FYI Plus

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# Countrywide–Frequently Asked Questions About Item E-1402–Revisions to the Experience Rating Plan Primary/Excess Split Point Value and Maximum Debit Modification Formula

NCCI recently completed an Experience Rating Plan (Plan) methodology review. As a result of that review, and in order to maintain the Plan's optimal performance, NCCI has submitted Item E-1402 for state regulatory approval as announced in Circular CIF-2011-14.

The purpose of this item is to:

- Increase the current $5,000 experience rating split point over a three-year transition and index the split point for claim inflation, and
- Adjust the maximum debit modification formula

For a better understanding of the proposed changes in Item E-1402, please review the following Frequently Asked Questions (FAQs):

1. **What is an experience rating split point?**
   In the promulgation of an experience rating modification, a split rating approach is used 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 this 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. (Note: In states that have approved the Experience Rating Adjustment (ERA), the new split point value will apply; after determining the primary and excess loss amounts of a medical-only claim using the new split point value, the primary and excess loss amounts will be reduced by 70%, respectively.)

   For a detailed explanation of the experience rating modification and how it is calculated, please see the "How to Understand Your Worksheet" Webinar located at **ncci.com**.

2. **Why does the experience rating split point need to change?**
   Since the last split point update occurred two decades ago, the average cost of a claim has tripled. Because of this, the portion of each claim that flows into the experience rating formula at full value (primary loss amount) is much smaller than what it was 20 years ago. The result is that the Experience Rating Plan (Plan) is giving less weight to each employer's actual experience. Consequently, the Plan formula has become less responsive and individual risk experience rating modifications have gravitated toward the all-risk average over time. To address this issue, a transition plan to increase the split point amount over time is being proposed.

3. **What is the proposed experience rating split point transition plan?**
   The proposed transition plan is:

   - Year 1: The split point will initially be increased to $10,000, to become effective with each state's approved rate/loss cost filing on or after January 1, 2013
   - Year 2: A state's next effective year filing will further increase the split point to $13,500

- Year 3: A state's third effective filing year will further increase the split point to $15,000 plus two years of inflation adjustment (rounded to the nearest $500)

4. **What will be the premium impact of increasing the experience rating split point?**
The proposed split point change will be premium-neutral. That is, the *average* experience rating modification across *all* employers will not change due to an increase in the split point. This is because the change in primary and excess actual losses will be matched by a corresponding change in the primary and excess expected losses used in the experience modification formula. The impact of the split point change will be risk-specific and will vary from risk to risk depending on individual risk loss experience.

5. **How will the split point change impact individual employers?**
The impact to individual employers will vary according to how many claims they have that exceed $5,000. If none of their claims exceed $5,000, they will generally see a decrease in their experience rating modification. This is because no additional actual losses will flow into their modification under the higher split point and they will get the benefit of less expected excess losses in their modification calculation. An increase or a decrease in an experience rating 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, they will balance out.

   It should also be noted that the new experience rating values will not only reflect the new split point, but they will also reflect the regular annual update of all experience rating values. This further makes it difficult to make broad statements about individual employer modification changes.

6. **When will the experience rating split point begin to increase?**
The increase in the experience rating split point cannot begin without state regulatory approval. NCCI has filed the proposed change for state regulatory approval in all states where its Plan applies. If approved, the change would become effective on each state's loss cost (rate) filing effective date, beginning with January 1, 2013 filings.

7. **Are there any other changes being proposed?**
Yes, NCCI is proposing a change to the maximum debit modification formula.

8. **What is the maximum debit modification formula?**
Debit experience rating modifications that exceed a specified amount are subject to a cap, which is determined by a formula located in NCCI's ***Experience Rating Plan Manual***. The cap varies by state and by the size of an employer. The smaller the employer, the lower the cap.

9. **What are the proposed revisions to the maximum debit modification formula?**
NCCI is proposing that the cap be increased slightly for very small employers, but reduced for other employer sizes in many states. Only 2% of experience-rated employers reach this cap.

10. **Why is the maximum debit modification formula being changed?**
There are two reasons. First, the proposed formula is more equitable from one state to another. Second, the current cap approaches a maximum debit modification of 0% for the smallest employers. Given that this is designed to be a maximum debit, the proposed cap is less restrictive and approaches a maximum debit modification of 10% for the smallest employers.

11. **How will NCCI communicate the approval status of Item E-1402?**
As state regulators approve Item E-1402, NCCI will publish approval circulars. In addition, NCCI's ***Status of Item Filings*** circular, which is updated weekly through **ncci.com**, will provide a compilation of the approval status of the item filing by state.