In workers' compensation, the experience modification is the critical component of the premium calculation. Even so, it is often misunderstood by the employers who receive these experience ratings.

WHY ARE EXPERIENCE MODIFICATIONS USED?
Workers’ Compensation is a class rated insurance program. That is, within a state, an insurance company applies the same rate to all employers who fall into a given class. For example, all plumbers are subject to the plumbing rate, all truck drivers are subject to the truck driver rate, etc. The rate applied in each class is an average rate, and does not recognize any individual characteristics of the employer. Because of this, there is a need for a statistically supported means of differentiating one business in a given class from another, for the purpose of determining policy premiums. This is where experience rating comes in—the great equalizer.

WHERE DOES THE INFORMATION COME FROM?
Because workers' compensation coverage is mandatory, it is an industry that is rich with statistical information. Each state subscribes to an independent statistical organization or bureau, to gather and analyze data and trends in the industry. For most states, this organization is the National Council on Compensation Insurance (NCCI), although some states have their own bureaus. Every year insurance companies are required to submit to the NCCI or state bureau information for each employer they insure. These reports, known as unit statistical reports, include classification codes, audited payrolls by class, premium and claim information. The statistical organization then collects the data, which allows it to predict expected losses for each payroll classification based on the historical performance of that business class.

WHAT IS AN EXPERIENCE MODIFICATION FACTOR (EXPERIENCE MOD)?
An experience mod is a factor that is calculated for each employer who qualifies (typically premium in excess of $10,000 or a 3 year average premium of $5,000, depending on the state). The mod factor is a value that compares the claim profile of the employer to the claim profile that would be expected of an employer of similar size (payroll) in the same industry (class codes). A value of 1.00 is average, meaning the frequency and severity of actual losses equaled the expected losses. A mod factor greater than 1.00 means the employer experienced worse than expected losses during the rating period, and a mod of less than 1.00 indicates the employer’s losses were better than expected for the rating period.

HOW IS THE MOD CALCULATED?
An individual employer’s experience mod is calculated using claims data from the three most recently completed years, excluding the expiring term. To determine a 2003 mod, payrolls and claims from 1999, 2000 and 2001 will be included. First, each claim’s incurred (paid plus reserved) value is listed. Next, the frequency of claims is evaluated. An organization with one $25,000 claim will fare better than one with five $5,000 claims. In spite of the equal dollar amount, the second organization is more prone to claims. Therefore, for any claim over $5,000, only a fraction of the amount in excess of $5,000 is used in the formula. Also, in some states only a percent of the ‘medical only’ claims are used in the formula, further adjusting the calculation which puts more weight on frequency of claims than severity of claims. Finally, these adjusted claims are compared to the expected losses for the class and size of the organization, which ultimately determines the experience modification factor assigned to the individual employer. Credit mods (less than 1.00) reduce premium, while debit mods (greater than 1.00) result in a premium surcharge.

HOW CAN AN EMPLOYER REDUCE THEIR EXPERIENCE MOD?
First, create an environment of safety. Frequent losses are heavily weighted in the calculation. What’s more, frequent losses often result in the occurrence of a severe loss. An employer that invests in eliminating work related losses will save in the long run. In addition, it is important to check the calculations on the experience modification worksheet each year. Most calculations are correct, but mistakes can occur. Common mistakes include inaccurate, outdated or incomplete data provided to the statistical rating bureau. The most common errors are incorrect or incomplete payroll data, missing data for a year or portions of a year, and claims included at the wrong amounts or even claims that belong to another employer. Experience mods can be recalculated if there is a clerical error, there is a recovery from a third party, or a claim that has been reported is found to be noncompensable by an official ruling. You can obtain your experience mod worksheet through your agent, or directly from the rating bureau. It’s a good idea to review each year to make sure the data being reported is correct, and to understand how workers’ compensation losses to your business compare to state industry averages.