**How the Experience Modification Factor Affects Workers’ Comp Costs**

**Introduction: (5 minutes)**

* Welcome to WC Mastery training
  + Talk about our metrics of injury management, exp mod is main metric of premium pricing
  + Something you should know and understand, something should be able to explain to others
  + Some better with numbers than others, all should understand relationship
* Introduce 3 Major Points
  + Foundational Definitions & Concepts
  + The Mod Formula & Relationship of the Numbers
  + Leverage Mod to Lower Costs

**Main Point #1: Foundational Definitions – (25 minutes)**

* How premiums are calculated
  + Payroll x Rate x Exp Mod x Adjustments = Premium + Losses (high deduct) = Total WC Cost
    - Payroll x Rate = Manual Premium
      * Rates all employers in same class code equally
    - Adjustments: schedule credits/debits, premium discounts, other credits drug-free, etc.; or deductible discount
  + Injury management focuses on Losses, Adjustments, & Impact on Exp Mod
  + Percentage Difference
    - 0.80 to 1.2 = 50% higher premium
    - 0.60 to 1.2 = 100% (double) premium
* High Level - method for tailoring the cost of insurance to the characteristics of an employer or risk.
  + Credit report
    - Indicators performance regardless of insurance structure
  + Biggest driver of company’s premium
    - Loss Development Factor in Self-Insureds (LDF)
  + Actual vs Expected losses
    - **Better or worse than average**
  + 1.0 as pre-qualifier for bidding on projects
    - Contractors, project managers use.
  + Put insurance “out to bid” to obtain lower quote.
    - Never usually works out
    - Get better services to address the problem.
  + **Perception of Risk**
    - Responsible for how hire, train, protect, and manage injuries
  + Entire formula calculated from top line of worksheet
* Assigned by Rating Bureau
  + NCCI = 35 States, 4 monopolistic, 11 independent
  + Interstate vs Intrastate Rating
* Primary vs Excess Loss –
  + Primary- first $18,000 on any single claim (most states)
    - Varies each year, actuarial number; indexed by countrywide severity change
    - Primary = more predictable
    - Excess = less predictable
  + Excess Loss – amount greater than $18,000 on a single claim
  + Mathematical way to better predict future losses
    - Unsafe employers subsiding safe employers
  + Split rate by state
* Frequency vs Severity
  + Predictor of future losses
  + 10 - $15,000 claims vs 1 - $150,000
  + No as dramatic in Larger Premium (weighting value)
* Experience Period:
  + Last 4 policy periods, 48 months; only uses oldest 36 months
    - 3 years worth of data
  + ‘Large loss year’ with company for ‘x’ years
  + Insurers “ride mod down” until bad year rolls off
    - Overcome what loss runs show
  + Delayed gratification
    - Results on emod reduction are not immediate;
* ERA – Experience Rating Adjustment
  + 70% reduction for medical only claims
    - $1 of indemnity eliminates 70% reduction
  + decreases incentives for employers to pay MO claims w/o reporting
  + 34 States ERA Approved
    - Example: $20,000 medical only claim
      * Primary - $18,000 reduced to $6,000
      * Excess - $2,000 reduced to $600
* Unit Statistical Date
  + Most important date of policy year
    - Date claim values ‘set in stone’ & reported to Rating Bureau
  + Reserve audit prior to unistat date
    - Don’t pound on adjusters
      * Proactively manage claims
      * Ask specific questions
      * Online access to your claims is valuable
* Minimum Mod & Controllable Premium
  + Easy calculation
  + Tie into Sales to Pay for Accidents
  + Connect with leading indicators
    - RTW Ratio
    - Lag Time
  + Payroll x Rate x Emod x Adjustments = Premium
    - 100,000,000 x 0.0215 x 0.84 x 1.0 = $1,806,000
    - 100,000,000 x 0.0215 x 0.26 x 1.0 = $559,000
    - Controllable Premium = $1,247,000

**Definitions**

* Weight:
  + Amount of weight given to excess losses
  + Larger premium size is more reliable predictor of future losses.
  + Excess losses subject to ‘credibility’ factor
  + Allows possibility of lower minimum experience mod
    - Demonstrate on Excel Worksheet
* ELR: Expected Loss Rate
  + Amount of expected losses for the classification for each $100 of payroll.
  + Published in Rating Table by Class Code
* Expected Losses
  + Losses statistically expected per class code
    - Average of all losses in state for particular class code
  + (Audited Payroll x ELR) / 100
  + Prior Year Audited Payroll affects entire formula
    - Past years audit should match exactly with experience modifier
  + Can auditor easily determine payroll exclusions (must provide)
    - Overtime, double-time, severance
    - Separation of payroll
    - Executive officers
    - Certificates of Insurance
  + Proper classification
    - Effect of classification on expected losses
* D Ratio: Discount Ratio –
  + Portion of the expected losses that are expected primary losses
  + Published in Rating Table by Class Code
* Expected Primary Losses = Expected Losses x D Ratio
* Ballast:
  + Gives stability
  + Heavy material in the hold of a ship
  + Rate table data published by NCCI
* Actual Incurred & Actual Primary Losses
  + Total Paid plus reserved
  + Claim Data – From Loss Runs
    - Could be considered the “reduced” actual incurred losses in ERA states
* Stabilizing Value:
  + Sets minimum experience mod
  + Maintains balance to avoid wild swings
  + Larger the risk, generally lower “lowest possible” experience mod
* ARAP – Assigned Risk Adjustment Premium

**Main Point #2: The Mod Formula & Relationship of the Numbers– (10-15 minutes)**

What happens to mod if:

* Actual losses & actual primary losses decrease / increase?
* Actual incurred losses stay the same & actual primary losses increases?
  + Same scenario, but at a smaller company and a lower Wt value?
* Actual incurred losses stay the same and payroll increases
* A company fraudulently uses a lower priced class code to save money and actual incurred losses stay the same?

**Main Point #3: Leverage Mod to Lower Costs – (10-15 minutes)**

* + Perception of Risk – Overcoming High Mod
    - Injury management systems implemented
    - Schedule adjustments
  + Pricing with high mod
    - Percentage different
      * 50% greater or less
    - Pay back much more than cost of claim
      * Paying back 2-4x greater in premium over 3 years
      * Larger claims is why have insurance, pay back less
      * Smaller the claim, the larger amount paying back in premium
        + $5,000 – pay back $15,325
        + $100,000 – pay back $45k
        + Run scenarios using Mod Software
  + Impact on claims & amount payback with premium
    - ERA vs Non-ERA
      * ERA example (experience rating adjustment)
      * $10,000 medical only claim = $3,000 actual incurred
        + $100 in indemnity cost $10,100 in actual incurred
  + Frequency vs Severity
    - Should I pay for small claims out of pocket?
      * Net Deductible plan – excluding losses within the deductible
      * Gross Deductible – including losses w/in deductible
        + Small deductible plan
        + About 15 states allow Net, about 22 states allow Gross
      * Use injury triage to qualify
        + Can use Mod Software to analyze ‘what-if’ for deductible
      * Just not reporting is bad risk management
  + Minimum Mod & Controllable Premium
    - Easy calculation
    - Tie into Sales to Pay for Accidents
    - Connect with leading indicators
      * RTW Ratio
      * Lag Time
  + Summary of Main Points
    - Actual vs Expected
    - Primary vs Excess
    - Frequency vs Severity
    - Relationship of the Numbers
    - ERA vs Non-ERA
    - Minimum Mod