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Experience Rating Made Easy!

Manage Your Mod



WHAT'S UP WITH THE MOD? TEN REASONS IT MAY INCREASE

The number one complaint we hear about experience rating is an unexpected increase in the workers compensation mod factor. In fact, this problem is one of the strongest motivations for subscribing to ModMaster: insurance and risk management professionals use the software to forecast the mod and thus avoid any surprises.

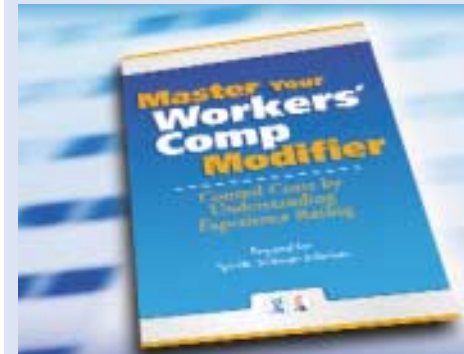
Obviously, when losses go up, the mod generally follows suit. But there are many other situations that can cause a mod increase. This article outlines those reasons so that you can anticipate and explain this unwelcome situation.

First, a very brief explanation of experience rating is in order. The mod is computed by comparing actual losses to expected losses. The time frame for this comparison is called the experience rating period. It is typically a three year period that excludes the most recently completed policy. For example, a mod effective 1/1/2006 would use data from 1/1/2002 – 12/31/2004.

Expected losses are computed using payroll and rates (called expected loss rates) for each job classification code. Actual

Insurance and risk management professionals use ModMaster to forecast the mod and thus avoid any surprises.

losses are limited according to a state loss limit and then split into primary and excess. In most states, the primary is the first \$5,000 of loss and the excess is any remainder of the loss amount which exceeds \$5,000. The mod computation also uses ballast and weighting values designed to make the formula more "fair."
(cont. 2)

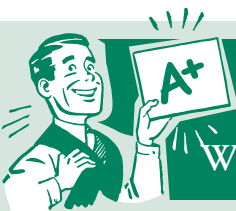


MASTER YOUR WORKERS COMP MODIFIER

With minimal industry jargon, this booklet and the associated website QuickMod.com can save you or your client thousands of dollars in workers compensation premiums by teaching you:

- An introduction to experience rating
- The experience rating process and formula
- How to analyze your mod
- Tips for controlling your mod
- How to use QuickMod.com or ModMaster software to serve your clients

For more information visit:
www.specificsoftware.com/ModBooklet



MODMASTER TOUTED IN AMERICAN AGENT AND BROKER AS "MIGHTY TOOL" WITH "BEST TECHNICAL ASSISTANCE"

ModMaster version 4 is praised in the article "Finding programs that can boost agent productivity" in the June 2005 issue of American Agent and Broker. Writer Charlie Epes, CIC, vice president and team leader of administration for the Gernold Agency Inc, says, "We entered

five years of loss data from 43 states to make sense of the interstate experience mod for a major client. The software lets you play 'what-if' with claim thresholds, and that's just the start. The reports helped our client keep a huge contract."
(cont. 2)

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ModMaster Touted...

For Charlie's complete comments about ModMaster functionality and support, plus many other software tools that might benefit your office, see the American Agent and Broker article: "Finding programs that can boost agency productivity" on the web in [ARTICLE ARCHIVES](#): June 2005 at www.agentandbroker.com

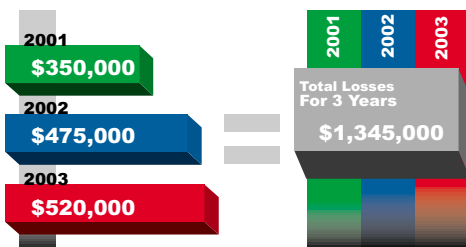
Charlie's comments about ModMaster are near the end of the article, just before the heading "Present and future tense."

What's Up with the Mod?

A change in any of the components in the formula will, of course, change the mod. The list below details ten specific scenarios that can result in a mod increase.

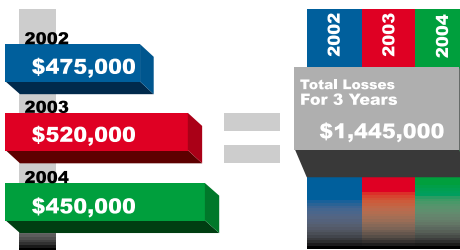
#1 – An overall increase in losses. It may sound obvious that if losses increase, the mod will increase. However, this scenario is sometimes not as straightforward as it appears. It is not unusual for us to have clients call because their losses have decreased from one year to the next, but their mod has gone up. How can that be? Let's look at this example:

Let's suppose that last year's mod, effective 1/1/2005, included the following loss data:



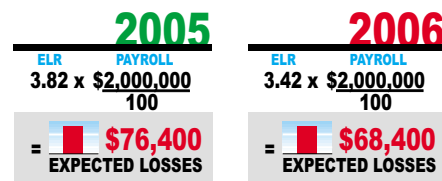
The agent who took over the account at the end of 2003 implemented some loss control and loss prevention measures. Losses in 2004, as compared to 2003, improved dramatically to \$450,000. So the client expectation was that the mod would go down, perhaps significantly.

