NCCI's Experience Rating Plan: A Critical 2013 Update

NCCI's Experience Rating Plan was created in the early 1900s as a comprehensive method for adjusting premium costs to reflect the unique claims experience of each eligible individual employer relative to other employers within the same industry group.

In 2013, the Experience Rating Plan will be undergoing a change that NCCI believes will more accurately reflect individual employers' claims experience.

Background

As designed, the Experience Rating Plan adjusts the premium charged to individual employers, so that those employers who perform better than the expected average losses are charged less than other employers. To do this, the Plan compares an individual employer's actual loss history against the predicted average loss history in that employer's industry type. If the individual employer's loss history is better than the expected average, that employer receives a credit modification factor. If the employer's history is worse than expected, the employer receives a debit modification factor.

The two primary benefits of experience rating are:

- It tailors the cost prediction and final net premium cost to the individual insured
- It provides added incentives for loss reduction

Split Point: A Significant Plan Update

One of the key elements to formulating an individual experience rating modification is the development of a split point to reflect both the frequency and severity of losses. Currently, the split of actual incurred losses used in the experience rating calculation is applied as follows:

- The amount of the loss up to $5,000 is known as the primary loss, which reflects frequency
- The amount of the loss in excess of $5,000 is known as the excess loss, which reflects severity

Under the existing split rating method, actual primary losses are given full weight in the experience rating formula, while actual excess losses only receive partial weight. The dollar value—which splits a loss into its primary and excess portions (currently $5,000)—is known as the primary/excess split point.

Due to inflation, the Plan has become less responsive. Since the average claim has tripled since the last split point update, a significantly smaller portion of the average loss is considered primary. This leads to less weight being given to an employer's loss history and experience rating modifications that are not as responsive to actual losses as they should be. Given these realities, a modification to the Plan was needed to restore equity.

In July 2011, after extensive research and analysis, NCCI submitted proposed changes to state insurance departments where NCCI is the licensed advisory organization. These changes were proposed to be effective in 2013. In total, 39 states have approved the split point filing. The changes to the Plan include:

- Increasing the current $5,000 experience rating split point over a three-year transition* indexing the split point for claim inflation, and
- Adjusting the maximum debit modification formula.

Transitioning to a New Plan

There will be a three year transition plan* to spread the full impact of the split point change over several years. The current transition plan contains the following key steps:

- Year 1: The split point will initially be increased to $10,000, to become effective with each state's approved rate/loss cost filing for an effective date of January 1, 2013 or later
- Year 2: A state's next rate/loss cost filing (effective the following year) will further increase the split point to $13,500
- Year 3: A state's third effective rate/loss cost filing year will further increase the split point to $15,000 plus two years of inflation adjustment (rounded to the nearest $500)

What to Expect

An increase or a decrease in an experience modification will generally depend on whether an employer has a below-average amount or an above-average amount of claims above $5,000. Another general rule of thumb is that credits will tend to get larger and debits will tend to get larger. There will be exceptions to this, but across all risks the proposed split point change will be premium-neutral.

Looking Forward

NCCI understands that once the implementation of the proposed changes begins in 2013, it will often be agents that employers will turn to for an explanation of their experience rating modification. As a result, NCCI is committed to working closely with agents to ensure that they have the information they need for those discussions.

We have also compiled a series of educational webinars, brochures and fact sheets, all available for viewing at no charge by clicking on the education tab on **ncci.com**. Among the offerings:

- ABC's of Experience Rating (downloadable brochure)
- "How to Understand Your Worksheet" Webinar on Demand
- "Introduction to Proposed Experience Rating Plan Changes Item E-1402" Webinar on Demand
- "Understanding the Filed Experience Rating Plan Changes-Item E-1402" Webinar on Demand (which includes several hypothetical examples of how the split point change could impact employers)

As always, our goal at NCCI continues to be to do our part to help maintain a healthy workers compensation insurance market that is able to deliver promised benefits quickly, fairly and effectively to the injured worker while providing the proper incentives to inspire the safest possible workplaces.

*Missouri has approved a four year transition plan