

November 10, 2009

CIRCULAR LETTER TO ALL MEMBER COMPANIES

Re: Workers Compensation Insurance

NCCI Item R-1401 – Retrospective Rating
Plan Parameters

The Bureau has adopted and the North Carolina Commissioner of Insurance has approved changes to the Retrospective Rating Plan Parameters.

This filing withdraws the four-hazard group system and updates the state hazard group relativities.

The attached Filing Memorandum further describes the changes which have been approved to become effective January 1, 2010, applicable to new and renewal business.

Sincerely,

Sue Taylor

Director of Insurance Operations

ST:dg

C-09-27

FILING MEMORANDUM

ITEM R-1401—2009 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS—STATE HAZARD GROUP RELATIVITIES—REVISION TO RETROSPECTIVE RATING PLAN MANUAL RULE 3-F—REVISION TO BASIC MANUAL APPENDIX E

PURPOSE

This item updates the State Hazard Group Relativities in NCCI's 2009 Edition of the *Retrospective Rating Plan Manual for Workers Compensation and Employers Liability Insurance*.

In addition to updating the state hazard group relativities, this item clarifies Rule 3-F of NCCI's *Retrospective Rating Plan Manual*.

NCCI is also discontinuing the alternative four-hazard-group option. Currently, both the four- and seven-hazard-group options are included in Appendix E of NCCI's *Basic Manual for Workers Compensations and Employers Liability Insurance*. Appendix E is being revised to remove the four-hazard-group option by striking the last column of the table. There are several hundred classifications included in the Table of Classifications by Hazard Group, and Appendix E is revised for most classification-related filings. Rather than include a very large exhibit containing a current version of Appendix E, an illustration of the revised Table of Classifications by Hazard Group is included in this item.

The countrywide Table of Expected Loss Ranges is not being updated with this filing. A review of recent changes in countrywide claim severities indicates that no change is needed. The current table, which became effective on January 1, 2008, will continue to apply.

BACKGROUND

The Retrospective Rating Plan adjusts a risk's premium for a policy according to the loss experience during the effective period of the policy. At the simplest level, an insured's retrospective premium is determined by the formula $R = (b + cL)T$, where:

R	=	Retrospective premium, subject to minimum and maximum amounts
b	=	Basic premium
c	=	Loss conversion factor, generally reflecting loss adjustment expense
L	=	Actual incurred loss during the effective policy period
T	=	Tax multiplier

The retrospective premium, R, is not known until after the policy has expired and the actual losses are fully developed. The basic premium contains provisions for the expenses of the carrier. It also includes a net insurance charge, which results from the maximum and minimum limitations on the retrospective premium. The net insurance charge reflects the charge to compensate for the possibility that R will exceed the maximum premium amount. It also reflects the savings resulting from the possibility that R will be less than the minimum premium amount. The net insurance charge is the difference between the charge for the maximum and the savings from the minimum.

The Table of Insurance Charges contains the excess ratios needed to quantify the insurance charge and savings previously described. The ratio of the loss limit to expected losses—the entry ratio—is used to

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look up the values in the Table of Insurance Charges. The charges depend not only on the maximum and minimum subject losses, but also on the size of the insured. This is because the expected variation in losses is lower for larger employers.

State Hazard Group Relativities

The variation in the loss ratios for employers in the lower hazard groups generally should be smaller than the variation for employers in the higher hazard groups. The State Hazard Group Relativity Factors adjust for this difference by placing lower hazard group employers in a higher Expected Loss Size Range and higher hazard group employers in a lower Expected Loss Size Range than would otherwise be the case. This adjustment affects the column selection in the Table of Insurance Charges, which then impacts the basic premium portion of the retrospective policy premium.

The State Hazard Group Relativities should be updated regularly to reflect changes in the circumstances (e.g., state statutory benefit levels, inflation, etc.) underlying each state's severity.

2009 Edition—*Retrospective Rating Plan Manual*

In 2009, NCCI filed Item R-1399, which introduced the new 2009 Edition of the *Retrospective Rating Plan Manual*. Two minor revisions to Rule 3-F are necessary to clarify the proper premium calculation when a retrospective rating policy is cancelled.

