

NCCI Holdings, Inc.


WC-5 Just How Credible Is That Employer? Proposed Experience Rating Plan Changes

CAS RPM Seminar
Philadelphia, PA
March 21, 2012
Presented by Tom Daley, ACAS, MAAA

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Agenda

- What is the Split Point?
- NCCI's proposed changes
- What prompted the changes?
- What impacts can be expected?
- Hypothetical examples




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What is the Split Point?

- The split point is the value that separates an employer's actual loss dollar amounts into a primary component and an excess component within NCCI's Experience Rating Plan mod formula
- The portion of each claim below the split point is considered the actual primary loss
- The portion of each claim above the split point is considered the actual excess loss



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Experience Rating Formula

Current Mod Formula 
$$\frac{A_p + A_e(W) + E_e(1-W) + B}{E + B}$$

A = Actual
E = Expected
p = primary
e = excess
B = Ballast
W = Weight

- Actual losses are split into primary and excess components based on the split point.
- Expected losses are split into primary and excess components based on the D-ratio
- D-ratio represents the expected % of primary loss for a class code:
 $E_e = (1.0 - D) \times E$

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Experience Rating Plan Changes Reflected in NCCI Item Filing E-1402

- Increase the split point
- Index the split point so future increases are automatic
- Revise the maximum modification formula/cap so the maximum mod is not less than 1.10
- Experience rating changes will be premium neutral statewide

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Experience Rating Plan Item Filing E-1402 Timeline

- Effective on the loss cost/rate effective date for each state beginning with 1/1/13 filings
- Transition program will phase in the split point change
 - In the first year of implementation, the split point will be increased to \$10,000
 - In the following year, the split point will be increased to \$13,500
 - In the third year, the split point will be increased to the indicated split point of \$15,000 plus 2 years of inflation adjustment (rounded to the nearest 500)
- In subsequent years' filings, the split point will be increased as indicated
- The status as of 2/17/12: 33 approvals, 0 disapprovals, 6 pending (CO, CT, FL, IL, MA, MO)

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What Prompted the Changes? NCCI's Review of the Plan

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Experience Rating Plan Split Point Review

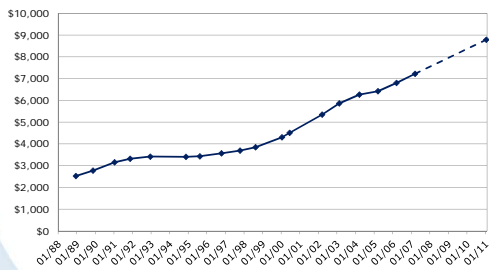
- The current split point of \$5,000 has been in place for over 20 years
- When the split point is not indexed for claim cost inflation, over time, a greater proportion of actual losses fall into the excess category
- Actual excess losses receive less weight than actual primary losses—as a result, the plan becomes less responsive
- Indications are that the split point should be increased to \$15,000. This is not surprising since the average cost of a claim has tripled since the last split point update

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Changes in Average Claim Cost Over Time Average Cost at First Report Lost time and medical only claims

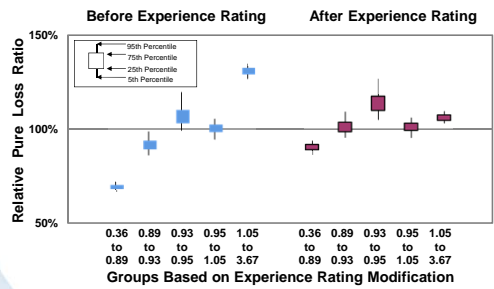


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Quintile Analysis: Current \$5,000 Split Point
 PY 2006 experience under the ER Plan, indexed for severity inflation

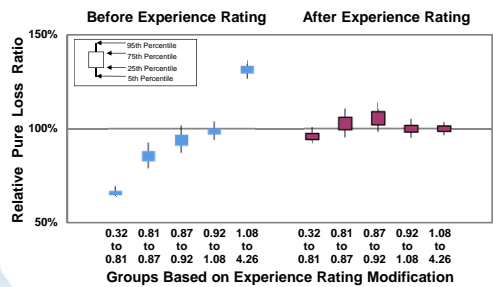


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Quintile Analysis: Indicated \$15,000 Split Point
 PY 2006 experience under the ER Plan, indexed for severity inflation



