



## EMR as Qualifier to Bid on Construction Projects

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### Introduction

This “white paper” discusses the use of the experience rating modification (commonly referred to as “EMR” in the construction trades) as a metric for safety prequalification programs and how the EMR is derived and utilized within the insurance industry.

The EMR is typically one criterion in a contractor risk assessment. Safety prequalification programs are designed to give project owners/managers and contractors an objective measurement tool to analyze contractors' safety records. The altruistic goal of any safety program is to minimize or eliminate worksite injuries.

However, the EMR was designed solely as a premium calculation factor, not as an indicator of overall contractor safety. Using the EMR for other than its intended purpose (to modify premium) has several significant flaws and can produce inequitable conclusions about safety, which are reviewed in this analysis.

### About the ICRB

The ICRB is a private non-profit, unincorporated association of all insurance companies licensed to write workers compensation insurance in Indiana. The ICRB is a statutory rating organization as set forth in be Ind. Code § 27-7-2 et. sec. of the Indiana Insurance Laws.

The law empowers the ICRB to gather information from its member insurance companies that may be necessary to establish fair and adequate advisory rates. This information is submitted to the Indiana Department of Insurance for review and then distributed to all member companies who use the rates or file their own rates.

In addition to the data collection and ratemaking functions, the ICRB is responsible for various workers compensation programs: rules promulgation, experience rating, inspection and classification, assigned risk administration, industry education, and dispute resolution.

It is the ICRB, not the “The State,” that calculates and produces the workers compensation experience rating modification.

### Executive Summary

- Across the country, many construction project owners/managers use the EMR to pre-qualify contractors for worksite eligibility
- Requirement that EMR is below 1.00 or 0.90 or even lower, to qualify is common
- There are flaws in using the EMR as a qualifying metric
- EMR is designed as a pricing modifier to determine insurance premium, not to qualify contractors for projects
- EMR includes reserves on open claims which will change from year to year
- Successfully subrogated claims can be excluded from an EMR, but may occur years after the policy year experience is no longer part of the EMR 3 year period
- EMR formula is refined from time to time. A recent change in 2010 can cause a contractor’s EMR to go up, even with no losses.
- EMR experience period is one to four years old, thus, it may not reflect current conditions of a contractor in terms of safety.
- Using the EMR as a qualifying metric encourages employers to not report injuries and pay claims out of their own pockets, a practice which is not cost effective and may be illegal.
- Contractors with no losses can realize an increase in their EMRs simply because of statewide drop in claim frequency (that must be recognized in annual updates of rates and rating values)

### Issue

Under the concept of “risk-based procurement,” the EMR has been utilized as a criterion to determine a contractor’s eligibility to bid and work on construction projects. Its use has been in place for many years as an indicator of how safely an employer conducts operations.

The benchmark for eligibility has been 1.00 or less for the majority of bid specifications. This benchmark has been reduced to .90 or as low as .80 in some cases. The presumed logic in establishing an EMR benchmark is to validate the

safety programs that each contractor has implemented by utilizing data that has a historical high degree of credibility.

As mentioned in the introduction, the EMR is not intended to be used as a qualifying criterion upon which project owners/managers should rely to award contracts. As the producer of employer experience ratings, the ICRB has no control over how outside parties use the EMRs, and rating organizations cannot tailor this premium development plan to suit their criteria. The EMR was designed solely as a premium modifier. It is not designed as a tool to evaluate overall contractor safety for qualification on construction projects.

Over the past several months, the ICRB President has participated in meeting discussions with the Metro Indianapolis Coalition for Construction Safety, Inc. (MICCS) and the Indiana Construction Association. Our goal is to communicate our concerns with construction project owners/managers who promulgate criteria of using EMRs to determine eligibility to bid on jobs. For instance, one of the MICCS certification criteria is to have an “EMR below 0.90” (reference MICCS webpage <http://www.miccs.org/certification>).

### **Background Information on Experience Rating**

The Experience Rating Plan has been in place since the 1930's. Its use is required by the Indiana statute and the Plan rules are approved by the Indiana Department of Insurance. Most states follow a very similar plan. Experience Rating is intended to assist insurance companies in the development of an appropriate premium amount for a workers compensation policy.

From an actuarial and ratemaking perspective, the process of rate setting and experience rating values is driven by many different factors other than just claims. This is an important message for contractors, project managers, and owners to understand.

