed by definition and the process described above does not apply. Therefore, the incurred costs from these claims are entered into the group retro premium calculation dollar for dollar. The second segment takes **all other injury costs**, including the medical payments, compensation payments to the injured worker, and reserves for future expenses in these claims that occurred during the group retro year and multiplies them by a **loss development factor**. This factor accounts for the fact that the total dollar cost of claims is likely to increase over time. The **loss development factor (estimated to be in the range of 3.280 to 2.317)** will be multiplied by the incurred losses in these claims. The loss development factors create a significant incentive to settle claims. Settling a claim will help the retro group avoid increasing the incurred cost of a claim by two to three times. The actual **loss development factor** applied depends on the point in time after the group retro year ends that the **group retro premium** is calculated.

The group retrospective premium calculation for each policy year will occur, as mentioned previously, at three points in time (twelve, twenty-four, and thirty-six months) following the end of the group retro policy year. For example, a group retro program starting July 1, 2009 would have the policy year end on June 30, 2010. The first (twelve month) calculation of the **group retro premium** would occur June 30, 2011. The second (twenty-four month) calculation would occur June 30, 2012, and the third (thirty-six month) calculation would occur June 30, 2013. The **loss development factor** applied at the first (twelve month) evaluation will multiply the applicable incurred claim costs by an estimated 3.280 factor. The factor decreases to an estimate of 2.604 at the twenty-four month evaluation and 2.317 at the thirty six month period. At the time of each **group retro premium calculation**; only the claims that were incurred between July 1, 2009 and June 30, 2010 are being evaluated.

The BWC has indicated that they may hold a portion of calculated group retro refunds or defer a portion of assessments owed by the group retro members in the first (twelve month) and second (twenty-four month) evaluation periods to minimize the program's volatility. The full net refund or assessment will

be distributed after the third evaluation period. Refunds will be issued within four months of the three evaluation dates. If an assessment is owed, it will be included in the employer's next BWC invoice and must be paid by the due date stated on the invoice. The bureau will charge penalties on any additional premium not paid when it is due.

When first introduced to the group retro rating option, some employers do not find it attractive due to the time it may take to see an initial refund, which can be two or more years. The delay is because the BWC must provide sufficient time to allow injuries to play out before determining the group's true performance results. Employers cautious of participating for this reason should understand that their current rating plan also has inherent time lags before rewards or penalties are assessed. For instance, once an employer is disqualified from a classic group rating program, it can be three to four years before they might qualify for the group plan again. In group retro, once the initial waiting period is overcome, an employer participating in a good performing group could begin to realize refunds annually.

Another barrier to participating in group retro often voiced by employers is the fear that they will do well but the performance of the other group members will cause an assessment. This is a very legitimate fear. Employers should be cautioned against joining a group retro plan that has minimal safety and claims management criteria by which all members must abide. The group's TPA should also have methods to identify poor performing members and built in services that support the development of each member's safety program. A strict safety program evaluation process for joining a group retro plan would assure you that other group members would also be properly scrutinized and suited for participation.

A group retro rating option facilitates competition among group sponsors because groups that consistently deliver a refund will be more attractive for employers wishing to participate. In the near future, we will see groups advertising their track record of securing refunds and offering innovative incentives to attract members. An example of such an incentive might be a safety grant program administered by the group that uses a portion of the group refund to pay for safety equipment or safety services that are then directed to the members that need them the most, such as new members. Such incentives will facilitate good performance and better ensure that refunds will be issued year in and year out.

Employers participating in group retro cannot participate in the following BWC programs: individual retrospective rating, \$15,000 medical-only program, deductible discount program, one claim discount program, classic group rating, drug-free workplace discount program, & self insurance. State agency public employers are also not eligible for participation.

If you have been contacted by a TPA or association sponsor about participating in their group retro plan, beware and ensure that they understand and can easily explain the risks and are capable of managing the group to better ensure a refund.

For more information or details about how Ohio's group retrospective rating plan works or to discuss any other safety or workers' compensation topics, call Brad Hunt at 330-301-3262 or email at bhunt@riskcontrol360.com.