

# Your Risk...Your Choice

## Workers' Compensation Modification Factor

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*The experience rating process used by the National Council on Compensation Insurance (NCCI) is complex, but the underlying theory and purpose of experience rating is simple.*



An Experience Modification Factor (mod) is a rating that determines how an organization's loss experience compares to the expected loss for your industry. A modification higher than 1.0 indicates loss experience higher than expected and, conversely, one lower than 1.0 indicates better than expected losses. The end result is that you can pay more or less for Workers' Compensation premium based upon how your loss experience compares to expected losses. Many companies interpret a rating of 1.0 as "good," when it actually means that your loss experience is average for similar types of risks. Every organization should aspire to have a modification factor below 1.0 to achieve the following benefits:

- Lower insurance costs
- Improved productivity
- Less workplace stress
- Good working morale

A basic understanding of your experience rating worksheet will help you to identify the following:

- Minimum mod for your company
- Contribution of loss frequency and/or severity to your mod
- Whether your severity or frequency is better or worse than the competition
- Impact of specific loss to your premiums
- Actions you can take to affect the ultimate cost

### The basics

The experience mod is computed using three years of loss data, excluding the most current year. Three years provide a more accurate analysis; the current year is excluded because losses are not fully developed until year end. For example, a 2009 modification uses loss data from 2006, 2007 and 2008, assuming a January experience rating date.

The simplified formula is:

$$\text{Mod} = \text{Your company's losses} \div \text{Average company's losses.}$$

For each four-digit code, NCCI determines the expected losses. A second computation breaks the losses into primary and excess losses. This split rating is important because of the impact primary and excess losses can have on your mod. Primary losses measure frequency and the first \$5,000 of each loss, while excess losses measure severity of losses above \$5,000, which are greatly discounted later in the calculation.

NCCI publishes two types of ratios: an expected loss ratio (ELR) and a D ratio. The ELR determines the expected losses based upon a factor multiplied by payroll per \$100 for each four-digit classification. The D ratio determines the percentage of expected losses that will be classified as primary. *(An important note: you can significantly improve your mod score by focusing on primary losses.)*

Two major changes to mod calculation occurred in 1998: first, the weighting value table was changed from .63 to .80. This increases the emphasis on actual excess loss experience of larger companies. Secondly, medical-only claims were reduced by 70%. This significant change eliminated the advantage of not reporting small medical-only claims. *(Note: if you still use the old calculations, please talk to your broker; you may be in violation of state law, which could adversely affect your current modification.)*

It is important to verify that your broker understands your modification and is able to assist you with the analysis. SilverStone Group provides a rating system that can help you make decisions based on the following criteria:

- Definition of your perfect mod
- Determination of the percentage of your mod controlled by loss experience
- Identification of types of loss that contribute to your mod factor
- Development of loss cost analysis by body part and injury type
- Calculation of each claim's cost for a 3-year period, which will help identify the real cost of losses
- Identification of repeat claimants and the impact they have on your bottom line
- Development of implementation plans and determination of premium savings that can be achieved by improvement in overall loss experience

The wise allocation of an organization's finances to prevent loss has the potential to lower insurance premiums while allowing you to control resource utilization. Being proactive and planning ahead is far more cost effective than dealing with a skyrocketing experience modification factor. If you have questions about strategies to control your workers' compensation premium, we're here to help.