

Workers' Compensation Experience Modification Factor Insights: *How Your Experience Rating is Calculated and How an Analysis of Your Trending Can Prevent Claims*

Presenter: Patti Orbell
Senior Principal, Claims
Equity Risk Partners
September 28, 2011

Josh Warren: Hello, my name is Josh Warren and I am a director at Equity Risk Partners. I would like to thank you for taking part in this recorded webinar that discusses workers' compensation experience modification factors.

The title of this webinar is Workers' Compensation Experience Modifications Factor Insights: How Your Experience Rating is Calculated and How an Analysis of Your Trending Can Prevent Claims. The presentation will be led by Patti Orbell, senior principal, at Equity Risk Partners. She will discuss experience modification factors including what they are, how they are calculated and why they matter. With that, I will hand it off to Patti to take you through her presentation.

Patti Orbell: Thank you Josh for the opportunity to present this important topic today. As Josh stated, I will be discussing experience modification factors, also known as Ex Mods. I will discuss what they are, how they are calculated and why they matter. Later in the presentation I will discuss how an analysis of your losses and the trending of your losses can prevent employee injury claims from occurring in the first place.

What Is An Experience Modification Factor?

This first slide outlines what an experience modification factor is. An Ex Mod compares your workers' compensation claims experience to other employers of similar size operating in the same type of business. For most states, the "interstate" Ex Mod is calculated by the NCCI or National Council on Compensation Insurance. Some states utilize their own rating bureau to calculate an "intrastate" Ex Mod.

In a future slide, we have listed the states that utilize the “intrastate” Ex Mod. The Ex Mod appears on your workers’ compensation insurance policy and directly affects your work comp premium by applying either a credit or debit to the base or manual premium.

Let’s discuss what it is not. The Ex Mod assigned to your company does not apply to monopolistic states. As you probably know, any employees in North Dakota, Ohio, Washington and Wyoming are covered by a work comp policy purchased by the state’s work comp program. These states do not participate in an Ex Mod program, but may have other mechanisms to reflect a company’s losses vs. its premiums.

Also, there are states that have their own rating bureaus, outside of the NCCI rating bureau. These states may provide what we call an “intrastate” Ex Mod. When I discuss how an experience modification factor is calculated, I will focus on the NCCI interstate Ex Mod calculation.

Why Does Your Ex Mod Matter?

The Ex Mod benchmarks your losses against other similar company’s losses. If your company’s losses are at the industry average, your Ex Mod is at 1.00. If your company’s losses are 20% better than average, your Ex Mod is 0.80 and you may see a 20% premium credit on your work comp policy. If your company’s losses are 20% worse than average, your Ex Mod is 1.20. Here you’ll have a 20% increase appraised to your work comp premium.

The NCCI uses workers’ compensation losses and payroll to promulgate an Ex Mod for your company. A minimum of three years of data, both payroll and losses, are included in the experience rating formula. An example of the data used in the calculation is the easiest way for me to outline this fact. If the current policy period incept on October 31, 2010, the losses used in the calculation are valued as of six months prior, or April 30, 2010. The policy years used in the calculation will be 10/31/08 to 10/31/09, 10/31/07 to 08 and 10/31/06 to 07. As you can see from the example, the most recent policy year, in this example 2009 to 2010 is not used because the losses are too green or not developed enough. The audited payroll for each policy is also used in the calculation.

This information gets a bit more complicated when a company has acquired another company. In those cases, the data included in the calculation is not as simple as I have outlined on this slide. Please contact your Equity Risk Partners account executive to assist with any questions you may have about acquisitions and divestures and how they impact your experience modification factor.

The Experience Rating Formula

The Experience Rating Formula compares expected losses against actual losses. An actual loss is the actual loss incurred by your company's employee as reported to the NCCI or the intrastate's rating bureau. Your insurance company reports the actual losses to the NCCI. For each actual loss, there are two components: primary losses and excess losses. As of now, a primary loss is the first \$5,000 of each loss; however, currently in California, it's the first \$7,000. Excess losses are the amount of each loss above or over the primary value. Expected losses are determined based on the amount of your company's payroll and the type of work your employees do. Expected losses are determined by each state using an expected loss rate, which is multiplied by the policy year's payroll in each state.

Because the average claim cost has increased by almost 250% since 1993, the NCCI is changing the Primary-Excess split point in 2013.

Beginning in 2013, the primary loss split point will change to \$10,000 or less. In 2014, the primary loss split point will increase to \$13,500, and in 2015, the expected split point will be about \$15,000 plus a factor for the claim cost inflation rate.

The Experience Rating Formula treats medical only claims differently than lost time claims. Medical only claims are reduced by 70% by the Ex Mod calculation. Lost Time Claims are claims in which the employee misses time away from work as a direct result of the workers comp injury and are not discounted by 70%. The first \$5,000 of that claim is counted at full value and dollar amounts after \$5,000 are discounted, but at a much lower rate than medical only claims are discounted.

Additionally, the Experience Rating Formula contains other factors that are beyond your control as an employer. These factors are the ballast, the expected loss rate

and discount ratios. Each states' rating bureaus dictate these factors. Even though they are beyond your control, they still matter. For example, if all of your actual losses stay exactly the same from one experience period to the next but expected loss rates go down, your Ex Mod will go up.