Table of Classifications by Hazard Group

In 2006, NCCI filed Item B-1403, which introduced a seven-hazard-group option and made the four-hazard-group option available on a temporary basis in order to give carriers sufficient lead time to reprogram their systems from four to seven hazard groups. The Table of Classifications by Hazard Group is provided in Appendix E of NCCI's *Basic Manual*. On August 15, 2008, NCCI issued FYI-CW-2008-05 to provide notice to carriers that NCCI would be making a filing to withdraw the four-hazard-group option.

PROPOSAL

It is proposed that the State Hazard Group Relativities, revision to *Retrospective Rating Plan Manual* Rule 3, and removal of the four-hazard-group option be effective at 12:01 a.m. on January 1, 2010, applicable to new and renewal voluntary policies only.

Exceptions:

- In Hawaii, the effective date is determined upon regulatory approval of the individual carrier's election to adopt these changes.
- In Virginia, these changes will become effective for policies effective on or after 12:01 a.m. on April 1, 2010.

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ITEM R-1401—2009 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS—STATE HAZARD GROUP RELATIVITIES—REVISION TO RETROSPECTIVE RATING PLAN MANUAL RULE 3-F—REVISION TO BASIC MANUAL APPENDIX E

IMPACT

State Hazard Group Relativities

Retrospective rating should produce premium that is equitably distributed to all insured employers, but, on average, close to the guaranteed cost premium. The object of this change is to maintain the aggregate expected balance, although the impact will vary slightly for each insured employer. Therefore, insurance charges and premiums will be higher for some insureds and lower for others in order to maintain equity. For most of the insured employers electing retrospective rating, the impact on final premium from these changes is expected to be minimal.

The improved equity afforded by retrospective rating from this change will result in slightly lower average insurance charges for some states and slightly higher charges for others. However, the statewide impact will be negligible. The program is designed to be revenue-neutral countrywide.

2009 Edition—*Retrospective Rating Plan Manual*

No premium impact is expected as a result of the clarification revisions to the 2009 Edition of the *Retrospective Rating Plan Manual*.

Table of Classifications by Hazard Group

No overall premium impact is expected as a result of withdrawing the four-hazard-group option from the Table of Classifications by Hazard Group.

IMPLEMENTATION

In order to implement this item, the attached exhibits detail the changes required in NCCI's *Retrospective Rating Plan Manual* (2009 Edition) and *Basic Manual*. This filing updates the State Hazard Group Relativities and Rule 3-F of NCCI's *Retrospective Rating Plan Manual* and Appendix E of NCCI's *Basic Manual*.

As explained in these exhibits, individual state severities, as well as countrywide severities, are used in the calculation of the relativities. The following is a summary of the exhibits included in this item filing package:

- **Exhibit 1** provides the State Hazard Group Relativities, if applicable
- **Exhibit 2** provides a description of the development of the relativities, if applicable
- **Exhibit 3** provides the changes required for Rule 3-F—Cancellation
- **Exhibit 4** provides an illustration of the changes to Appendix E

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ITEM R-1401--2009 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS--STATE HAZARD GROUP RELATIVITIES--
REVISION TO RETROSPECTIVE RATING PLAN MANUAL RULE 3-F--REVISION TO BASIC MANUAL APPENDIX E

