BWC
BUREAU OF
WORKERS' COMPENSATION

pring Street. Columbus. Ohio 43266-0581

October 15, 1993

Dear Board Member:

In preparation for the Board Meeting on October 21, 1993, I am providing this letter and the attached information for your examination. An agenda item for the meeting will be an information presentation on the group rating plan. The Actuarial Section and William M. Mercer, Inc., the BWC's actuarial consultants, have recently concluded a group rating pricing study which has been presented to the Group Rating Advisory Committee. The results of this study have caused a great deal of concern among the sponsoring associations, third party administrators, special interest groups and group employers.

In an effort to deal with concerns generated from the pricing study, it is necessary for the board members to be informed about the group rating plan, the pricing study and the potential action that may be necessary for the board members to take. The outside parties mentioned above may request the opportunity to present information and recommendations from their perspectives on the group pricing study results. Any decisions regarding the pricing of the group rating plan need to be made by the Board since the decision will impact rate calculations.

Issues that may be considered by the Board include:

(a.) when and in what forum the pricing study should be presented to the Board, its Committees or members

(b.) the form the change (if any) in rate calculations (pricing) may take, including the possibility of phase-in

(c.) the effective date of the action (if any)

The pricing of the group rating plan became an issue in the first year that the rating plan became effective. At the quarterly Group Advisory Committee meeting held on September 20, 1991, Jim Inkrott from William M. Mercer, Inc., made a presentation on the premium rating methodology for group. His analysis concluded that the credits given to groups were likely to be too great. Mr. Inkrott suggested that a group dividend or retrospective program might improve the problem of equity and the inflated credits. At that time, little specific data was available to support this position because the group rating program had just begun.

William M. Mercer, Inc. (Mercer), is an actuarial consulting firm, a division of Marsh & McLennan Company. Jim Inkrott, a principal with Mercer, is the person directly responsible for the consulting work done for the BWC. Mr. Inkrott is a Fellow in the Casualty Actuarial Society, Member of the American Academy of Actuaries, a Chartered Property Casualty Underwriter, and a Chartered Life Underwriter.

The group rating study did not commence until 1993. At this time, the BWC had available empirical data as of March 31, 1993 for the three six-month reporting periods that the group rating plan had been in effect. The information that was used in the study was the actual losses (medical payments, compensation awards, and reserves) incurred and the actual payroll and premiums paid by the group members in each six-month reporting period. The same information was gathered for all non-group members for the same reporting periods. The Actuarial Section of the BWC used significant resources reviewing the data to ensure its accuracy. The information was then given to Mercer to complete their study. Mercer's original intuition from September of 1991 was proven to be correct and their recommendation is still to reduce the amount of credit being given to groups to achieve greater equity among all State Fund employers.

The pricing of the group rating plan has been an ongoing concern for the BWC and has been a topic of discussion in seven of the quarterly meetings with the Group Rating Advisory Committee for the past two years. It has been the intent of the BWC to keep interested parties aware of the BWC positions and to share information with these persons timely. The record of discussions of pricing concerns supports the BWC in meeting this goal. The timing of the issue is entirely the result of completion of the BWC/Mercer pricing study and the BWC's distribution of that information as expeditiously as is possible.

I appreciate the complexity of the issues surrounding the group rating plan. The information provided in the enclosed documents and the presentation scheduled for the upcoming meeting should provide a basis for dealing with these issues. If you have specific questions concerning group rating, feel free to contact me or my staff at any time.

Sincerely,

Wes Trimble
CEO/Administrator

Group Rating Plan

The group rating plan was enacted into legislation with House Bill 222 which became effective November 3, 1989. The proponents of the bill were primarily the Ohio Retail Association, the Ohio Manufacturers' Association, and the Ohio Chamber of Commerce. After the law had been passed, the Group Rating Advisory Committee was formed to attempt to obtain the consensus of interested parties in the development of the group rating rules. The committee was charged with the responsibility to develop proposed rules which amplified the law and the design of the program. The rules were ultimately adopted by vote of the Workers' Compensation Board in October of 1990. The group rating plan was first offered beginning July 1, 1991.

