

## Understanding Your Experience Modification: What You Need to Know

BY MEGHAN BANKHEAD, CET, CAVIGNAC & ASSOCIATES

### What is an experience modification, and how does it affect you?

Insurance is based on the theory of spreading or sharing risk by members of a group who are likely to experience losses. The losses of an entire group can be predicted with a fair degree of accuracy; however, it is not possible to determine which group members will actually suffer a loss. Because of this, the cost of insurance is apportioned to each member on the basis of average cost for the group. It is assumed that over time, each member's experience will approximate the average.

In reality, very few risks are "average." Some are much worse, and others are much better. A method is needed to allocate costs appropriately among various members of the group and at the same time provide incentives to reduce employee-related accidents.

The experience rating or modification compares an employer's claims history with those of other employers in the same industry. Insurance Code Section 11730(c) defines experience rating as "a rating procedure utilizing past insurance experience of the individual policyholder to forecast future losses by measuring the policyholder's loss experience against the loss experience of policy holders in the same classification to produce a prospective premium credit, debit or unity modification."

The experience modification has two purposes. First of all, it attempts to adjust premium levels so that the amount that the employer pays will be sufficient to cover



its losses as well as the expenses incurred by the insurance company in the process of handling the employer's workers compensation program.

Secondly, it provides the employer with an incentive to reduce losses by awarding a credit for favorable loss experience or imposing a debit for poor loss experience.

### How does it work?

**Who is eligible?** Every policyholder in the state of California that meets a minimum threshold is eligible for an experience modification. In order to qualify for an experience modification in 2011, the employer would need to generate at least \$16,700 of premium during the experience period. Note that "premium" in this context means applicable payroll multiplied by pure premium rates, not what was actually paid.

The experience period is basically the last four years, excluding the current year. (The actual "experience period" can be a little more complicated if you have had a shortened policy period, or have participated in wrap-up insurance policies during the last four years and nine

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Understanding Your Experience Modification

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months. However, if your normal anniversary date has remained unchanged, and that policy is the only workers compensation coverage your company has had, then the experience period is as described.) For example, if an employer's policy renewed on January 1, 2011, the policies used to calculate the rating would be those beginning on January 1 2007, 2008, and 2009.

**How does the formula work?** In simple terms, your "actual losses" are divided by "expected losses" and the resulting factor is your experience modification. "Expected losses" are the dollars of loss that an average employer in a specific line of business would be expected to have, given the amount of payroll reported.

If an employer's losses are lower than average, they would receive a credit modification - a mod under 100%. If an employer's losses are higher than average, they would receive a debit modification, which would be over 100%. Every insurance company writing coverage is required by law to use this experience modification.

## How does the Bureau Experience Rating Form work?

As we review this rather complex arithmetic calculation, please refer to the Experience Modification Worksheet on page five of this newsletter.

## Expected Losses

Expected Losses are calculated by taking payroll for the applicable classification for each of the three years in the experience period, totaling it, and multiplying the total (divided by 100) by an Expected Loss Rate (ELR).

Expected Loss Rates are published semi annually by the Bureau. Rates vary by classification. In the exhibit there are five classifications: Code 8742 is "Sales", code 8601 is "Engineers", code 8810 is "Clerical", etc. The ELR for 8742 is .19. This means that for every \$100 of payroll you can expect \$0.19 of losses. In contrast, code 0042, "Landscaping" has an ELR of 2.38. This means that for every \$100 of payroll you can expect \$2.38 in losses. ELR's for some construction codes can be as high as \$5.

Expected Losses, in turn, are divided between Primary Expected Losses and Expected Excess Losses. In order to arrive at Primary Expected Losses, multiply Expected Losses by what is known as a D Ratio (the D Ratio is published by the Bureau).

# RISK MANAGEMENT SEMINAR SERIES

## Mid-Year Legal Update

Friday, July 8, 2011

Registration: 8:00 am

Program: 8:30 am - 10:30 am

## First Aid and Workers Compensation

Friday, August 12, 2011

Registration: 8:00 am

Program: 8:30 am - 10:30 am

## Sexual Harassment Prevention Training

Friday, September 2, 2011

Registration: 8:00 am

Program: 8:30 am - 10:30 am

All training sessions available to our clients

\* Reserve early / seating is limited!