Instead the mod increased because the total losses in the experience rating period increased:



The year that came into the experience rating period (\$450,000 for 2004) has to be better than the year leaving the period (\$350,000 for 2001) in order for the mod to go down. This was not the case in this example, so the total losses in the three year experience rating period actually increased.

#2 – A change in expected loss rates. The expected loss rates (ELRs) used in a mod calculation represent the expected losses that will occur per \$100 of payroll for each job classification. ELRs are determined by the individual states and are typically updated once per year. If the loss and payroll amounts in a mod calculation remain similar from one year to the next, a mod increase can still occur due to new expected loss rates. For example, payroll code 2095 in Illinois had an ELR of 3.82 in 2004 and an ELR of 3.42 in 2005.



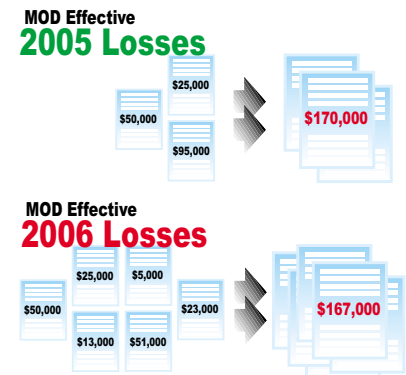
Even if losses didn't change from 2004 to 2005, the mod would increase due to the less favorable ratio of actual losses to the new lower expected losses.

#3 – A change in job classifications, or the amount of payroll per classification. Even if losses are remaining stable, a change toward more payroll in job classification(s) with lower expected loss rates can cause the mod to increase. For example, if an organization hires more

office staff while payroll for riskier job classifications stays the same or even decreases, the net result can be lower expected losses. If the actual losses do not decline, then the mod will increase. The confusion comes when you simply look at this calculation from a summary level: payroll is up, losses are stable, and therefore you would think that the mod would go down. But a deeper analysis shows that lower ELRs are being applied to more payroll, so expected losses are down and the mod may be up.

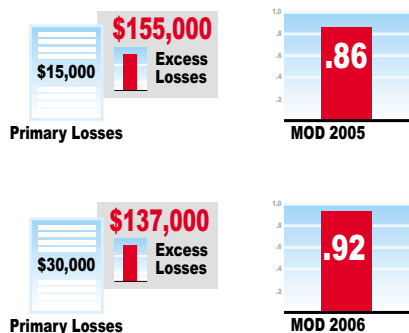
#4 – A decrease in payroll. If a business is no longer growing and its payroll decreases, you might expect that actual losses will decrease as well. However, there is a tendency for businesses to experience more workers compensation claims as they begin to close operations or layoff workers. Even in situations where both payroll and losses are decreasing, it is often the case that expected losses will decrease faster than actual losses and the mod will thus go up.

#5 – A change in the primary/excess mix of losses. Over time, the mix of losses in a calculation can change in a way that increases the mod. Even if total expected losses and total actual losses are remaining at about the same level from year to year, there are several ways that changes in the specific losses can cause the mod to increase. Below is one example of how this might occur.



For the 2006 mod, the losses have actually decreased, so we would expect the mod to decrease, right? But when we see that the mod has gone up, we look clos-

er at the losses and find that the amount of primary losses (the first \$5,000 of each claim) has increased due to the additional number of claims. In this case, the mod will go up even though the total losses have come down. A closer look at the distribution of primary and excess losses explains what happens:



As more losses move to the primary category, the mod increases. This is because primary losses have a larger impact on the mod than excess losses.

#6 – A change in the amount of medical-only claims. In most states, medical-only (IJ code type 6) claims are reduced by 70% before the mod is computed. Therefore it is important to keep losses medical-only if possible. Even though total losses may be about the same from one year to the next, a slight shift in the medical-only status of the claims will have a dramatic impact on the mod. If the number of medical-only

losses decreases from one experience rating period to the next while the overall number of losses remains about the same, then a mod increase is almost certain to happen.