The purpose of the group rating plan is to offer an alternative method of rating for those small and medium employers who have an excellent loss history, but are statistically too small to be individually experience-rated. The plan is intended to improve accident prevention and claims handling by allowing similar employers to pool their resources and develop a plan for achieving a better safety program and accident reduction and lower premium rates than an employer may be able to achieve as an individual.

The attached Group Experience Rating Fact Sheet highlights the criteria each group must meet and the criteria that each member within the group must meet. The formation of the groups is the responsibility of the sponsoring organization, and the BWC has no input in the initial formation of the group. Once the sponsoring organization selects its members, it files with the BWC an application listing the employers in the group. The Actuarial Section of the BWC then evaluates the group applications to ensure that both the group and individual criteria are met. An employer can be potentially rejected at the sponsoring organization level or by the BWC if it fails to meet the individual criteria. Once the groups are evaluated and accepted for group rating, the Actuarial Section develops the premium rates for each group. The group must make an annual application with the BWC, and each year new rates are calculated. It is important to note that the BWC does not select employers for membership into a group and the BWC cannot have any influence or impact on whom the sponsoring organization will include in the group rating application. Employers who are rejected from the group rating plan by the BWC have a right to appeal to three levels within the BWC. The first level is an informal group rating review committee, the second level is the Adjudicating Committee, and the final level is the Board Subcommittee. At any level a decision is in favor of the employer, the appellate process is concluded. (The BWC has no right of appeal.)

The inclusion of the group rating plan into the rate-setting systems was designed to be revenue-neutral with regard to all private employers collectively. This basically means that the overall premium needed to be collected by the BWC to cover the cost of claims occurring in a policy year remains the same but the BWC must redistribute the premium to be collected from various private employers. The premium obligation for the non-group employers must be increased to counterbalance the discounts granted to employers in groups. In the case of group rating for the rating year beginning July 1, 1993, the increase in premium for the non-group employers to offset the discounts given to group employers amounted to 13.1% or $222,320,437. This shift in premium payment caused by the group rating plan increased the base rates by an average of 13.1%.

The number of groups and the number of employers participating in the group rating plan have increased over the three year period. Below are the numbers of groups and employers for each rating year.

	7-1-91	7-1-92	7-1-93
Groups	95	271	357
Employers	5426	20,716	33,815

Due to the popularity of group rating and the large numbers of employers involved in the group rating plan, the timeline for assembling groups has evolved into a full year of activity. Each year, sponsoring organizations and their consultants begin their process of evaluating individual employers for the formation of groups sometime in June or July. They will usually obtain temporary authorization from potential group members via a BWC form AC-3 to obtain claim loss and risk data on those individual employers. In mid-August, the sponsoring organizations may request such information from the BWC. This process currently involves the BWC providing information on approximately 7,500 requests each week for a period of approximately 15 weeks. Once the sponsoring organization has received the information, it proceeds to form the groups using the payroll and loss information to maximize the benefits allowed by the group rating plan. The sponsoring organization may also screen out employers that they may feel do not conform to the sponsoring organizations criteria or the criteria established by the BWC. Applications for the groups must be filed with the BWC on or before December 31 of each year. The Group Rating Unit of the Actuarial Section then begins the application evaluation process. The evaluation process must be completed by March 31 so that the development of new base premium rates for all classifications and new experience-modified rates for each group may begin. The Group Rating Unit mails out rejection notices to employers in early April at which time those employers may begin their appellate process described earlier. The development of rates requires 3 months with the filing of base rates in June and the mailing to employers their experience rate notification letters in early July. Then the cycle repeats itself. The PEC employers timetable is somewhat different with the rating year beginning January 1.

The structure of the groups can vary by type of sponsoring organization. Some of the groups are formed by parent corporations that sponsor their wholly-owned subsidiaries in a group plan and some are franchise owners who form groups under a franchise agreement. However, the groups are predominantly sponsored by trade associations that sponsor groups made up from their constituencies. The sponsoring organizations administer groups and charge fees to the plan participants in various ways. Services offered by the sponsoring organization can be limited to association membership and participation in a group to a full service agreement providing claims management, risk reviews and safety programs. The fee structure can range from simple percentage of base rate premiums (i.e. 4% to 8%) to highly complex sharing of savings within a group. One large sponsoring organization that sponsors about 4 different groups charge a fee of 4% of base rate premiums, a $40.00 set-up fee and collects from the employer the difference between the employer's individually rated premiums had he not been in group and the premium charged at the group rate level. The difference between the two rates is then paid back to the employer based upon the sponsoring organization's predetermined formula of equitable sharing of the savings for all the group members. In all cases, the group member must be a member of the association which requires that annual dues are paid to the sponsoring organizations. Documents provided the BWC have shown membership dues ranging from $250.00 to almost $30,000.00.