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Experience Rating Plan
Maximum Debit Modification

- Currently, experience mods are subject to the following cap:
 $1 + [0.00005 \times (E + 2E/G)]$
 where E = an employer's expected losses and G = state average claim cost
- For very small risks, this can produce a very low cap
- The formula for the calculation of the maximum mod will be revised so the maximum mod is not less than 1.10:
 $1.10 + 0.0004 \times E/G$
- This will increase the mod cap for small policies and reduce the mod cap for other policy sizes
- More information is found in the appendix

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What Impacts Can Be Expected?

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Potential Impacts from Split Point Change

When the split point is increased from \$5K to \$10K:

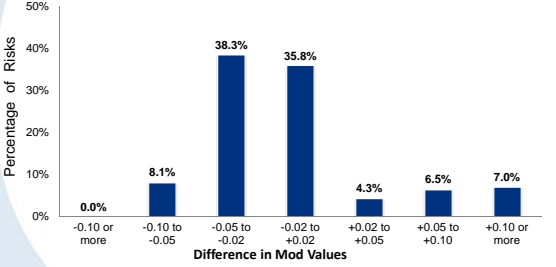
- Overall, the experience rating changes will be revenue neutral
 - In general, experience credits will become larger and experience debits will become larger.
 - There will be exceptions to the above, especially when the mod is near 1.00.
- In conjunction with the split point change, D-ratios will also be adjusted
 - A typical D-ratio may increase by 50-60%

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Distribution of Differences Between Old and New Mod Values

Impact of \$10K Split Point on 2009 ER Plan Intrastate Mods




Difference in Mod Values	Percentage of Risks
-0.10 or more	0.0%
-0.10 to -0.05	8.1%
-0.05 to -0.02	38.3%
-0.02 to +0.02	35.8%
+0.02 to +0.05	4.3%
+0.05 to +0.10	6.5%
+0.10 or more	7.0%

Impact of changing the split point to \$10,000 and implementing new cap formula on intrastate mods effective in 2009
Excludes large deductible policies
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Hypothetical Examples: Differences by Employer Loss Experience



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Potential Impacts from Split Point Change

Credit Mod Risk

Loss experience: No claims

E = \$50,000
W = 0.10
B = 30,000
D-ratio = 0.20 at \$5K split point
D-ratio = 0.30 at \$10K split point*


Current Mod = $\frac{0 + 0(.10) + 40K (.90) + 30K}{50K + 30K} = 0.83$

New Mod = $\frac{0 + 0(.10) + 35K (.90) + 30K}{50K + 30K} = 0.77$

Mod Change = **-7.2%**

* Estimated

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Potential Impacts from Split Point Change

Debit Mod Risk

Loss experience: Three \$25K claims

E = \$50,000
W = 0.10
B = 30,000
D-ratio = 0.20 at \$5K split point
D-ratio = 0.30 at \$10K split point*


Current Mod = $\frac{15K + 60K (.10) + 40K (.90) + 30K}{50K + 30K} = 1.09$

New Mod = $\frac{30K + 45K (.10) + 35K (.90) + 30K}{50K + 30K} = 1.20$

Mod Change = **+10.1%**

* Estimated

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Hypothetical Examples: Differences by Class Severity or D-Ratio



Differences by Class Severity or D-Ratio

- Generally, employers in classes with low severities (high D-ratios) have lower mods than employers of the same size in classes with high severities (low D-ratios) **given the same actual loss experience**
- With a higher split point, this gap will widen since classes with low severities (high D-ratios) will generally see more of an (absolute) increase in D-ratios (thereby reducing the expected excess losses)
- As is the case today, employers in low severity classes will generally have a higher proportion of actual primary losses, offsetting their lower expected excess losses.