EXHIBIT 1

RETROSPECTIVE RATING PLAN MANUAL
STATE HAZARD GROUP RELATIVITIES

State	Hazard Group						
	A	B	C	D	E	F	G
AK	1.69	1.25	1.11	1.00	0.86	0.70	0.53
AL	1.65	1.22	1.08	0.97	0.83	0.67	0.50
AR	2.01	1.50	1.32	1.19	1.02	0.83	0.62
AZ	1.71	1.28	1.12	1.01	0.86	0.69	0.50
CO	1.99	1.49	1.33	1.19	1.02	0.83	0.63
CT	1.71	1.27	1.12	1.01	0.86	0.70	0.52
DC	1.82	1.35	1.19	1.06	0.91	0.74	0.55
FL	1.97	1.50	1.32	1.20	1.04	0.83	0.59
GA	1.54	1.15	1.02	0.92	0.79	0.64	0.48
HI	2.28	1.70	1.51	1.36	1.17	0.96	0.72
IA	1.83	1.36	1.21	1.09	0.93	0.76	0.58
ID	1.87	1.41	1.25	1.13	0.98	0.81	0.61
IL	1.18	0.90	0.80	0.72	0.62	0.51	0.39
IN	2.03	1.54	1.38	1.25	1.08	0.89	0.68
KS	1.75	1.32	1.18	1.06	0.91	0.74	0.56
KY	1.63	1.20	1.06	0.95	0.81	0.65	0.47
LA	1.62	1.20	1.07	0.96	0.83	0.68	0.51
MD	1.69	1.25	1.11	0.99	0.85	0.69	0.51
ME	1.73	1.28	1.13	1.02	0.88	0.72	0.54
MI	1.98	1.48	1.33	1.20	1.05	0.87	0.66
MO	2.15	1.64	1.46	1.31	1.13	0.91	0.69
MS	1.85	1.38	1.22	1.10	0.95	0.77	0.58
MT	1.61	1.20	1.06	0.95	0.81	0.66	0.50
NC	1.31	0.99	0.87	0.78	0.67	0.54	0.40
NE	1.75	1.31	1.16	1.04	0.89	0.73	0.54
NH	1.62	1.19	1.06	0.95	0.81	0.66	0.49
NM	1.84	1.37	1.22	1.10	0.94	0.77	0.58
NV	1.88	1.40	1.23	1.10	0.94	0.76	0.56
OK	1.63	1.23	1.09	0.97	0.83	0.67	0.50
OR	2.34	1.74	1.54	1.38	1.18	0.95	0.70
RI	2.14	1.59	1.41	1.27	1.09	0.89	0.66
SC	1.49	1.12	1.01	0.90	0.78	0.63	0.48
SD	1.88	1.40	1.23	1.11	0.95	0.77	0.57
TN	1.80	1.36	1.21	1.08	0.93	0.76	0.57
UT	1.95	1.45	1.28	1.15	0.98	0.80	0.59
VA	1.44	1.07	0.95	0.85	0.73	0.59	0.44
VT	1.73	1.28	1.14	1.02	0.88	0.71	0.54
WI	2.17	1.62	1.45	1.31	1.13	0.93	0.72

**ITEM R-1401—2009 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS--STATE HAZARD GROUP RELATIVITIES--
REVISION TO RETROSPECTIVE RATING PLAN MANUAL RULE 3-F--REVISION TO BASIC MANUAL APPENDIX E**

EXHIBIT 2

**DEVELOPMENT OF NORTH CAROLINA HAZARD GROUP RELATIVITIES
FOR HAZARD GROUPS A TO G**

- Step 1.** Historical experience is trended, on-leveled, and developed to estimate the severities for each hazard group.
- Step 2.** The severities are weighted with the countrywide severities by hazard group using a credibility that varies by state. For this purpose, 155,000 claims are regarded as fully credible and the square root rule is used to compute partial credibilities.
- Step 3.** Credibility weighted severities for each state hazard group are produced. A new countrywide average severity is calculated by taking the weighted average of the formula for state severities using claim counts as weights.
- Step 4.** The relativities are calculated by dividing the countrywide severity by the individual state hazard group severities. The final relativities are derived by capping the indicated relativities at a 15.0% increase or decrease from the prior update.

<u>Step 1</u>	<u>Hazard Group</u>	<u>North Carolina</u>	<u>Countrywide</u>
Severities	A	50,082	32,677
	B	66,175	43,969
	C	74,711	49,846
	D	83,536	55,540
	E	97,838	64,867
	F	122,053	79,630
	G	163,060	106,607
 <u>Step 2</u>	Claim Count	=	67,345
	Credibility	=	$(67,345 / 155,000)^{0.5} = 0.659$
 <u>Step 3</u>	<u>Hazard Group</u>	<u>North Carolina</u>	
Credibility	A	44,150	= (0.659)(50,082) + (0.341)(32,677)
Weighted	B	58,606	
Severities	C	66,236	
	D	73,994	
	E	86,600	
	F	107,593	
	G	143,818	
	Countrywide Overall:	57,797	
 <u>Step 4</u>	<u>Hazard Group</u>	<u>Relativities</u>	
Relativities	A	1.31	= 57,797 / 44,150
	B	0.99	
	C	0.87	
	D	0.78	
	E	0.67	
	F	0.54	
	G	0.40	

Note: The underlying data source for the above calculations is NCCI's *Statistical Plan for Workers Compensation and Employers Liability Insurance (Statistical Plan)*, excluding medical-only claims. The *Statistical Plan* data for each state is adjusted accordingly, as reflected in the data underlying the Excess Loss Factor (ELF) calculation.