FACT SHEET

Bureau of Workers' Compensation

Group Experience Rating

April 1993

Prior to the basic rates effective July 1, 1991 employers could qualify for experience rating only as individuals. However, House Bill 222, effective November 3, 1989 mandated that the Bureau of Workers' Compensation (BWC) offer group experience rating. BWC implemented group experience rating for the rating year beginning July 1, 1991.

The group rating plan allows employers that are substantially similar to group together, to potentially achieve lower premium rates that they cannot otherwise acquire as individual employers.

Criteria for Group Experience Rating for the Group

- All of the employers within the group must be members of an organization that has been in existence for at least two years prior to the last date upon which the group's application for coverage has been filed with BWC.
- The organization must have been formed for a purpose other than that of obtaining group workers' compensation coverage. The bureau shall require the organization to document its purpose by charter, by-laws and/or other evidence.
- The business of the employers in the group must be substantially similar. A group shall be considered substantially homogeneous if the main operating manuals of the risks as determined by the premium obligations are assigned to the same or similar industry groups.
- The group of employers must consist of at least 100 individual members or in the absence of 100 members the aggregate workers' compensation premiums of the members, as determined by BWC's Chief Executive Officer/Administrator must be expected to exceed $150,000 during the policy year.
- The formation and the operation of the group program must substantially improve accident prevention and claims handling for the employers in the group. BWC shall require the group to document its plan or program for these purposes; and for groups reapplying annually for group coverage, the results of prior programs must be documented.

Criteria for Group Experience Rating for Individual Employers

- The employer must be current (not more than 45 days past due) on any and all undisputed premiums, administrative costs, assessments, fines or monies otherwise due to any fund administered by BWC, including amounts due for retrospective rating at the time of the application deadline.
- The employer cannot be participating in a part-pay agreement for payment of assessments due the State Insurance Fund at the time the application for group rating is due.
- The employer cannot have cumulative lapses in workers' compensation coverage in excess of 59 days within the 18 months preceding the application deadline date for group rating.
- The employer must be in an active status the first day of the policy year for group rating.

Application for Group Rating

The group rating plan is an annual plan for the rating of a policy year. Groups must reapply each year for group premium rates. Continuation of a plan for subsequent years is subject to timely filing of an application and the meeting of eligibility requirements each year. The application should be filed with the Bureau of Workers' Compensation, Actuarial Section, 30 W. Spring St., L-25, Columbus, OH 43266-0581.

Retention of Experience

The payroll and loss history experience of an individual member will be retained within the group's experience rating calculations for the three policy years subsequent to the member leaving the group.

Contact: BWC Actuarial Department, Group Rating Unit • (614) 466-4660 • 30 West Spring Street • Columbus, Ohio 43266-0581

MEMORANDUM

TO: Board of Directors

FROM: Wes Trimble

SUBJECT: Group Rating Report #2

DATE: December 23, 1993

I have enclosed the second of three reports on Group Rating. The second report discusses the Mercer findings and the implication of the recommendations on current group discounts.

As you are aware, our customers have raised numerous concerns regarding the Mercer Report findings. In response to these concerns, we agreed to fully cooperate with an independent consultant hired by our customers to review the Mercer Study. The independent study will be completed by January 31, 1994.

Once the study is completed, we will seek input from our customers on necessary changes to the group rating program. We will then submit the third and final report to the Board in late February 1994, with our recommendations.

At this point, we believe the inadequacy of premiums results from applying the same formula approach to determine the discount for the group as a whole as if it were one big company. This is not consistent with the way in which groups are typically being formed. For the most part, the employers who were permitted into groups are those who had much lower than average claims for their industry over the four year experience period used to determine discounts. In fact, studies of Ohio experience show as many as 75% of small employers would be expected to have no claims at all in any four year period.

