Plan for Adequacy and Equity in Ohio's Group-Experience-Rating Program

Prepared in accordance with House Bill 79 of the 127th General Assembly

Tuesday, Sept. 15, 2009

Ohio | Bureau of Workers' Compensation

Introduction

On Jan. 6, 2009, Governor Ted Strickland signed Amended Substitute House Bill 79 (127th General Assembly) into law. The bill contained the following requirement: "The Administrator of Workers' Compensation shall examine the group-experience-rating program and make a plan to address the equity and adequacy of workers' compensation premiums for Ohio employers."

By law, the administrator must provide the report to the Speaker of the House of Representatives, the President of the Senate, the minority leaders of the House and Senate, the chairperson of any standing committee of the General Assembly that regularly considers workers' compensation bills and the Workers' Compensation Council by Sept. 15, 2009. This report fulfills that requirement.

Overview and progress of rate reform efforts

On March 20, the BWC Board of Directors (Board) approved BWC's comprehensive rate reform plan. BWC has implemented elements of the plan for the July 1, 2009, policy year for private-sector employers. BWC is in the process of implementing a similar plan for public employer taxing districts effective Jan. 1, 2010.

This landmark decision by the Board emphasizes BWC's ongoing commitment to all Ohio employers to establish the right rate for the right risk. By providing more accurate, competitive rates and new performance-based programs, Ohio's workers' compensation system can now become an asset for economic development and provide more options for all employers to reduce costs and improve safety.

Highlights of the plan include:

- Severing the connection between discounts for group-rated employers and the off-balance factor used to increase base rates to offset the discounts;
- Reducing base rates for July 1, 2009, by 25.3 percent on average;
- Increasing group-rated employers' premiums by an average of 9.6 percent;
- Capping increases in an employer's individual experience modifier (EM) at 100 percent if the employer's EM is 1.01 or greater and the employer agrees to participate in BWC-approved safety programs;
- Implementing two new program options (a deductible program and a group-retrospective-rating program) to provide more performance-based options for employers seeking to control costs.

The signature achievement of this plan is that non-group employers' rates more accurately reflect the level of risk they bring to the system and are not inflated to cover premium shortages caused by the group-experience-rating program. By setting the base rates for all employers independent of the pricing actions in group-experience rating, BWC eliminated any chance of non-group employers bearing any additional costs created by group formation.

This action, combined with an overall rate reduction of 12 percent based on downward trends in claims costs, resulted in an average base rate reduction of 25.3 percent. To ensure group employers paid premiums that reflect the costs they bring to the system, BWC implemented a break-even factor for group employers. This factor adjusts the discount level for all group participants to the right level for the risks that are in group. The application of this factor resulted in a 9.6 percent increase in group premium after all adjustments are made. Collectively, these changes will result in balanced premium collection. Non-group employers are paying the right rate and despite these changes, the majority of employers participating in group will continue to receive lower premiums through their participation.

In addition, BWC implemented changes in other areas related to the group-experience rating program. BWC initiated sweeping changes with respect to the rules governing which associations are eligible to sponsor a group-experience-rating or group-retrospective-rating program.

Previously, BWC never re-evaluated approved associations. Now, BWC must recertify sponsors at least once every three years. In addition, BWC will evaluate these applications while having access to additional information, including marketing materials, affiliate sponsors, articles of incorporation and financials. BWC will also require group-experience-rating employers that sustain a claim while in group to attend two hours of safety training.

History and background

The problems inherent in the group-experience-rating program have been chronicled since its inception in 1991. By the time the 127th General Assembly passed House Bill (HB) 100, creating the BWC Board of Directors and giving it the same fiduciary duties as the administrator, nine studies by independent actuarial firms detailed the inequities and flaws within group-experience rating and pointed to methods that could restore fairness and equity to the program.

Deloitte Consulting LLP conducted a 10th independent actuarial study as a part of the comprehensive study, which HB 100 also required. In the report Deloitte states, "Addressing the group-experience rating inequity is also recommended as one of the highest priorities. In this Executive Summary and the underlying report we suggest alternatives to repair and/or replace the current group-experience rating process."

