



Workers' Compensation Experience Rating

At LCIS, we frequently receive questions from employers wanting to have a better understanding of the experience rating process. How do I qualify for an X-mod? What does it mean? What claims are included in the calculation? So perhaps this is a good forum to provide an overview of the process.

What is the purpose of experience rating? Experience rating is an objective method of establishing fairness in workers' compensation premiums for employers within the same industry. It uses actual loss results to establish experience modifications (X-Mods) for individual employers and compares an individual employer's loss results to the industry average. An employer with a 100% X-mod reflects that the employer's loss results are "average" for its industry. An X-mod less than 100% reflects that the employer's experience is better than the industry average and an X-mod over 100% reflects below average results. The X-mod is considered a reliable predictor of future claims experience.

How does an employer qualify for an X-mod? Not all employers qualify for experience rating. In fact less than 20% of all California employers have X-mods. Through 2015, in order to be eligible for experience rating, an employer must develop a minimum amount of "pure premium" within a 3-year period of time (pure premium rates are established by the insurance commissioner). Effective 2016, "expected loss rates" for the pure premium rates. As a rule of thumb for the landscape industry, if an employer has payrolls in the 0042 landscape class code totaling \$300,000 over the 3-year period, it will qualify for an X-mod. Employers do not have to "apply" to be experience rated. Every insurance carrier files statistical data with the WCIRB, who reviews every employer each year to determine eligibility for experience rating. Due to fluctuations in the pure premium rates (and expected loss rates) and employers' year-to-year payrolls, it is possible for an employer to have an X-mod one year, but not the next. Experience rating is mandatory for all employers who qualify, and *all insurance carriers must utilize the existing X-mods in their policies.*

How does the X-mod impact WC insurance rates? The impact of the experience rating process is that, with all other factors being equal, an employer with a higher X-mod will pay higher premium rates than an employer with a lower X-mod. It is not quite this simple, but a business with a 150% X-mod might wind up paying double the premium of a competitor whose X-mod is 75%. This puts the business with the lower X-mod at a distinct advantage when it comes to bidding on a job. Some businesses and municipalities will not contract business with employers with high X-mods because it may reflect unsafe work practices. Employers with X-mods of 125% and higher are assessed fees to fund Cal-OSHA's Targeted Inspection and Consultation Program.

The experience rating process provides a strong financial incentive for employers to reduce the frequency and severity of work-related injuries.

How is the X-mod calculated? Every carrier files reports with the WCIRB providing payroll and claims results for your expired policy periods. The claims data is reported using the values of the claims as of 18 months after the policy inception (in most cases this will be 6 months after policy expiration). Closed claims are reported by the carrier at the actual claim cost (excluding claim expenses such as defense costs). Any claims still open at the valuation date are valued at the insurance carrier's reserves. These reserves are the carrier's best estimate of the ultimate cost of the claim. This process is repeated at 30 months post policy inception, and then again at 42 months post-policy inception. These second and third filings use the claims values as of those later dates. So an employer with a policy inception date of 4/1/2012 will have the claim values reported as of 10/13, 10/14 and 10/15 that would be used to calculate X-mods for 4/1/14, 4/1/15 and 4/1/16.

The precise X-mod formula is rather complex but it is essentially the ratio of the employer's actual losses to the expected losses for that employer. Thus the experience modification can be expressed as the following formula: **Experience Modification = Actual Losses / Expected Losses.**

From this formula, you can tell that the higher the actual losses an employer has, the higher the X-mod will be. Expected losses are calculated by multiplying employer payrolls by an expected loss rate for the industry (approved by the insurance commissioner). So higher payrolls result in higher expected losses and this can decrease the X-mod.

Here are some other common questions...

1. **My X-mod is high. How do I get it down?** The claims and payroll data that is used in the X-mod calculation is from the last 3 completed policy years. Each year, one year of data falls off and is replaced by the newest completed policy-year of data. So you need to replace each year that falls off with a better year. To do this, you need to look at your safety practices and procedures, hiring practices, training, modified work program, medical control (use of the Medical Provider Networks) and anything else you can think of to reduce the frequency and severity of claims.
2. **I had an X-mod last year, but not this year. Why?** Each year, the WCIRB checks your eligibility for an X-mod. If your payrolls have fluctuated or the pure premium/expected loss rate threshold established by the state changes, an employer can have an X-mod one year, but not the next.
3. **I have never had any claims. Why does my X-mod change?** If your payrolls change, the expected loss portion of the calculation would change and this could cause fluctuations in the mod. If your payrolls stay the same, your mod could also change as the state's expected loss rate changes each year. You are being compared to the industry average, so as the industry average goes up or down, your relationship to that average may change also. That industry average is a moving target.

- 4. None of the claims filed against me are legitimate. Why are they in the X-mod?**
Disputes regarding the validity of claims often arise. The California Experience Rating Plan requires that these claims be included in any X-mod calculations. However, if those claims are ultimately judged to be entirely non-compensable claims by a Workers' Compensation judge (or a claim is denied and the denial is not contested by the claimant), the claims will be re-coded by the insurer as non-compensable claims and any X-mods that used those claims in the calculation will be retroactively revised. Any premiums you paid that were impacted by those X-mods will be recalculated.
- 5. What about motor vehicle accidents caused by someone other than my employee?**
These claims will also be included in your X-mod. However, if the Claims Administrator is successful in recovering from the responsible party (subrogation), the insurer must credit the file with the amount of the net recovery and file a correction with the WCIRB on that claim. The WCIRB will then revise the X-mods impacted by that claim and premiums you paid that were impacted by the higher X-mod will be revised.
- 6. I have heard that the number of claims I have impacts my X-mod more than large claims. How does that work?** While the method of calculating an X-mod does not actually include using the number of claims filed, the frequency of claims does play a significant role in the calculation. All claims valued at under \$2001 are lumped together by policy year and the full value of these smaller claims is used in the X-mod calculation. For claims valued at \$2001 or more, the claims are identified individually and the values of these larger claims are discounted. Having 5 small claims of \$2000 each would more severely impact an employer's X-mod than one claim valued at \$10,000. Still, anyone who has had a high X-mod can likely tell you that large claims are still a major factor in the X-mod process.

The Workers' Compensation Insurance Rating Bureau (WCIRB) website has some tutorials that help employers to better understand the Experience Rating process, as well as other WC Fundamentals:

http://www.wcirb.com/online_learning/WC_Fundamentals_for_Employers/WC_Fundamentals_for_Employers.htm.

If you would like to have a better understanding of the experience rating process or an analysis of your individual X-mod, please contact the LCIS Claims Team.