

Why Have Experience Rating on Workers Compensation?
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If workers compensation rates are designed to predict future losses, why use experience rating? How does experience rating benefit employers? Implicit in most risk-specific programs of experience rating is the prospect of both debits and credits. **Since experience rating gives individual employers some influence over the final premium they pay, it provides an incentive for employers to develop loss prevention as well as incentives to have the injured employees return to work as soon as reasonably possible. In this way, experience rating benefits employers by promoting occupational health and safety.** Experience rating represents a refinement in the premium determination process. It benefits employers by producing a net premium cost that is the best indicator of an employer's own potential for incurring claims. This means that the insurance premium will be appropriate for the coverage being provided by using sound insurance principles and an employer's own payroll and loss data.

What Does Experience Rating Do?

Insurance spreads, or shares, the cost of a loss with members of a group that are likely to experience similar losses. While the cost and probability of injuries for the *whole* group can be predicted with a fair degree of accuracy, it is impossible to determine which member of the group will actually be responsible for these costs. This is why insurance exists. If predictability were perfect, the members of the group that do not expect to experience a loss would have no incentive to purchase insurance, while the premium charge for the members that will experience the loss would need to include the value of the loss. Historically, we know that serious individual injuries generally are rare and that the cost could vary from very minor amounts to millions of dollars. The simplest rating method for workers compensation and employers liability insurance is "manual rating." Under manual rating, all employers are grouped according to their business operation or classification. The estimated losses of the group are added together and an average cost is obtained. The rates determined for manual rating are averages which reflect the normal conditions found in each classification. An employer is assigned to a classification to ensure that the rates reflect the costs of all employers with similar characteristics. Although each classification contains "similar" risks, each individual risk in a class is different to some extent.

Experience rating is designed to reflect these individual differences in loss potential.

If the rating system went no further than manual rating, insurance providers could seek employers with lower-than-expected costs and possibly avoid employers with higher-than-expected costs. To avoid this scenario, the rating system must be further refined. Experience rating is one such refinement. In workers compensation experience rating, the actual payroll and loss data of the individual employer is analyzed over a period of time. **Usually, the latest available three years of data is compared to similarly grouped risks to calculate the experience modification. In general, an employer with better-than-average loss experience receives a credit, while an employer with worse-than-average experience carries a debit rating. Experience rating takes the average loss experience and modifies it based on the individual's own loss experience.**

The two primary benefits of experience rating are:

- It tailors the cost prediction and final net premium cost to the individual employer more closely than does manual rating alone.
- It provides added incentives for loss reduction that are absent from manual rating alone.

The next issue I will continue with further information on “HOW to reduce your experience modification factor.”

My firm and myself are now Certified Work Comp Advisors and have joined the Institute of Work Comp Professionals, a firm dedicated to helping their certified agents reduce work comp expenses. WE HAVE 25 WORK COMP MARKETS!