Potential Impacts from Split Point Change

Low Severity Class/High D-ratio

Loss experience: No claims

E = \$50,000

W = 0.10

B = 30,000

D-ratio = 0.24 at \$5K split point

D-ratio = 0.36 at \$10K split point*

$$\text{Current Mod} = \frac{0 + 0(.10) + 38K(.90) + 30K}{50K + 30K} = 0.80$$

$$\text{New Mod} = \frac{0 + 0(.10) + 32K(.90) + 30K}{50K + 30K} = 0.74$$

$$\text{Mod Change} = -7.5\%$$

* Estimated



Potential Impacts from Split Point Change

High Severity Class/Low D-ratio

Loss experience: No claims

E = \$50,000

W = 0.10

B = 30,000

D-ratio = 0.12 at \$5K split point

D-ratio = 0.20 at \$10K split point*

$$\text{Current Mod} = \frac{0 + 0(.10) + 44K(.90) + 30K}{50K + 30K} = \mathbf{0.87}$$

$$\text{New Mod} = \frac{0 + 0(.10) + 40K(.90) + 30K}{50K + 30K} = \mathbf{0.83}$$

Mod Change = **-4.6%**

* Estimated

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Differences by Employer Size

- Generally, larger employers receive larger credits and larger debits than smaller employers with similar experience due to credibility considerations
- Under the higher split point, this gap will widen
- See Appendix for examples

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Summary: Impacts from Split Point Change

All else equal, when the split point is increased from \$5K to \$10K:

- If an employer has no losses, or no losses greater than \$5K, E-1402 will reduce their mod
- If an employer has a relatively large # losses approaching or exceeding \$10K, E-1402 will increase their mod
- At the same time, experience rating values will receive their regular annual update.
 - This could exacerbate or offset the split point change
 - The impact of the regular annual update will vary (as always) by state and by class

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Other Resources

The following resources can all be found on NCCI.com:

- Item filing E-1402 Circular, dated August 3, 2011
- FAQs have been posted
- A webinar was posted on NCCI.com in the Fall, 2011
- A new, more technical webinar containing examples was posted in February, 2012

Thank You!

Questions?

Appendix

- Impact of Mod cap formula change
- Hypothetical Examples: Differences by Employer Size

Impact of Mod Caps on 2009 ER Plan Intrastate Mods

Expected Loss (\$)	Total Intrastate Risks	Number of Risks Reaching Current Mod Cap	Number of Risks Reaching Proposed Mod Cap
1	1,000	187	10
1,000	5,000	128,904	6,788
5,000	10,000	166,352	3,154
10,000	20,000	120,013	312
20,000	50,000	85,418	8
50,000	100,000	30,323	0
100,000	200,000	13,815	0
200,000	500,000	5,950	0
Over	500,000	1,284	0
Total	552,246	10,272	15,077
Percentage	100.0%	1.9%	2.7%

Proposed impact includes new mod cap formula and 10K split point
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Potential Impacts from Split Point Change

Small Employer

Loss experience: No claims

E = \$5,000

W = 0.05

B = 25,000

D-ratio = 0.20 at \$5K split point

D-ratio = 0.30 at \$10K split point*

$$\text{Current Mod} = \frac{0 + 0(.05) + 4K (.95) + 25K}{5K + 25K} = 0.96$$

$$\text{New Mod} = \frac{0 + 0(.05) + 3.5K (.95) + 25K}{5K + 25K} = 0.94$$

$$\text{Mod Change} = -2.1\%$$

* Estimated

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Potential Impacts from Split Point Change

Medium Employer

Loss experience: No claims

E = \$50,000

W = 0.10

B = 30,000

D-ratio = 0.20 at \$5K split point

D-ratio = 0.30 at \$10K split point*

$$\text{Current Mod} = \frac{0 + 0(.10) + 40K (.90) + 30K}{50K + 30K} = 0.83$$

$$\text{New Mod} = \frac{0 + 0(.10) + 35K (.90) + 30K}{50K + 30K} = 0.77$$

$$\text{Mod Change} = -7.2\%$$

* Estimated

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Potential Impacts from Split Point Change

Large Employer

Loss experience: No claims

E = \$500,000

W = 0.32

B = 70,000

D-ratio = 0.20 at \$5K split point

D-ratio = 0.30 at \$10K split point*

$$\text{Current Mod} = \frac{0 + 0(.32) + 400K(.68) + 70K}{500K + 70K} = 0.60$$

$$\text{New Mod} = \frac{0 + 0(.32) + 350K(.68) + 70K}{500K + 70K} = 0.54$$

Mod Change = **-10.0%**

* Estimated

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