Based upon the actual purpose of the Experience Rating Plan, we believe it is inappropriate in many cases for project owners/managers to rely upon the EMR as a criterion for judging a contractor's devotion to a safe workplace.

### **Understanding the Experience Rating Formula**

The EMR can be found in the bottom right hand corner of an employer's experience rating worksheet printout. An EMR higher than 1.00 means the premium will be higher than that of the average company in the same business classification. For example, an EMR of 1.10 means the base premium will be increased 10%. An EMR of 0.90 means a 10% decrease on the base premium.

Many items impact the final EMR including an employer's business classification(s), its payroll, the frequency of injuries to employees, loss limitations, and the dollar value of those injuries (the amount of medical and lost wage benefits paid to injured employees as well as the amount of money held in reserve to pay continuing benefits). This information is reported to the ICRB annually by insurance companies so that we can produce experience ratings for employers, as required by statute.

There are several principles associated with the experience rating formula with which you should be familiar:

- Actual losses / Expected losses = EMR
- Actual losses include reserve amounts for open claims
- Expected losses depend upon payroll size

For a more detailed and technical explanation, please refer to the Appendix.

In looking at an inquiry from one employer, its EMR increased 5.6% over the course of the last 5 years even though the business experienced no losses. The EMR increased because the base rates and expected losses have decreased over that time.

To explain this phenomenon, more contractors are having fewer or no losses, so that employer with zero losses, although commendable, compared to the average, is just not quite as remarkable as it used to be (the average is decreasing, or getting closer to zero). Also consider that over this same time period, the advisory rate per \$100 payroll for its business (class 5606) has decreased by 24%. (please see table below).

*Note on advisory rates: on average, Indiana has enjoyed the second lowest rates in the country for many years. So, in general, employers pay less for their workers compensation insurance than in other states.*

<u>Policy Term</u>	<u>EMR</u>	<u>Advisory Rate</u>
6/1/2011-2012	0.94	1.33
6/1/2010-2011	0.93	1.29
6/1/2009-2010	0.92	1.46
6/1/2008-2009	0.92	1.65
6/1/2007-2008	0.91	1.56
6/1/2006-2007	0.89	1.74

In summary, from our perspective, this employer's five year rating history indicates the Experience Rating formula is working properly as a premium development plan. Conversely, as you can see from this example, the Experience Rating formula is not working properly as a metric to qualify contractors to work on projects because that is not the intended use of the factor.

## Experience Rating Plan Limits

Since the EMR is a pricing formula for workers compensation insurance premium, the Plan is actuarially designed to limit or exclude certain losses from the calculation. The limits recognize that since the EMR modifies premium, the formula needs to account for unusual and severe situations. Otherwise, the price for insurance would be prohibitive for employers who might experience the rare severe claims that sometimes occur.

All loss limitations and exclusions are intended to help the employer. The more common ones are:

- Maximum EMR cap
- Limited losses
  - medical-only loss (injury type 6), *reduced 70%*
  - 2011 per claim accident limitation (\$135,500)
  - 2011 multiple claim accident limitation (\$271,000)
- Excluded losses
  - Subrogation recovery
  - Noncompensable claim

## Anecdotal ICRB Cases

The actual case studies described below are illustrative of what has happened to a few employers as their EMRs change and impact their ability to bid on projects.

### Case study 1

My company has always carried an EMR rating of .82-.84 since the company was formed. In 2009 we had a claim for an injured worker for hernia repair. I am in the process of bidding my workers compensation and general liability insurance and was informed that my EMR will change from an 0.83 to 1.07 as of November 1, 2010 because of this claim. This could potentially be financial ruin for my company. I am a sub-contractor for many of the larger prime contractors. Prime contractors typically review all sub contractors through pre qualification before they hire them for a job.

The main focus of this pre qualification is the EMR rating. If a sub contractor has an EMR rating of 1.00 or above they can choose not to use them on a job site. I have a very active safety program and pride ourselves in our safety record. Now, because of one claim, I stand to lose a substantial amount of revenue. In this economy this could be the end of my small business

### Case study 2

My EMR is increasing when my business has achieved zero losses in recent years. My concern is that if my EMR continues to increase, my business could be in jeopardy of being disqualified to bid on construction projects where the construction managers require the EMRs of bidding contractors to be below 1.00, or even lower. I've written to my State Senator.