The largest flaw of the group-experience-rating program is that employers participating in the program do not pay sufficient premiums to cover their costs. On average, there are approximately 100,000 employers that join a group. The majority of these employers expect significant premium discounts in exchange for their participation. As a result, sponsors and their third-party administrators (TPAs) have become hyper-focused on remaining able to offer discounts that have historically been as high as 95 percent to attract and retain employers.

To provide such deep discounts, most groups reform annually by shedding employers who have losses. This allows groups to become very large and achieve target discount levels. Most groups are formed with little claims losses in their experience to achieve the largest discount possible. When filed, they take advantage of a rate setting system that calculates significant discounts because their size and loss history has been gleaned to suggest they present little risk and extremely low (or non-existent) costs. In reality, most groups have losses during the policy year that far exceed the level they were expected to incur, which means their discounts are too high.

Giving group (or class) discounts is a common practice and it is not, on its face, unfair or unsound. Done properly, these types of discounts may provide safety incentives. That was the original intent of the group-rating-experience plan as implemented in Ohio.

While part of the challenges with respect to group-experience rating revolve around discounts, it is also unclear how effective groups have been in improving safety among their member employers. Part of the impetus for the creation of group-experience rating was that sponsoring associations and TPAs could improve accident prevention among employers by working with them over a period of years to identify and mitigate hazards while strengthening their safety culture. This was designed to help them achieve lower rates.

However, the massive size of some groups and the constant turnover among most rosters suggests that safety efforts offered by sponsors may be at risk. In the past two years, incurred losses among group and non-group employers in the aggregate are relatively the same even though there are approximately 35 percent more non-group employers. While discounting remains the primary factor when evaluating loss ratios, an erosion of safety efforts may also be contributing to the situation.

BWC must annually collect enough premiums to cover expected losses within the policy year. Because groups generate losses that are greater than expected, BWC has historically inflated base rates to ensure sufficient overall premium. With higher base rates, non-group employers must pay additional premium to offset this imbalance. Further, group employers historically received significant discounts, but they are also based on these inflated rates.

Since 2005, BWC has modified the maximum discount level from 95 percent to 77 percent to reduce the imbalance. However, group reformation has continually eroded those gains, as more and more employers receive discounts that are at or near the maximum discount. The Deloitte study suggested additional solutions, including alternatives to this program. These included changing the structure of group-experience rating to improve equity within the system. Deloitte also suggested applying a separate group-experience rating off-balance adjustment to the group discount factors, rather than applying an overall off-balance adjustment to all employers through class rating.

Components of 2009 plan for rate equity

At the same time that Deloitte brought the comprehensive study to a close earlier this year, BWC established a plan to set rates more accurately and equitably for non-group employers, and ultimately for employers also in group-experience-rating programs. To establish accurate and equitable prices for all employers, BWC set out to accomplish four things:

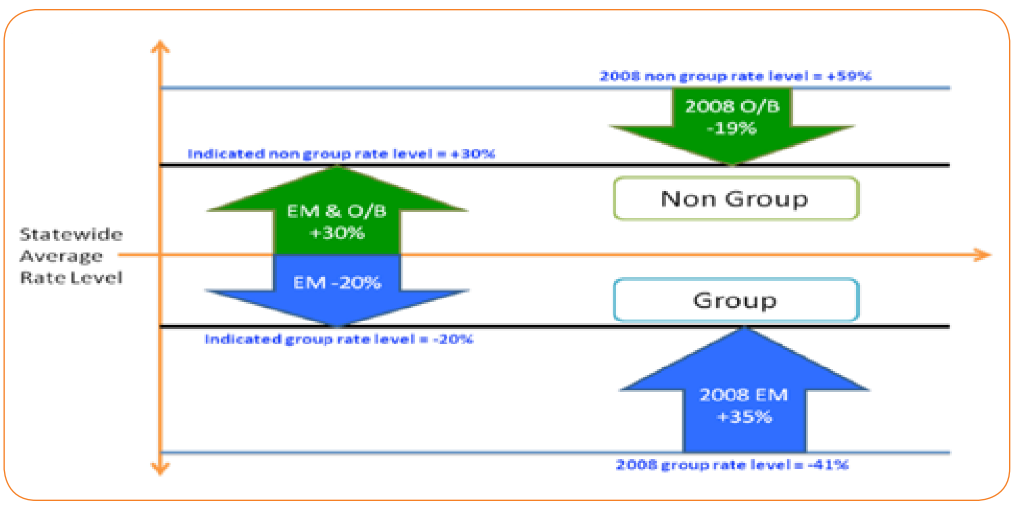
1) Study the performance differentials among all private-sector, state-fund employers to identify the cost levels of group and non-group employers;
2) Set more accurate, equitable rates for non-group employers based on the underlying cost differences;
3) Improve the performance of the group-rating program; and
4) Control for premium volatility in extreme circumstances.