In general, the good experience of employers pooled into a group is more likely to be due to random good fortune among those employers selected than to their active and conscious activities to prevent accidents and to manage their claims costs. This is especially so given that the experience period used to determine the discount relates to a time period before the group was even formed. In contrast, a single large employer who exhibits better than average claims experience is more likely to have achieved that result through conscious effort and consistent application of good safety and loss control practices.

cc: Executive Staff

EXECUTIVE SUMMARY

Mercer Report on Group Rating Claims Experience

Group rating began for private employers in July 1991. The current design of the program was developed by the Group Rating Advisory Committee. Under that design, the experience rating discount for the members of each group is based on the collective claims experience of all its members combined. In other words, the claims loss experience of the group as a whole is treated exactly the same as if it were one big company.

CREDIBILITY AND DISCOUNT LEVELS

An important factor in determining discount levels is the credibility the individual, or in this case, the group generates. Credibility can best be described as the "law of large numbers". The bigger you expect the claims costs to be, the more you can believe that the actual losses can be used to predict future losses and therefore predict the premium that needs to be charged to cover those losses.

In setting premium rates for each group member, the credibility given to the group's collective experience is generally much larger than the credibility that would be given to an individual employer's experience on its own. Because groups are composed mainly of companies who have better than average claims experience, the increased credibility of the group's experience results in experience rating discounts for group members that are much higher than they would receive as individual companies.

To assess the current impact of group experience rating discounts, we analyzed the 32,500 private employers participating in groups for the July 1993 to June 1994 rating year. A total of 43% of them would not be eligible for any discount on their own. In other words, even if they had no claims, they would be base rated. On average, the employers in groups would have had a discount of 5% if they had NOT been in group. In the best case scenario, the maximum average discount available to these employers without the group program would have been 10% if they had no claims in the 4-year experience period. However, under group rating their average discount is 57%.

Of the 32,500 employers in group this year, over 23,000, or 71% of them, have discounts greater than 50%, that is they pay less than half of their normal premium. A total of 95% of group employers receive a discount of more than 30%.

GROUP RATING STUDY

During 1993, claims experience data from Ohio's group rating program was analyzed to determine how appropriate the assumptions underlying the level of group discounts have proven to be.

For the current study, our actuarial consultant, William M. Mercer, looked at the actual claims experience and premiums for the 5,000 private employers in groups from July 1991 to June 1992, and for the 20,000 in groups from July to December 1992. Mercer compared this claims and premium data with actual claims and premiums for the same periods of time for all employers not in groups. Data on claims after December 1992 is considered too incomplete or "green" to be statistically reliable.

The term "green" refers to claims which may be filed during the most recent year. Premium rates are calculated based on claims experience in the oldest four of the last five years. The most recent year is not part of the calculation as statute allows an injured worker to file a claim within two years from the date of notice the injury occurred.

RESULTS OF MERCER STUDY

The goal of the Ohio Workers' Compensation system is to set premiums at a level that will cover claims costs, and to spread those premiums among all employers in a manner that is equitable. To this end, if the level of experience rating discounts provided to groups were appropriate, two results would be expected: 1) that the ratio between claims and premiums would be about the same for group employers as for non-group employers, and 2) that the ratio between claims and premiums would be fairly consistent at all levels of group discount. The target ratio for achieving equity would be 100%.

With regard to the spread of premiums between group and non-group employers, when Mercer compared the ratio of actual claims to premiums charged, there was significant discrepancy between group and non-group employers. The loss ratio, which is the cost of claims divided by the amount of premium paid, is 49% higher for all group employers than for all non-group employers. This means that group employers are paying significantly less for each dollar of their claims costs than are non-group employers.

Although Mercer's analysis did confirm groups had overall lower losses and that significant discounts were appropriate, premiums charged to the groups were inadequate. In fact, the discounts being provided to group members are much higher than would be supported by the actual experience of those in the group program for the first 18 months.

In analyzing the ratio between claims and premium at the various levels of group discounts, it was found that there are significant discrepancies between discount levels. In particular, the higher the discount provided under group, the more inappropriate the current discounts seem to be. This is illustrated in Appendix A. For example, the loss ratio for groups that had the highest discounts (65% or more) was more than double the loss ratio for nongroup members. Overall, it was noted that the discrepancies were quite similar between the claims experience for the 5,000 employers in groups between July 1991 and June 1992 and the 20,000 employers in groups from July to December 1992.

