

WORK COMP INSIGHTS

Understanding Your California Workers' Compensation Experience Modification Factor

The key to calculating a workers' compensation premium is the experience modification factor, also known as your mod. Understanding your company's mod and the data used to obtain it helps you identify ways to minimize your workers' compensation premium.

Do all companies have a mod, and why does it matter?

The mod factor is a number that represents whether a company's workers' compensation losses are better or worse than average. The mod works as a credit or debit that is applied to your workers' compensation premium. A mod factor greater than 1.0 is a debit mod, which means that your losses are worse than expected and a surcharge will be added to your premium. A mod factor less than 1.0 is a credit mod, which means losses are better than expected, resulting in a discounted premium.

Numerous factors affect whether a company is experience rated. In general, very small companies may not be eligible. The mathematical determination is based on the sum of a company's payroll by classification code multiplied by the pure premium rate for that code. If this total exceeds the state's premium threshold—a number that is updated each year—then the company is experience rated.

Who calculates the mod factor?

In California, the Workers' Compensation Insurance Rating Bureau of California (WCIRB) calculates employers' experience modification factors. The WCIRB is a private, nonprofit association comprised of the

companies licensed to transact workers' compensation insurance in the state.

Outside of California, most other states use the National Council on Compensation Insurance (NCCI) to perform a similar function. However, the following states also have their own rating bureaus: Delaware, Indiana, Massachusetts, Michigan, Minnesota, New Jersey, New York, North Carolina, Pennsylvania, Texas and Wisconsin.

How is a mod calculated?

The process of calculating the experience modification factor is complex, but the underlying theory and purpose of the formula is straightforward. Your company's actual losses are compared to its expected losses by industry type. The formula incorporates factors that account for company size, unexpected large losses and the difference between loss frequency and loss severity to achieve a balance between fairness and accountability.

What is the experience rating period?

The mod is calculated using loss and payroll data for an experience rating period. The experience rating period typically includes data for three policy years, excluding the most recently completed year. For example, for a mod factor calculated on Jan. 1, 2013, data would be used for the Jan. 1, 2009-2010, Jan. 1, 2010-2011 and Jan. 1, 2011-2012 policy periods. The data for the Jan. 1, 2012-2013 would be excluded.

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Three years of data is used to provide a more accurate reflection of the losses, smoothing out the impact of any exceptionally bad or good year for losses.

The actual loss data is separated into primary and excess pools. Primary losses, which are the first \$7,000 of every loss, measure frequency. Excess losses—or amounts more than \$7,000—measure severity. The formula penalizes loss frequency by including all loss amounts in the calculation. The reason for this is that these types of claims can be controlled through proactive loss control programs. Large losses are capped at levels that can vary each year. This minimizes the impact that any single claim can have on your premium.

Expected losses are then calculated using your payroll data by class code and applying the Expected Loss Ratio (ELR). ELRs are provided by the bureau and usually updated on an annual basis. These figures are also broken down into expected primary losses and expected excess losses. Credibility factors, also supplied by the bureau and determined based on expected losses, are applied in a final step of the calculation.

How do your losses compare?

The final mod calculation compares your actual primary and excess loss figures to those expected for a company of the same size and industry type. To understand how workers' compensation losses to your business compare to state industry averages, contact Signature Insurance Group to review your experience modification worksheet.

How can you control your mod?

Your mod factor has a direct impact on your workers' compensation premium. The loss-free rating value shows you how low your mod could be if you had no losses. The key to achieving the lowest possible mod and thus controlling your insurance costs is accident prevention.

- The mod is calculated based on data reported to the rating bureau by past insurers. Incorrect or incomplete data can cause incorrect mod factors. Review loss and payroll data to ensure the calculation is complete and accurate.
- Losses remain in the experience rating formula for three years. The experience modification factor is influenced more by small, frequent losses than by large, infrequent ones.

- Develop a sound safety program, return to work program and appropriate prevention procedures to reduce loss frequency.
- An effective self-inspection and accident investigation program are critical to managing claim frequency.
- Implement an active claims management program to manage outstanding reserves and focus on efficiently resolving open claims.
- Report all claims to your carrier immediately.
- Take an aggressive approach to providing light duty to all injured employees upon their release from treatment.
- Set safety performance goals for supervisory roles. Success in achieving safety goals should be used as one measure during performance appraisals.
- Train employees on their responsibilities for safety, and enforce violations.
- Frequently communicate with employees on a formal and informal basis regarding the importance of safety.

How can your experience rating save you money?

Establishing a proactive safety program is an effective way to reduce losses, positively impacting your mod and workers' compensation premium. Contact us today at (949) 365-5100. We have the loss control experience to help you promote safety and control your workers' compensation premium.