2017 UPDATE: NCCI's Revised Experience Modification Calculation

In 2013 The National Council on Compensation Insurance (NCCI) began making fundamental changes in the way the experience modification factor is calculated for workers' compensation policy holders. The new approach is designed to collect more premium from insureds with relatively high losses, while at the same time reducing premiums for insureds with low losses. Because the experience rating system encompasses losses over a three year period, these new changes were retroactive back to Policy Year 2009. In this White Paper we discuss changes in the experience mod calculation and its implications for insureds and their agents.

NOTE: The new experience rating plan is effective in all New England states with the exception of Massachusetts, which is governed by its own rating system.

Background

In 1990 NCCI overhauled the experience rating procedure. The goal was to implement a system that surcharged employers for frequency (more claims than expected) and severity (bigger claims than expected). At the same time, the system offered discounts to employers with low frequency and severity. Insureds with higher than expected losses paid more for insurance; insureds with lower than expected losses paid less.

In 1990 the average lost-time claim was about $12,000. In the intervening years, the average lost time claim has risen substantially, reaching $50,000 or more in a number of states. As a result, the old method for calculating the experience mod became obsolete, no longer reflecting the realities of the claims cost structure.

Beginning in January 2013, a revamped rating system was rolled out in NCCI states across the country. Before we examine the impact of these changes, let's first briefly review the mechanics of the old system.

The Mod Calculation from 1990 through 2012

Under the prior approach to experience rating, each claim was divided into three segments:

- **Primary losses**: the first $5,000 of *each* claim in the rating period, which goes into the mod calculation dollar for dollar. This is the most expensive component of the calculation.
    - **NOTE**: Medical-only claims, where no indemnity is paid, are discounted by 70 percent

- **Excess losses**: The losses above $5,000 within each claim, which is discounted substantially, often by as much as 90% or more, depending upon the size of the employer.
- T**he state rating point**: each state establishes a cap on the losses to be included in the calculation, ranging in New England from $138,000 (Maine) to $283,500 (Connecticut). Losses above the state rating point are excluded from the mod and ARAP calculations.

Expected and Actual Losses

To calculate the experience mod, all the losses over a three year rating period are divided into the above three categories: the primary losses count the most; the excess losses are discounted; and losses above the rating point are excluded from the calculation.

Expected losses: In order to penalize "high loss" insureds and reward those with low losses, you have to establish a point of comparison. This is done through the rate setting process. Within each state and across the country, NCCI tracks the losses for each of the approximately 650 job class codes and projects a rate for each class. (State regulators must approve any rate changes proposed by NCCI.)

> Let's look at a hypothetical class rate of $5.00 per $100 of payroll. Buried within this rate are the total expected losses, which usually run anywhere from 35 to 60 percent. Let's assume that expected losses are 50 percent, in this case $2.50 per $100 of payroll. Under the old rating system the expected *primary* losses were usually about 20 percent of the losses, in this case, about $0.50 per $100 of payroll.
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> To establish the premium, you multiply the class rate times the estimated payroll; then apply the experience mod and, if applicable, the ARAP surcharge for insureds in the assigned risk pool.
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> An insured with average losses would have a mod of 1.0 and pay $5.00 per $100 of payroll. Insureds with higher than average losses would find themselves with higher mods: for example, the actual cost for an insured with a mod of 1.50 and ARAP of 1.25 would be $5.00 times 1.50 times 1.25, a total of $9.37 per $100 of payroll. On the other hand, insureds with very low losses over the three year rating period might have a mod as low as 0.80, resulting in a net rate of $4.00 per $100 of payroll. It pays to control losses!

The New Rating Process

Under the new experience rating process, the *split point* between primary and excess losses has gone up substantially. In 2013, the split point went from $5,000 to $10,000; by 2017 primary losses moved to $16,500. In subsequent years, the primary split point will continue to be adjusted, based upon inflation and aggregated loss data.

As the split point has risen, "expected primary losses" have also gone up, but only by about 50%. In our example of the $5.00 rate, expected primary losses would go from $0.50 per $100 of payroll to $0.75.

A Big Problem for Smaller Insureds

While the impact of the higher split point on larger insureds ($30K + premium) has been moderate, smaller insureds are bearing the brunt of the new calculation. Here's why:

> Total expected losses for an insured with $25,000 premium is roughly $12,500 (50% of the premium). Expected *primary* losses would be about $3,750 (30% of expected losses). If a smaller insured has a single claim valued at $16,000 (a relatively small lost-time claim), their primary losses would be *over four times higher* than expected. This single claim drives the mod well above 1.30 and likely adds an ARAP of 1.25 for the entire three year rating period.

In other words, for smaller insureds the higher split point transforms a single claim into a penalty for both frequency and severity. This is patently unfair and appears to be an unintended result of the new rating system.

> A Modest Proposal: NCCI might consider the use of a sliding split point for primary losses, beginning at $5,000 for smaller insureds, and rising to $16,500 and even higher for larger insureds.

Renaissance Resources

NCCI's new experience mod calculation is a reality for all New England states except Massachusetts, which still uses the original $5,000 split point. High loss insureds have seen a dramatic increase in their mods, while low/no loss insureds have seen mods drop slightly below the old system's floor. Employers need help in anticipating the impact of the new calculation method from year to year; agents need to make sure their insureds are not blind-sided by the changes.

Renaissance Alliance offers direct support to agents in understanding the changes in the experience mod calculation and in communicating these changes to their valued customers. Jon Coppelman, our Senior Workers Compensation Consultant, is available to provide a "workers comp tune up" for your accounts:

- A detailed analysis of historical losses, including a projection of future experience mods
- Claims reviews to ensure that reserves are appropriate and that each open claim has an effective strategy toward closure
- Site visits to go over the experience mod and answer questions relating to workers comp, including compensability, the strategic use of Temporary Modified Duty, OSHA reporting requirements, and the impact of related human resource issues such as the FMLA and the ADA.

Contact Jon with any and all questions relating to workers compensation:

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