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Contact Darcee Nichols at [dnichols@cavnac.com](mailto:dnichols@cavnac.com) or call 619-744-0596

\* **NOTE:** Due to the popularity of our seminars and limited space available, we regret we cannot provide refunds or credits with less than 72 hours advance notice of cancellation.

Total the columns for Expected Losses (d) and Primary Expected Losses (e). Subtract (e) from (d) to obtain Expected Excess Losses (f). Expected Excess Losses equals the difference between total Expected Losses and Primary Expected Losses. The distinction between Primary and Excess is important, because the previously mentioned Experience Rating formula penalizes frequency and discounts severity.

## Actual Losses

Your Actual Losses are shown in the next table. Actual Losses are also split between Primary and Excess portions. Any losses of \$7,000 or less are the Primary portion and are weighted at 100%. However, losses greater than \$7,000, are considered excess. As you will see below, the dollars in excess of \$7,000 are discounted by the W factor. This discount is taken from all claims over \$7,000. For Example, the second claim on the

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example experience modification incurred a loss of \$65,018. However, the rating formula discounts severity and penalizes frequency. Although this claim has an "Actual Incurred Loss" value of \$65,018, the Primary Actual Losses go in at \$7,000. The rest of the claim goes into the Actual Excess portion of the calculation, which is discussed below.

The Bureau also tracks Claim Status. There is a column entitled "O" or "F". "O" stands for Open, and "F" stands for Final. In this instance, Claim 2 was still open at the time the modification was calculated. Finally, the Policy Year references the year in which the claim took place (1/1/07-08 for Claim 2).

Total the columns for Actual Incurred Losses (a) and the Primary actual Losses (b). Subtract (b) from (a), which will give you the Actual Excess Losses (c).

## Rating Procedure

The calculation is the final element of the worksheet. Remember that you are taking actual experience and dividing it by expected experience.

Total Primary Actual and Total Expected Losses come straight from the tables above the Rating Procedure.

The Ballast, or "B" value, is calculated by the Bureau and placed in the top and bottom portions of the formula to mitigate the impact on small employers of infrequent large losses. The "B" value is determined by an employer's size, and will keep a single large loss from overwhelming the small amount of Expected Losses assigned to smaller employers and causing a dramatic upswing.

A Weighting Value, or "W Value" is utilized in the experience rating formula to determine the percent of actual excess losses to be used in the calculation. The W Values for smaller companies can be zero. The larger the company, the higher the W value. This recognizes that excess losses, especially for smaller companies, are less "credible". The larger the firm, the more control it should have over excess losses, which is why they are factored into the equation for larger firms.

Ratable Excess Losses are the actual excess losses (c) multiplied by the W Value. In our example, the W Value is .20. This means that Excess Losses are charged at 20% of their total as opposed the Primary Losses, which go in at 100%. The final item in the numerator (the top part of the equation) is calculated by taking 1-W and multiplying it by the Expected Losses (f). In this case, since  $W=.20$ , this item is \$76,071.

When you divide the top and the bottom figures, the result is the employer's experience modification. In this

case, it is 142%.

Remember that the formula penalizes frequency and discounts severity. In other words, an employer is supposed to have more control over "claim frequency" as opposed to "claim severity".

For example, the employer represented by the attached worksheet has a claim valued at \$65,018 and a mod of 142%. If however, that same employer had six \$10,000 claims and one \$5,018 claim equaling a total of \$65,018 instead, the mod would be 168%. If the premium of the sample employer is \$100,000, the difference between 142% and 168% equates to \$26,000 in premium for one year, and \$78,000 in premium for the three years those claims will affect the mod, despite the fact that the total incurred losses were the same.

Note that if the employer had no claims, its modification would be 63%.

