How the Experience Modification Factor Effects WC 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

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        - 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 $18,500 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 $18,500 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

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        - 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: $10,000 medical only claim
            - Primary - $10,000 reduced to $3,000
- 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 0.02 x 0.8 x 1.0 = $1,600,000
        - 100,000,000 x 0.02 x 0.26 x 1.0 = $559,000
        - Controllable Premium = $1,041,000

Definitions

- Weight:
    - Amount of weight given to excess losses
    - Larger premium size is more reliable predictor of future losses.

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    - 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

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  - 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 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
  - 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
  - ERA vs Non-ERA
      - ERA example (experience rating adjustment)
      - $10,000 medical only claim = $3,000 actual incurred

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        - $100 in indemnity cost $10,100 in actual incurred
- Frequency vs Severity
    - Should I pay for small claims out of pocket?
        - Use injury triage to qualify
            - Can use Mod Software to analyze 'what-if' for deductible
        - 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
        - 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

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