

PENNSYLVANIA COMPENSATION RATING BUREAU
NCCI Filing Memorandum

Attached are selected portions of an NCCI Filing Memorandum (ITEM R-1403-2011 Update to Retrospective Rating Plan Parameters). All state specific pages have been excluded from this attachment.

The PCRБ is filing the Table of Expected Loss Ranges as shown on page 4 of ITEM R-1403.

FILING MEMORANDUM

ITEM R-1403—2011 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS—EXPECTED LOSS RANGES AND STATE HAZARD GROUP DIFFERENTIALS—AND CREATION OF RETROSPECTIVE RATING PLAN MANUAL APPENDIX D

PURPOSE

This item updates Appendix A—Table of Expected Loss Ranges and the Hazard Group Differentials (commonly referred to as Relativities), and creates Appendix D—Basic Premium Factor Calculation Example in NCCI's 2009 Edition of the *Retrospective Rating Plan Manual for Workers Compensation and Employers Liability Insurance*.

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.

Expected Loss Ranges

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

As inflation increases claim size, there is an apparent growth in the size of the insured, measured in expected losses, but no real growth in the size of the insured, measured in the expected number of claims. To correct for the impact of loss size inflation, NCCI is proposing that Appendix A—Table of Expected Loss Ranges be updated for the trend in average size of loss. The last time such an update was made was in 2007 (Item R-1396—2007 Update to Retrospective Rating Plan Parameters). The current Table of Expected Loss Ranges is based on a projected annual increase in average loss size of 8.5% from March 26, 2004 to January 1, 2009. NCCI has observed an actual annualized growth in average loss size of 5.5% from March 26, 2004

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to March 5, 2008, and projects an annual growth in average loss size of 5.5% from March 5, 2008 to January 1, 2013. The new table incorporates both of these observed and projected changes in severity.

Hazard Group Differentials

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 Hazard Group Differential factors adjust for this difference by placing lower hazard group employers in a higher Expected Loss Range and higher hazard group employers in a lower Expected Loss Range than would otherwise be the case. This adjustment affects the column selection in Appendix B—Table of Insurance Charges, which then impacts the basic premium portion of the retrospective policy premium. The Hazard Group Differentials should be updated regularly to reflect changes in the circumstances (e.g., state statutory benefit levels, inflation, etc.) underlying each state's severity.

NCCI's 2009 Edition of the Retrospective Rating Plan Manual

In 2009, NCCI filed Item R-1399, which introduced the 2009 Edition of the *Retrospective Rating Plan Manual*. In addition, the 2009 Edition of the *Retrospective Rating Plan Manual User's Guide* was also introduced. This companion product contains nonpremium-impact-related information and is not filed for regulatory approval. Section D of the *User's Guide* contains the calculation of a basic premium factor. NCCI has determined that this calculation should be filed for regulatory approval and included in the *Retrospective Rating Plan Manual* as Appendix D. It will be removed from the *User's Guide*.

PROPOSAL

It is proposed that changes be made, as described in the Background section, to Appendix A—Table of Expected Loss Ranges, and the Hazard Group Differentials/Relativities, and the creation of Appendix D, in NCCI's 2009 Edition of the *Retrospective Rating Plan Manual*. Please note that this item is not being filed in Virginia at this time. The proposed changes will be included in the next loss cost filing.

Exception: In Hawaii, the effective date is determined upon regulatory approval of the individual carrier's election to adopt these changes.

Florida State-Specific

It is proposed that Florida revise Appendix A—Table of Expected Loss Ranges and the Hazard Group Differentials to NCCI's 1984 Edition of the *Retrospective Rating Plan Manual* since the 2009 Edition has not yet been approved in Florida. Also, the creation of Appendix D is not being proposed in Florida since the 1984 Edition of the manual contains the basic premium factor calculation example.

Texas State-Specific

It is proposed that Texas discontinue its state special Appendix D to NCCI's 2009 Edition of the *Retrospective Rating Plan Manual* and adopt the national proposal, which mirrors the Texas version.

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West Virginia State-Specific

It is proposed that West Virginia adopt only Exhibits 1 & 4 of this item. The Expected Loss Ranges and the Hazard Group Differentials will be included in the next loss cost filing.

IMPACT

Expected Loss Ranges

The proposed changes to the Expected Loss Ranges are necessary to maintain the aggregate expected balance between the retrospectively rated premium and the guaranteed cost premium. If these ranges were not updated, there would be a natural slippage caused by inflation over time because risks would have an apparent growth in size as seen by increasing expected losses, but no real growth in size as seen by their expected number of claims. These changes are expected to be revenue neutral.