ITEM R-1401—2009 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS—STATE HAZARD GROUP RELATIVITIES—REVISION TO RETROSPECTIVE RATING PLAN MANUAL RULE 3-F—REVISION TO BASIC MANUAL APPENDIX E

**EXHIBIT 3
RETROSPECTIVE RATING PLAN MANUAL—2009 EDITION
RULE 3**

F. CANCELLATION OF A POLICY UNDER A RETROSPECTIVE RATING PLAN

The cancellation conditions of the standard policy permit cancellation by the insured or carrier. The premium determination for a cancelled policy is outlined in NCCI's *Basic Manual*.

Reasons for Cancellation and Retrospective Rated Premium Determination

Cancellation Provisions Table 1

If . . .	Then . . .
The policy is cancelled by the insurance carrier, except for nonpayment of premium	<ol style="list-style-type: none"> 1. The standard premium for the cancelled policy is calculated on a pro rata basis as outlined in NCCI's <i>Basic Manual</i>. 2. Basic premium and, if applicable, excess loss premium and retrospective development premium is calculated by using the pro rata standard premium calculated in 1.

Cancellation Provisions Table 2

If . . .	Then . . .
The policy is cancelled by the insured when retiring from business such that: <ul style="list-style-type: none"> • All the work covered by the policy has been completed, or • All interest in any business covered by the policy has been sold, or • The insured has retired from all business covered by the policy 	<ol style="list-style-type: none"> 1. The standard premium for the cancelled policy is calculated on a pro rata basis as outlined in NCCI's <i>Basic Manual</i>. 2. Basic premium and, if applicable, excess loss premium and retrospective development premium is calculated by using the pro rata standard premium calculated in 1.

Cancellation Provisions Table 3

If . . .	Then . . .
The policy is cancelled by the insured, except when retiring from the business	<ol style="list-style-type: none"> 1. The standard premium for the cancelled policy is calculated on a short-rate basis as outlined in NCCI's <i>Basic Manual</i>. 2. Basic premium and, if applicable, excess loss premium and retrospective development premium is calculated by using the short-rate standard premium as calculated in 1. 3. Minimum retrospective premium is the short-rate standard premium <u>calculation-cancellation</u>. 4. Maximum retrospective premium is based on standard premium. It is calculated by using the actual payroll for the period that the policy was in effect, extending that payroll pro rata to an annual basis, and then multiplying such extended payroll

**ITEM R-1401—2009 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS—STATE
HAZARD GROUP RELATIVITIES—REVISION TO RETROSPECTIVE RATING PLAN MANUAL
RULE 3-F—REVISION TO BASIC MANUAL APPENDIX E**

**EXHIBIT 3 (CONT'D)
RETROSPECTIVE RATING PLAN MANUAL—2009 EDITION
RULE 3
Cancellation Provisions Table 3 (Cont'd)**

If . . .	Then . . .
	by the authorized rates and experience rating modification.

Cancellation for Nonpayment of Premium

If the cancellation by the carrier is because of nonpayment of premium by the insured, the maximum retrospective premium is based on the calculated standard premium for the cancelled policy, extended pro rata to an annual basis.

*Refer to the **User's Guide** for an example.*

FILING NOTE:

1. Item R-1399 has not yet been approved in the states of AK, CT, FL, GA, IL, NV, and VA. If approved, the underlined language will appear in this rule.

**ITEM R-1401—2009 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS—STATE
HAZARD GROUP RELATIVITIES—REVISION TO RETROSPECTIVE RATING PLAN MANUAL
RULE 3-F—REVISION TO BASIC MANUAL APPENDIX E**

EXHIBIT 4

BASIC MANUAL—2001 EDITION

APPENDIX E

CLASSIFICATIONS BY HAZARD GROUP

TABLE OF CLASSIFICATIONS BY HAZARD GROUP

Class Code	Applies In:*	Discontinued:	Hazard Group A-G	Hazard Group 1-4**
XXXX	National		Appropriate Hazard Group	+

* The term "National" means that the classification code applies in all jurisdictions that follow the NCCI classification system.

** ~~Carriers that elect to use NCCI's four hazard groups must make a filing in each state to adopt the four hazard groups referenced in this item.~~