CHANGE PROPOSED BY MERCER

Reduction of group discounts by about 40% would have been necessary to achieve equity between group and non-group experience for the first 18 months under the current rating methods. Appendix B shows the results by group discount level using a 35% reduction in group discount for the July 1991 to June 1992 period, and a 39% reduction in group discount for July to December 1992. These reductions would have resulted in overall equity between group and non-group employers. As well, these adjustments would have resulted in a much more equitable spread of discounts within the range of discount levels.

The Mercer analysis supports reducing all group discounts by the same factor to achieve greater equity. For example, if a 40% reduction were applied to group discount levels, a group currently receiving an 80% discount would be reduced to a 48% discount; a group currently receiving a 50% discount would be reduced to a 30% discount.

Implementation of Mercer's proposed rate change would also have an impact on future base rates which apply to all employers. For July 1991 to June 1992, base rates were 3% higher because of group rating than they would have been without group rating. Under Mercer's proposal, this base rate increase would have been lowered to 1.5%. For July 1992 to June 1993, base rates were a total of 8% higher because of group rating. Based on the experience for the first 6 months of that year, it is estimated that the average base rate impact would have been lowered to 5%.

The overall effect of reducing group discounts would be to reduce the amount by which non-group employers subsidize group employers. Due to the revenue neutral nature of the group rating program, the total premium collected by BWC would not change if the group rating discounts were adjusted to a more appropriate level. Group members would still enjoy significant discounts in excess of those generally available to them on an individual basis, but equity between group and non-group members would be greatly improved.

The following examples demonstrate the potential effect of the Mercer recommendations on current groups.

EXAMPLE 1

The largest group currently has about 1,400 members. Almost all of them (98%) would be too small on their own to warrant any discount no matter how good their experience is. The largest member of the group would be eligible for at most a 15% discount on its own. When put together in a group, these employers now enjoy approximately a 90% discount. In other words, the premium they pay under the group program is about one-tenth of their normal premium. Under the Mercer proposal to improve equity between group and non-group, they would still enjoy a discount of better than 50%.

EXAMPLE 2

Towards the other extreme, a fairly typical example of a smaller group is one with 10 employers who each enjoy discounts on their own of between 30% and 60%. Their maximum individual credits if they had no claims ranges from 35% to 95% (95% is currently the maximum discount allowed). Under group, their discount is over 70%. With the Mercer proposal, their discount as a group would be under 45% and, because of the discounts they enjoy on their own, they probably would not form this group.

EXAMPLE 3

Another common example is a group of 40 employers ranging individually from a small penalty to a 70% discount. As a group, they have a discount of just over 40% which under the Mercer proposal would be lowered to about 25%. The interesting question is why an employer who would have a 70% discount on its own would join a group which had only a 40% discount.

Appendix A

COMPARISON OF PRIVATE EMPLOYER GROUP AND NON-GROUP EXPERIENCE UNDER CURRENT DISCOUNT APPROACH

	GROUP CLAIMS LOSS RATIO COMPARED TO NON-GROUP*	
LEVEL OF DISCOUNT IN GROUP	JULY 1991 TO JUNE 1992	JULY 1992 TO DEC. 1992
65% or more	212%	233%
55 to 64%	152%	164%
44 to 54%	128%	131%
43% or less	118%	121%
Combined	149%	149%

*If the level of group discount were equitable, these ratios would all be close to 100%.

Appendix B

COMPARISON OF PRIVATE EMPLOYER GROUP AND NON-GROUP EXPERIENCE WITH REVISED GROUP DISCOUNTS IN MERCER REPORT

	GROUP CLAIMS LOSS RATIO COMPARED TO NON-GROUP*	
CURRENT LEVEL OF DISCOUNT IN GROUP	JULY 1991 TO JUNE 1992	JULY 1992 TO DEC. 1992
65% or more	98%	101%
55 to 64%	101%	103%
44 to 54%	96%	95%
43% or less	104%	102%
Combined	100%	100%

*If the level of group discount were equitable, these ratios would all be close to 100%.