Hazard Group Differentials

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. For most 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 insureds, and slightly higher charges for others. However, the statewide impact will be negligible. The program is designed to be revenue-neutral countrywide.

NCCI's 2009 Edition of the Retrospective Rating Plan Manual

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

IMPLEMENTATION

In order to implement this item, the attached exhibits detail the changes required in NCCI's 2009 Edition of the *Retrospective Rating Plan 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** contains Appendix A—Table of Expected Loss Ranges
- **Exhibit 2** contains the State Hazard Group Differentials
- **Exhibit 3** contains a description of the development of the differentials/relativities
- **Exhibit 4** contains the new Appendix D—Basic Premium Factor Calculation Example
- **Exhibit 5** contains the Texas state special Appendix D to be discontinued

In all states this item will be implemented effective at 12:01 a.m. on January 1, 2012, applicable to new and renewal voluntary policies only.

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EXHIBIT 1

RETROSPECTIVE RATING PLAN MANUAL—2009 EDITION

APPENDIX A

2012—TABLE OF EXPECTED LOSS RANGES

(Applies in: AK, AL, AR, AZ, CO, CT, DC, GA, HI, IA, ID, IL, IN, KS, KY, LA, MD, ME, MI, MO, MS, MT, NC, NE, NH, NM, NV, OK, OR, RI, SC, SD, TN, TX, UT, VT, WI, WV)

Expected Loss Group	Range Rounded Values	Expected Loss Group	Range Rounded Values	Expected Loss Group	Range Rounded Values
95	1,069 — 1,668	65	89,596 — 96,768	35	1,117,459 — 1,254,650
94	1,669 — 2,469	64	96,769 — 104,515	34	1,254,651 — 1,408,687
93	2,470 — 3,262	63	104,516 — 112,881	33	1,408,688 — 1,606,329
92	3,263 — 4,312	62	112,882 — 121,917	32	1,606,330 — 1,846,373
91	4,313 — 5,608	61	121,918 — 131,677	31	1,846,374 — 2,122,290
90	5,609 — 6,774	60	131,678 — 142,246	30	2,122,291 — 2,439,441
89	6,775 — 8,175	59	142,247 — 153,803	29	2,439,442 — 2,899,798
88	8,176 — 9,490	58	153,804 — 166,063	28	2,899,799 — 3,467,527
87	9,491 — 11,016	57	166,064 — 178,922	27	3,467,528 — 4,146,414
86	11,017 — 12,778	56	178,923 — 192,782	26	4,146,415 — 5,111,668
85	12,779 — 14,451	55	192,783 — 207,716	25	5,111,669 — 6,504,746
84	14,452 — 16,337	54	207,717 — 224,594	24	6,504,747 — 8,277,480
83	16,338 — 18,450	53	224,595 — 242,913	23	8,277,481 — 10,577,165
82	18,451 — 20,529	52	242,914 — 262,733	22	10,577,166 — 13,534,484
81	20,530 — 22,841	51	262,734 — 284,159	21	13,534,485 — 17,318,654
80	22,842 — 25,410	50	284,160 — 306,638	20	17,318,655 — 22,160,857
79	25,411 — 28,271	49	306,639 — 330,841	19	22,160,858 — 28,356,911
78	28,272 — 31,196	48	330,842 — 357,128	18	28,356,912 — 38,897,361
77	31,197 — 34,345	47	357,129 — 388,536	17	38,897,362 — 57,528,883
76	34,346 — 37,816	46	388,537 — 422,704	16	57,528,884 — 85,084,766
75	37,817 — 41,556	45	422,705 — 459,879	15	85,084,767 — 125,839,689
74	41,557 — 45,495	44	459,880 — 502,548	14	125,839,690 — 186,115,898
73	45,496 — 49,808	43	502,549 — 549,895	13	186,115,899 — 275,263,927
72	49,809 — 54,536	42	549,896 — 601,708	12	275,263,928 — 430,893,183
71	54,537 — 59,530	41	601,709 — 663,309	11	430,893,184 — 681,845,588
70	59,531 — 64,935	40	663,310 — 733,021	10	681,845,589 — 1,078,952,801
69	64,936 — 70,826	39	733,022 — 810,061	9	1,078,952,802 — & over
68	70,827 — 76,791	38	810,062 — 895,197		
67	76,792 — 82,946	37	895,198 — 995,262		
66	82,947 — 89,595	36	995,263 — 1,117,458		