Finally, let's take a look at the calculation. The most important item to take away from the calculation is the actual losses are analyzed in the numerator and the expected losses are analyzed in the denominator. Therefore, if the actual is greater than the expected, the Ex Mod will always be greater than 1.0. Taking a closer look, you can see the actual excess losses are separated from the actual primary losses and the excess losses are subjected to a weighting value. In the denominator, the expected excess losses are subjected to the same factors.

In our example we have actual primary losses, remember these are \$5,000 or less of \$215,667. The actual excess losses are a portion of each of those losses over \$5,000. In this case it is \$1,046,912.

In the denominator, the expected primary losses are \$91,264 and the expected excess losses are \$382,090.

As you can imagine, in this example, our company has greater actual losses than expected so therefore the Ex Mod is greater than 1.00. It is actually 1.65.

Why Does the Ex Mod Matter?

When your Ex Mod increases, your workers' compensation premium may also increase. Therefore we have a built-in incentive to prevent claims and keep claims as low as possible.

Why Does an Ex Mod Increase?

Of course, the first bullet is intuitive. An Ex Mod may increase when losses are trending more severe and/or more frequent. Not so intuitive is when an Ex Mod increases when recent losses are decreasing. Remember, if your current premiums or losses are trending low, you should definitely be happy; however, the current policy year's experience is not included in the Ex Mod calculation. Next, your Ex Mod may increase even when your losses are trending downward. This can occur

when your payroll is decreasing at a faster rate than your losses are decreasing. Finally, as stated earlier, your Ex Mod may increase even when your losses remain static, but the state's rating bureau have lowered the expected loss rates. If your expected losses go down, your Ex Mod can increase.

Severity vs. Frequency

It is difficult to say what matters more: frequency or severity. One thing to remember, all losses matter. But let's take a closer look at the facts.

Frequency Facts:

- If you are having a lot of losses, even if they are relatively minor, those losses will likely impact your Ex Mod more than if you had only a few severe losses.
- Why is this? The Ex Mod is designed to reward pre-loss risk control and prevention measures so that claims do not occur in the first place.
- A single claim valued at \$20,000 has less affect on your Ex Mod than 10 claims valued at \$2,000. Remember, claims over \$5,000 are discounted.

Severity Fact:

- Although having a frequency problem can drive up your Ex Mod, having a few relatively high-dollar losses will also adversely impact your Ex Mod. The company with a strong return-to-work program and good injury management are rewarded with a lower Ex Mod.

Keys to lowering your Ex Mod?

First, know the causes of your claims and take steps to prevent the claims from occurring. Later, we'll go over how to do a trending analysis to help understand where your loss dollars are being spent. Loss control programs provided by most insurance companies can assist in preventing claim. When a claim does occur, try to prevent the employee from losing time from work and keep the claim a medical only claim. Medical only claims are discounted 70% in the Ex Mod calculation.

Also, try to aggressively return your employees to work by accommodating light duty restrictions. Get to know your local workers' compensation doctors. Make sure they understand your business and the constraints of each job.

This concludes my discussion on Experience Modification Factors. Please continue to watch as I provide a few examples of how trending your work comp losses can help in focusing your loss control expenditures.

Workers' Compensation Trending Analysis

So, we'll switch gears now and look at some examples of trending that we've done for clients. By analyzing your claims, you can prevent them from occurring in the future.

There are benefits to trending and analyzing your workers' compensation claims experience. Look at the data for both frequency issues and severity issues. A study of your claims experience helps to identify where to focus your efforts. Either pre-loss, or prevention and loss control, or post loss. Understand the source or cause of your claims and how much they cost. Allocate your risk control expenditure toward preventing both frequent and severe claims. Trending assists in allocating your risk control resources.

The following pages outline trending examples. The factors we trended include injury cause, by both frequency and severity, and we trended days of the week that the claim occurred. Another factor that we trended was month of the year. Finally, a very useful trending factor is to take a close look at the claim and date of hire versus the date of loss. If, like in our example, you have 47% of claims taking place in the first year of employment, your loss control dollars may best be spent on training.

As you can see, this first trending slide outlines the number of claims within each cause category. When looking at this data, it is not clear how to best spend your loss control dollars. But let's take a look at the data in another way.

This slide outlines the percentage of total incurred dollars spent on the loss causes. The lifting injuries make up 50 cents for every dollar spent on all work comp claims. This is where the loss control budget should be spent.

As you can see on the day of week analysis, claims are somewhat evenly spread throughout the week. However, if this were a retail risk, in which deliveries are received every Wednesday, there would probably be a disproportionate number of claims on Wednesday.

Once again, this is the day of the week analysis, but this time as a percentage of total incurred dollars spent. Here you can see the loss dollars are spent on claims occurring on Wednesdays more so than any other day of the week. In this example, we should concentrate our efforts to improve and prevent losses on Wednesdays.

To further outline the importance of analyzing both frequency, or the number of claims, and severity, the cost of claims, the next two slides outline the percentage of total claims by month. As you can see, this slide shows a seasonal trend of most claims occurring in the summer months. However, for the same company, you can see the loss dollars are spread out being incurred in January, July and August.

Lastly, analyzing your employees' dates of hire compared to their dates of loss, you may find, as this company did, that 48% of their claims happened to employees with less than one year's experience. This slide tells me that loss control dollars should be spent on training.

Thank you very much for your participation today. If you'd like further information about any of the topics discussed in this webinar, don't hesitate to contact me at porbell@equityrisk.com, (312) 980-7872, or your Equity Risk Partners Account Executive. Thank you very much.

END