



December 2009

## CHANGES COMING SOON TO YOUR X-MOD

### WHAT

On November 9th, Insurance Commissioner Steve Poizner approved the following changes effective January 1, 2010 to the California Workers' Compensation Experience Rating Plan (ERP):

- Expected Loss Rates (ELR) have been enhanced to reflect current statewide trends within the North American Industrial Classification System
- The Experience Rating formula has been modified to utilize a "single split" approach to segregate claims into their primary and excess components
- The ERP credibility values ("B" and "W") have been revised

### WHY

These changes are being implemented as a result of recommendations by the Experience Rating Task Force, formed at the request of Commissioner Poizner in 2007 and consisting of a broad array of members including the Worker's Compensation Insurance Rating Bureau (WCIRB). The changes are intended to accomplish the following goals:

- Simplify the experience rating system
- Improve its predictive accuracy
- Enhance its ability to provide a financial incentive for workplace safety

### DETAILS

#### Expected Loss Rate Changes

- ELR's represent the average loss per \$100 Payroll by Classification; these rates are the basis by which an employer's actual losses are compared in the experience rating

- Each year the ELRs for each individual class code are adjusted to reflect the anticipated cost of benefits for the upcoming term.
- This year the WCIRB enhanced the methodology to compute each class code's ELR in an effort to improve accuracy.
- As summarized in Exhibit A on the following page, a sample of construction class codes reveal an average decrease of 15% in ELRs from 1/1/09 to 1/1/10.
- If claims remain consistent, a decrease in ELRs will result in a commensurate increase in a firm's x-mod.

#### Single Split Formula

- The occurrence of past claims tends to be more statistically predictive of an employer's future claim frequency and less of a predictor of claim severity. As a result, the incurred loss amount reported for each individual claim is split into a "primary" and "excess" component. The "primary" component is related to claim frequency whereas the "excess" component relates to claim severity.
- In the past, losses were split into primary and excess components using a complex algebraic formula. Claims \$2,000 and under were valued at their actual loss amount while claims over \$2,000 were discounted to reflect an adjusted "primary" amount.
- The revised "single split" approach simplifies the process by considering the first \$7,000 of a claim's value as the primary component and any remainder as the excess.
- The effect of this change is to place greater emphasis on the frequency of claims rather than the severity, which was always a main objective of the plan.



### Revised Credibility Values

- The credibility values ("B" and "W"), which reflect the statistical reliability of an employer's past claims to predict future experience, have been updated.
- The combined impact of both the "single split" formula and revised credibility value changes are forecasted to improve the predictive accuracy of experience rating by roughly 12%.

### IMPACT ON CONTRACTORS

As Contractors are well aware, their Experience Modifier can have a significant impact on their business as it is a driver for worker's compensation premium and pre-qualification requirements. Though individual experience will vary, we are seeing a general increase in x-mod calculations for the Construction industry as a result of the changes. Specifically, the greatest impact is occurring on claims valued between \$2,000 and \$25,000.

### EXHIBIT A

	1/1/2008	1/1/2009	1/1/2010	1/1/2008-09	1/1/2009-10
Workers' Compensation Class Code	Expected Loss Rates (ELR)			% Change in ELR	
5213 - Concrete Construction - Foundations	2.73	2.76	2.72	0%	-1%
5432 - Carpentry - Equal or Exceeds \$24	2.12	2.57	2.39	13%	-7%
5506 - Street/Road Construction - Paving	2.32	2.56	2.34	1%	-9%
5507 - Street/Road Construction - Grading	2.05	1.71	1.07	-48%	-37%
5606 - Executive Level Supervisors	0.68	0.57	0.48	-29%	-16%
6220 - Excavation & Grading	1.39	1.68	1.40	1%	-17%
6308 - Sewer	2.41	2.34	2.19	-9%	-6%
6316 - Gas & Water Mains	2.04	2.46	1.73	-15%	30%
6325 - Conduit Construction	2.35	1.99	1.99	-15%	0%
8227 - Construction/Erection Permanent Yards	3.27	3.59	2.67	-18%	-26%
8742 - Outside Sales	0.27	0.25	0.20	-26%	-20%
<b>TOTAL</b>	<b>Average % Change</b>			<b>-13%</b>	<b>-15%</b>

### CONCLUSION

In summary, the new formula is expected to reduce some of the inherent volatility, incentivize workplace safety and improve the accuracy of employer's experience modifier. As always, Contractors can best control their own destiny by enforcing a strong safety program and culture. In order to better understand the specific impact of these changes to your organization, contact your Woodruff-Sawyer Account Executive.

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