

# Safety First

The construction industry is turning to wrap-up programs to reduce workers' comp claims.

by Emily Stone Allen

**T**o compete in today's construction market, it's not enough to have the best talent. A successful project requires workers to remain uninjured and on the job.

Safety, in many cases, goes hand in hand with profitability. But how does an owner or general contractor build a safety culture among perhaps dozens of subcontractors with diverse responsibilities and schedules—a safety culture that goes beyond mere compliance?

According to the U.S. Bureau of Labor Statistics, 3.8% of workers in the construction industry were injured on the job in 2013. Even more striking is the fact that more than 20% of 2013 workplace fatalities in the United States occurred in construction, making it one of the most dangerous sectors of the economy. Many of these injuries may have been mitigated or perhaps even avoided with an increased focus on safety.

At present, on-the-job safety incentive programs are often based on on-site confirmation of compliance with standards that align with or exceed those set forth by the Occupational Safety and Health Administration. As comprehensive as some of these standards are, they often do not lead to meaningful reductions in workers' comp claims and increased profitability of a project because of the subjective nature of safety enforcement.

But this need not be the case. One simple modification to the typical loss control incentive program is structured

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## Key Points

### The Big Picture:

Construction jobs accounted for more than 20% of 2013 workplace fatalities in the United States.

**The Issue:** On-the-job safety incentive programs are often based on OSHA standards and often do not lead to fewer claims.

### Changes Ahead:

Bonus systems reward subcontractors participating in a project's workers' comp wrap-up program for better-than-expected claim experience.

around a statistically driven bonus system that rewards subcontractors participating in a project's workers' compensation wrap-up program for better-than-expected claim experience. Many of the same proven allocation methods often used by corporations to transfer the cost of workers' compensation insurance to their various departments can be employed to assist the owner or general contractor in determining the claim experience expectation for the subcontractor.

Under the program, an owner or general contractor could focus on improving claim experience overall or in a problematic loss category. With this approach, each subcontractor is assigned an expected claim level or claim experience target based on its loss history, for claim categories that have a credible volume of information

for actuarial projections. If the subcontractor's actual experience on the project is less than expected, the owner or general contractor would pay the subcontractor a safety bonus.

A safety bonus system can be particularly beneficial to large owners or general contractors that have financial participation in the wrap-up through self-insurance, captive programs or high-deductible arrangements, where reduced claim costs translate directly into increased profits. Projects spanning several years would be expected to see more benefit from a bonus system as the program infiltrates the culture of the workers over a longer period.

## Safety Bonus Systems

How might a bonus system plan work? Let's take one example. If an owner or general contractor wants to reduce slip-and-fall claims, a per-claim, slip-and-fall

allocation of, say, \$10,000 would be applied to the subcontractor's claim experience target (or expected claim level). If the subcontractor's claim experience target was forecast at the program's outset to be 10 claims but its actual claim experience turned out to be only six, the subcontractor would be paid 40% of the total available bonus.

The distributed bonus could be paid simply as cash or could be used to buy updated safety equipment, participate in training, research new safety materials, or any of dozens of other initiatives to improve safety. The bonus system would also allow for considerable flexibility in the establishment of the claim experience target and the method of distribution of the bonus based on an owner or general contractor's relationship with individual subcontractors. The subcontractors' adoption of bonus-supported safety measures can translate into claim costs savings, not just in the following year but year after year, as safety continues to improve.

Using traditional actuarial methods, the claim experience expectation can be tailored to each subcontractor based on its individual historical loss experience. Developing a reasonable claim expectation—levels on which the subcontractor can improve but that do not guarantee a safety bonus—is critical to the success of a bonus program.

If the subcontractor's loss experience is higher than expected, the subcontractor forgoes the bonus but no penalties are imposed. The "all carrot, no stick" approach reduces the incentive to under-report or delay reporting of claims, a practice that could compromise morale or cause claim costs to increase because of lack of early treatment. It also avoids potential conflict with union representatives, who prefer programs that do not incentivize non-reporting of claims.

Because the subcontractor's claim experience target is based on its loss history over several years, its bonus threshold should remain relatively stable. One year of exceptionally low or high claims would not have a large impact on the future calculation of the expected claim levels or claim-experience target underlying prospective bonus programs. Even in

cases when a changing loss history might indicate the claim-experience target should be increased, the owner or general contractor has discretion to maintain claim expectations at current levels in order to make the safety bonus more attainable to a high-quality subcontractor with which it has a relationship.

The safety bonus system has considerable flexibility with regard to which types of claims can be the focus of the program, how the subcontractor can use the safety bonus, and where the claim experience target should be set in subsequent years of the program or on subsequent projects. In addition, the claim expectation can be based on claim frequency, total loss dollars, or a combination of the two in order to emphasize long-term savings without waiting for sometimes long-duration claims to close or settle.

Funding for the program in the first year is a financial commitment for the general contractor, but over time savings from improved claim experience can be used to fund the safety bonuses.

### Likes Attract Likes

In a tight labor market, where the best subcontractors may not be available for months, a safety bonus system may relieve some of the stress in identifying quality subcontractors by helping to attract similarly safety-minded subcontractors. In a sense, the safety bonus program can help to self-select subcontractors with a focus on safety—a great benefit to owners or general contractors entering new regions where the reliability and quality of subcontractors may be unknown.

A safety bonus system puts teeth into risk management for stakeholders across the board. Although financial incentives will not always trickle down to the level of individual employees, workers understand that their safety is important. A safer workplace translates to fewer injuries and deaths, which can improve productivity and morale.

Subcontractors can maintain their most experienced, and likely their most efficient, workers on the job while reducing their experience-modification rate and the cost of future insurance premiums. General contractors' and owners' profits can increase as subcontractors' workers' compensation experience improves, and all can benefit from the increased possibility of early project completion and a related completion bonus. An additional potential benefit of a safety bonus program may include a more attractive risk profile for excess insurers.

The fact is that owners and general contractors have little to lose compared with the potential gains of implementing a safety bonus system. Such an approach could potentially eliminate some of its toughest claims but doesn't require significant payouts unless results are delivered.

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## What's a Wrap-Up?

A wrap-up is a centralized insurance program under which a project owner or general contractor procures insurance on behalf of all (or most) subcontractors performing work on a construction project. Wrap-ups are also called contractor-controlled insurance programs or owner-controlled insurance programs. Typically, a wrap-up will provide coverage for the workers' compensation and/or general liability exposures of the subcontractors.