### Case study 3

My employees have been with me for years and are all in their fifties and early sixties. Statistics tell us that more experienced workers are less likely to get injured, but if so, older workers take longer to heal, and the claim costs are higher. Everything else being equal, this means my EMR could be higher than my competitor and disqualify me from bidding simply due to the age of my workforce. To be denied the ability to bid on a job for that reason seems discriminatory to me.

### Case study 4

My site supervisor was in his pickup, stopped at a stop light, when he was hit from behind. He's since had back and neck surgeries paid by my workers comp. The insurance company is still going after the third party that caused the accident to recover the costs of the injury. But in the meantime, the cost of the claim shows up in my experience. That puts my EMR over 1.00 and now I don't qualify to bid on jobs. So, through no fault of my business, and through no lack of safety management by me and my employees, we are virtually out of business. No one has yet explained to me how that's fair or even reasonable.

## Class Ratemaking Methodology Change (2010-2011)

Statewide ratemaking methodologies are periodically updated and tweaked as improved actuarial methodologies are recognized and implemented. These changes are designed to improve the pricing of insurance premiums.

It is apparent from the Class Ratemaking Methodology change implemented with a two year transition beginning with January 1, 2010, that the manner in which rates and values are now promulgated has had an impact on EMRs.

The change increased the EMR for some individual risks by up to 4 points, *due solely to a change in methodology and not a change in actual risk performance*. Consequently, some contractors could be in jeopardy of becoming ineligible for work on projects that use the EMR as a criterion.

## Insurance – Transfer of Risk

Insurance companies protect employers from the cost of compensating injured workers. Those costs can sometimes be small medical expenses or catastrophic events. Employers achieve a level of financial stability (and peace of mind) by transferring the risk of loss to insurance companies.

The transfer is achieved by paying insurance premiums. Premiums, within reasonable limits, reflect the degree of risk. The experience rating modification is one of the factors used to arrive at the price of insurance.

## Conclusion

The use of the EMR as a qualifying criterion upon which project owners/managers rely to award contracts has several significant flaws and will produce inequitable results. The ICRB does not believe third parties should utilize the EMR as the sole or primary method to judge a contractor's safe work environment. "Safe" contractors may be unfairly disqualified from bidding on construction jobs.

Consideration of changing the EMR eligibility thresholds for contractors or utilizing different data sets such as OSHA reports or NIOSH recordable and lost time incident rates that are relevant to hours worked may be a more reliable methodology.

## Appendix

### Experience Rating Phrases

The Experience Rating Plan tailors the price of insurance and provides an incentive for safety. Several terms or slang words are used to describe the plan or part of it. Those terms are:

- Experience Rating Plan (ERP)
- Experience Rating (ER)
- Rating
- Experience modification rating (EMR)
- Experience modification
- Experience modifier
- Experience mod
- Mod factor
- Factor
- E-mod
- Mod

### Understanding the Experience Rating Formula

- The EMR calculation compares actual losses to expected losses (actual / expected = EMR factor). The EMR is based on a comparison of your loss activity to that which is expected for your type of business and payroll size.
- Expected losses are based on the classifications that describe your business and the amount of associated payroll. There is an expected loss rate (ELR) for each business classification.
- Expected losses and payroll have a direct relationship. Payroll multiplied by ELR divided by 100 = expected losses. So, higher payroll = higher expected losses; lower payroll = lower expected losses.

As payroll might decrease from one year to the next, expected losses would also decrease. With zero actual losses and the lower expected losses, the higher your EMR will be, i.e. a roofer with zero losses and \$5 million in payroll will produce a lower EMR than a roofer with zero losses and \$1 million in payroll.

- Expected losses and the base rates used in the calculation of your insurance premium have a direct relationship. (higher rates = higher expected losses; lower rates = lower expected losses)

- Loss frequency across all industry groups has steadily and consistently declined over the past 15 years, in Indiana and countrywide. This trend offsets increases to base rates and expected losses that would otherwise be necessitated by rising medical costs.
- D-ratios are used to split the total expected loss amounts between primary losses and excess losses. Primary losses represent the first \$5,000 of a claim. Excess losses are the portion of losses that exceed \$5,000. This split is needed because primary and excess losses are treated differently in the Experience Rating formula.

**Ind. Code § 27-7-2-2(m)**

“Experience rating means a rating procedure utilizing past insurance experience of the individual policyholder to forecast future losses by measuring the policyholder's loss experience against the loss experience of policyholders in the same classification to produce a prospective premium credit, debit, or unity modification.”