## What does this mean to you?

With Workers Compensation, as with other lines of insurance, you ultimately end up paying for your own losses. The experience modification ensures that those who suffer more losses than others pay a higher premium. In the example we have used, if the employer had a unity, or 100% modification, they would pay \$100,000. If that same employer had no claims, they would have a best case rating of 63% and would pay \$63,000 in premium. In the sample attached, the employer's claim frequency and severity has increased their rating from a best case of 63% to 142%, meaning they are going to pay \$142,000. As we also saw, if those same claim dollars were spread out over more claims, increasing the employer's claim frequency (which is penalized) and decreasing claim severity (which is discounted), the rating would increase even more, to 168%, which would increase their premium by another \$26,000. The difference in premium between the best case mod of 63% and the actual rating of 142% represents \$79,000 per year in premium dollars that the example employer could eliminate by improving their claims experience. This, in and of itself, is reason to invest in preventing injuries and managing claim costs. In addition to this, having a mod over 100% can make it more difficult for construction companies to bid work, and all employers with experience modifications over 125% will be assessed penalties by OSHA (see sidebar).

Your workers compensation experience modification can have a significant impact on what you pay for workers compensation insurance. In order to effectively manage your experience modification, you need to not only understand how it works; you need to implement risk control techniques in the areas of human resources, loss control and safety, and claims management, in order to

## One Page Brief: Targeted Inspection & Consultation Fund

- Created by Labor Code 62.7 and 62.9 as a special account in the state treasury.
- Those insured employers having a workers' compensation experience modification rate (ExMod) of 125% or more and those private self insured employers having an equivalent workers' compensation experience modification rate of 125% or more will be assessed a fee and payments will go into this fund
- Assessment calculated by total payroll reported to workers' compensation carrier.
- Assessments are made annually.

Workers' Compensation Payroll Range	Assessment Amount
Less than 250,000	\$100
\$250,000 to \$500,000	\$200
\$500,001 to \$750,000	\$400
\$750,000 to \$1,000,000	\$600
\$1,000,001 to \$1,500,000	\$800
\$1,500,001 to \$2,000,000	\$1,000
\$2,000,001 to \$2,500,000	\$1,500
\$2,500,001 to \$3,500,000	\$2,000
\$3,501,000 to \$4,500,000	\$2,500
\$4,500,001 to \$5,500,000	\$3,000
\$5,500,001 to \$7,000,000	\$3,500
\$7,000,001 to \$20,000,000	\$6,700
\$20,000,001 and above	\$10,000

- Assessment notice provides the Ex Mod used for the calculations.
- Can dispute questionable Ex Mod calculations with your broker or workers' compensation carrier.
- Can dispute payroll calculations: contact workers' compensation carrier to verify payroll accuracy for the identified year.
- Must pay fine even if dispute or risk a 25% late penalty.
- Assessment funds are used to support Cal/OSHA's High Hazard Employer Program. This program provides consultative assistance to employers with high Ex Mods.



### Understanding Your X-Mod (Continued from page 3)

lower the frequency and severity of the claims that drive the rating. Your insurance broker should be working with you to implement these techniques.

The more you understand your experience modification and how it is calculated, the better you can control it. We would welcome the opportunity to answer any questions you might have.✂

**Disclaimer:** This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

## Full Service Surety Department

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**San Diego, CA**  
**2011 WCIRB Worksheet Abstract**

Prepared for:

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**EXPECTED LOSSES**

CLASS CODE	2009 PAYROLL	2008 PAYROLL	2007 PAYROLL		ELR	EXPECTED LOSSES	"D" RATIO	PRIMARY EXP LOSSES	
0005	477,545	498,553	337,029		2.07	27,182	0.22	5,980	
0042	1,059,807	1,152,577	924,066		2.38	74,648	0.21	15,676	
8601	2,392,860	2,472,134	1,952,863		0.18	12,272	0.21	2,577	
8742	183,225	167,226	170,729		0.19	990	0.21	208	
8810	1,115,291	1,163,361	1,155,835		0.17	5,839	0.24	1,401	
					<b>EXPECTED EXCESS (f)-(d)-(e)</b>	<b>EXPECTED LOSSES (d)</b>	<b>PRIMARY EXP LOSSES (e)</b>		
					95,089	120,931	25,842		