Cost differential study

An analysis performed by BWC's actuarial consultants indicates there is a noticeable and consistent difference in cost levels between group and non-group employers. The analysis shows claim costs for non-group rated employers are 30 percent higher than the statewide average for all employers. In addition claim costs for group-rated employers are 20 percent lower than the statewide average.

Set accurate rates for non-group employers

When comparing cost levels relative to pricing levels, it is clear that an imbalance exists. While non-group employers bring costs that are 30 percent higher than average, they pay premiums that are 59 percent higher than the statewide average. Conversely, group employers pay premiums that are an average of 41 percent lower than the statewide average when their cost levels are only 20 percent less.



The analysis shows the average impact of experience rating for non-group employers is a debit of 7 percent. To achieve the 30-percent target, the system off balance should be set to increase costs approximately 23 percent.

The Board approved BWC's recommendation to set the policy year off-balance factor at 1.23. This accomplished two things. First, it results in non-group employers' premium levels accurately reflecting the costs they present to the system. When combined with the 7-percent debit achieved through experience rating, non-group employers' premiums are priced to be 30 percent higher than the statewide average – precisely in line with the results of the cost differential study.

Second, the reduction in the overall system off-balance factor from 1.49 (the average of July 1, 2008), to 1.23 resulted in a significant reduction in base rates. When combined with BWC's overall recommendation to reduce base rates because of an overall reduction in claims costs, the net effect is an average decrease of 25 percent.

Improve performance of group-rating program

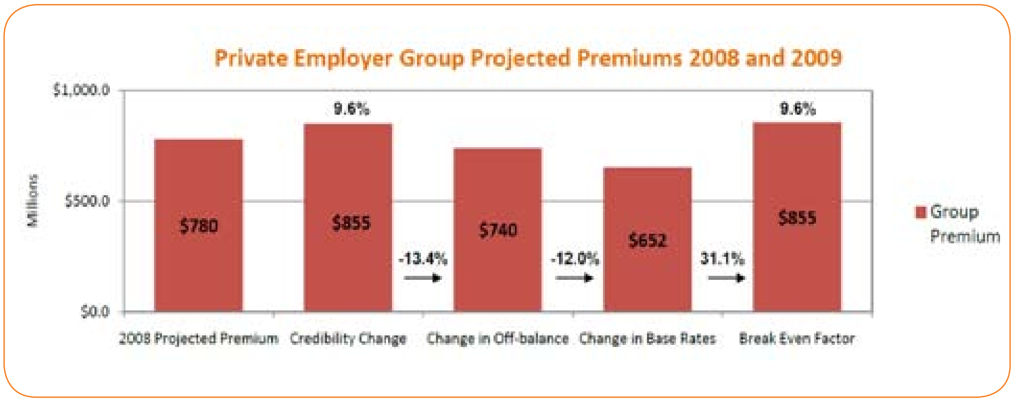
In June 2008, the Board approved BWC's recommendation to reduce the credibility table such that the maximum possible discount for employers was 77 percent. BWC expected this action to improve performance and equity among group-rating participants by increasing the average premium for a group-rated employer by 9.6 percent.