#7 – An increase in the state loss limit. The state loss limit varies by state but ranges from \$71,500 to \$225,000. Losses greater than the loss limit are reduced to the limit for the mod calculation. In most states, the loss limit tends to increase each year. An increase of \$10,000 or more is not uncommon. If a mod calculation includes one or more losses that exceed the loss limit, then a change in the loss limit will increase the amount of losses used to compute the mod. For example, a \$150,000 loss may contribute \$125,000 to the calculation in 2004 but contribute \$137,000 in 2005 due to a change in limits. If everything else is held constant, this will result in a mod increase.

#8 – A change in the weighting table. The weighting value determines the percentage of actual excess losses that are used in the mod calculation. This value generally ranges from 0.04 (for the smallest risks) to 0.80 (for the largest risks). This table is specific to each state and is typically revised each year when the expected loss rates are revised. Weighting value changes alone can cause an otherwise stable mod to increase – we’ve seen this happen. To check for this

yourself, compare the “W” value shown on the bureau report for each experience mod. If there is a considerable variation in the “W” value while payroll has remained relatively constant, you might suspect that a weighting table change is the culprit. You can also look at the state summary section of the ModMaster Detailed Report or a bureau worksheet to see the specific weighting values used for each state.

The mod computation also uses ballast and weighting values designed to make the formula more “fair.”

#9 – A change in the ballast table. The ballast value is used in conjunction with both the actual and expected losses in the mod formula. It is used to “stabilize” the formula and move the extreme mods (high or low) closer to 1.00.

Theoretically, a change in this table could cause a mod to increase. However, we have never seen this in a real case.

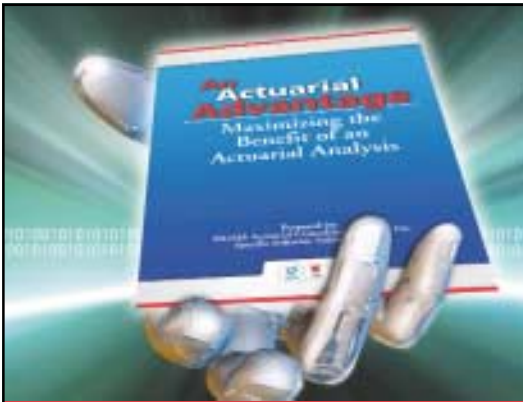
#10 – An increase in expected losses even when actual losses haven’t changed. This defies all reasonable expectations: when expected losses

ACTUARIAL SERVICES, MODMASTER SUITE HIGHLIGHTED AS COMPETITIVE ADVANTAGE FOR BROKERS



Specific Software Solutions and SIGMA Actuarial Consulting Group are featured in the February 2005 edition of Rough Notes magazine. The article, by Michael J. Moody, MBA, ARM, focuses on how brokers can gain a unique competitive advantage by using resources such as value-added actuarial services, the ModMaster Suite of software tools, the Master Your Workers’ Comp Modifier booklet, and future trends that may open doors of opportunity.

The article is available online at <http://www.roughnotes.com/rnmagazine/2005/february05/02p26.htm>



HOT OFF THE PRESS – AN ACTUARIAL ADVANTAGE

This new booklet by Specific Software Solutions and SIGMA Actuarial Consulting Group, Inc. explains the key concepts used by actuaries and shows you how to maximize the benefits of an actuarial analysis.

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What's Up with the Mod?

increase and actual losses remain constant, you normally expect the mod to decrease. However, we recently saw a case where the mod went up from one year to the next simply because expected losses increased. The underlying cause of this was a mod limitation rule which was affected by a change in expected losses.

Mods are limited, or capped, based on a formula. For example, in the state of Virginia, the formula effective 1/1/2005 is:

$$1 + \left[.00005 \times \frac{\text{EXPECTED LOSSES}}{\text{EXPECTED LOSSES}} \right] + 2 \times \left[\frac{\text{EXPECTED LOSSES}}{\text{EXPECTED LOSSES}} \div 4.95 \right]$$

MOD CAP

If the computed mod exceeds the MOD CAP, then the mod is limited to the MOD CAP.

In this case, if expected losses go from \$40,000 to \$42,000, then the maximum mod increases from 3.81 to 3.95. In the case we recently reviewed, the unlimited mod exceeded the mod limit in the previous year. In the following year, losses remained exactly the same, but the mod limit was slightly higher due to an increase in expected losses. The unlimited mod, although lower than the previous year's, still exceeded the new mod limit, so the final mod went up!

Conclusion

When you see a mod increase from one experience period to the next, a quick comparison of total actual losses and total expected losses for each experience rating period may provide valuable insight as to the cause of the increase. However, digging deeper into the individual components of the calculation may also be necessary. Keep these ten scenarios in mind as you seek to understand and explain an increase to your client.



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Brentwood, TN
37024-1007
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