**ACTUAL LOSSES**

CLAIM NUMBER	TYP INJ	O F	PLCY YEAR	ACT INCURRED LOSSES	PRIMARY ACT LOSSES	CLAIM NUMBER	TYP INJ	O F	PLCY YEAR	ACT INCURRED LOSSES	PRIMARY ACT LOSSES
*07-08	X	C	2007	636	636	Claim 1	N	C	2007	28,032	7,000
Claim 2	X	O	2007	65,018	7,000	*08-09	X	C	2008	700	700
Claim 3	N	O	2008	49,501	7,000	*09-10	X	C	2009	3,312	3,312
Claim 4	X	C	2009	3,876	3,876	Claim 5	X	O	2009	77,126	7,000
Claim 6	X	C	2009	2,033	2,033	Claim 7	X	O	2009	63,334	7,000
				<b>ACTUAL EXCESS (c)=(a)-(b)</b>	<b>ACTUAL INCURRED LOSSES (a)</b>	<b>PRIMARY ACT LOSSES (b)</b>					
				248,011	293,568	45,557					

**RATING PROCEDURE**

TOTAL PRIMARY ACTUAL (b) 45,557	"B" VALUE 0	"W" VALUE 0.20	RATABLE EXCESS LOSSES =W x (c) 49,602	(1-W) x (f) 76,071	TOTAL (g) 171,230
120,931 TOTAL EXPECTED LOSSES (d)	0 "B" VALUE				120,931 TOTAL (h)
					142 % EXPERIENCE MODIFICATION (g)/(h)



Articles courtesy of Cavignac & Associates Employee Benefits Department

## LIVE WELL, WORK WELL

### Home Safety Month

June is Home Safety Month and it's the perfect time for you to make sure your home is as safe as possible for you and your family. The Home Safety Council provides the following tips to help you avoid various hazards in your home:

- Put a non-slip mat in your shower.
- Keep stairs clear of clutter and ensure proper lighting at the top and bottom. Use safety gates if you have young children.
- Make sure you have sturdy handrails on all stairs (indoors and outdoors).
- Wipe up spills when they happen.
- Keep the Poison Control phone number (1-800-222-1222) by each telephone and programmed into your cell phone.
- Install smoke and carbon monoxide detectors and regularly check the batteries.
- Read labels of all products you use in your home. Any that say "caution," "warning" or something similar should be stored away from children, either locked up or on a high shelf.
- Keep all medications out of reach of children. Make sure they are not in purses, pockets or drawers where children could easily access. Keep original label on all medication and cleaning supplies.
- Always stay by the stove or grill when cooking.
- Keep grills at least 10 feet away from your house, garage and any trees or bushes. Keep children and pets away.
- Only light candles when an adult is in the room, and never leave candles burning unattended.

- Have a fire escape plan and hold a fire drill with your family. Make sure all adults in the house know how and when to use a fire extinguisher.
- If you have a pool or hot tub, install a fence around it.
- Always watch children carefully when in the bathtub or pool, even small, child-sized pools.



### Easy Calorie Burning

Looking for an easy way to increase the number of calories you burn each day? Try tapping your foot or twiddling your thumbs! Research shows that people who consistently fidget while sitting burn more calories than those who sit still.

Other ways to boost calorie burning while at your desk or on the couch include:

- Standing up while talking on the phone
- Focusing on maintaining good posture
- Bouncing your leg or tapping your fingers
- Doing neck, arm or leg stretches

# Community Bulletin Board

*"Neighbors helping neighbors in San Diego"*



## Monarch Schools

✦ Web Site

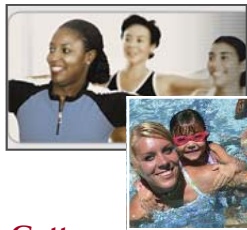


✦ Web Site



✦ Web Site

✦ Questions? Contact **Alicia Gettys** by phone at **619-232-7451** or e-mail **agettys@ymca.org**



### Mission:

To provide quality and compassionate services for the survival, health and independence of seniors living in poverty

✦ Web Site



The San Diego Police Foundation supports the men and women who "protect and serve" by raising community awareness of important unbudgeted or "discretionary" needs that will improve crime-prevention and law enforcement efficiency. The Foundation puts your tax-deductible contributions to measurable work in local communities.

✦ Web site

✦ For more information, contact **info@sdpolicefoundation.org**



✦ Web Site

✦ Questions? E-mail **info@SDArchitecture.org**



### Mission:

The Society for Design Administration advances management and administrative professionals in the A/E/C industry through education, networking and resources.

✦ Web Site

✦ For more information, e-mail **vicepresident@sdasandiego.org**