BWC anticipated similar progress as a result of prior reductions in credibility. However, when evaluating prior reductions in credibility (93 to 90 percent effective July 1, 2007, 90 percent to 85 percent effective July 1, 2008), actuarial studies have shown virtually no progress was made in reducing the overall shortfall.

While the maximum possible discount decreased, the number of employers receiving the maximum discount continued to increase. Thus, employers remaining at the maximum discount each year saw premium increases. But those increases were offset by more and more employers receiving discounts at or near the maximum level which were much greater than they received in prior years. As a result, progress stagnated.

To ensure BWC captured the 9.6 percent premium increase, BWC introduced a break-even factor of 1.311 for the July 1, 2009, policy year. The factor was intended to offset the overall 25.3 percent reduction in base rates that was achieved both through a decrease in overall claims costs and a reduction in the system off-balance factor.

In essence, the average group employer's premium would remain at the same level as for the July 1, 2008, policy year (assuming all other factors such as loss history and payroll remained the same). The only exception to this is the premium impact generated through reducing the maximum discount.



While the flat break-even factor did lead to some employers becoming ineligible for group, there was only a 5-percent overall decrease in private-sector group-experience-rating participation (approximately 100,000 employers participated in group for the July 1, 2008, policy year relative to approximately 95,000 for the July 1, 2009, policy year). Furthermore, it achieved its intended effect by reducing the shortfall dramatically.

Control premium volatility

One of the biggest criticisms of Ohio's workers' compensation system is that some employers experience significant premium increases from one year to the next. To mitigate these circumstances, BWC instituted an EM cap for employers whose EM increased by more than 100 percent resulting in their individual EM exceeding 1.0.

With this cap, approximately 1,700 employers will see their premiums collectively reduced by $25 million. In addition, the capping program requires them to invest in completing the 10-Step Business Plan for Safety. This will provide a strong foundation for strengthening risk and claims-management practices and allow employers to improve their workplace safety efforts.

Involving stakeholders

Throughout the process, BWC worked closely with multiple sponsoring associations and TPAs to devise a solution that reduced base rates and improved equity and performance throughout the system. From Jan. 23 and March 19, 2009, BWC participated in at least 23 meetings with various stakeholders working to implement the changes outlined above.

Looking forward

BWC will continue its reform efforts focused on ensuring overall equity in premium levels for all employers. This will include:

Further examination of the maximum discount afforded by the credibility table: The implementation of the break-even factor reduced the maximum discount and improved equity in group pricing. However, this fix is short term because it doesn't effectively distinguish among the individual groups and accurately reflect each group's individual premiums and losses within a policy year. BWC continues to examine solutions that move more toward matching premium with group performance.

Improving ratability of groups through the group-experience-rating program: BWC is continuing efforts to identify precisely what characteristics within group-experience rating generate reduced costs relative to the statewide average. As it defines those components, BWC intends to highlight them to encourage continued emphasis on keeping losses low.

Examining segments of employers and performing underwriting to determine eligibility for group-experience rating: BWC has begun analyzing the statewide book of business to determine whether all segments should be able to obtain the highest possible discounts. By examining premiums and losses based on sizes and industries, BWC may consider underwriting criteria that improve the overall performance of the group-experience-rating program.

Continuing to evaluate and improve the sponsorship certification: To ensure sponsoring associations provide value to employers that participate in their groups beyond just group-experience rating while also helping Ohio's workers' compensation system to achieve desired outcomes, BWC will continue to monitor its rules governing sponsorship and make improvements where appropriate.

Discouraging rejection of members from group-experience rating: A comprehensive solution for the group-experience-rating program should not encourage sponsors or their TPAs to remove employers to improve a group's discount level. Furthermore, improved group retention will improve BWC's ability to accurately price these groups and collect premiums that reflect their risk.

You can find a complete historical record of the Deloitte study and action taken to date by the Board's Actuarial Committee, which supports various decisions with respect to rate reform at http://www.ohiobwc.com/basics/BoardofDirectors/bdcommittee.asp#act. BWC will provide further recommendations to the Board during the coming months as BWC continues its reform efforts.