Introduction

This booklet is designed to further your understanding of experience rating and how it affects your workers compensation costs.

NCCI's Experience Rating Plan ("Plan") is an integral part of the final cost of workers compensation. It is a method for tailoring the cost of insurance to the characteristics of an employer. It gives the employer the opportunity to manage its own costs through measurable and meaningful cost-saving programs.

The Plan predicts whether a qualifying employer is likely to develop loss experience that is better or worse than that of the average risk in a particular classification. It modifies manual premium by a factor that is designed to more accurately price qualified employers. The Plan uses the employer's past experience to project future losses.

While the underlying concepts are complex, this booklet should clarify the application of these concepts.

Why Have Experience Rating?

If workers compensation rates are designed to predict future losses, why use experience rating? How does experience rating benefit employers? Implicit in most risk-specific programs of experience rating is the prospect of both debits and credits.

Since experience rating gives individual employers some influence over the final premium they pay, it provides an incentive for employers to develop loss prevention as well as incentives to have the injured employees return to work as soon as reasonably possible. In this way, experience rating benefits employers by promoting occupational health and safety.

Experience rating represents a refinement in the premium determination process. It benefits employers by producing a net premium cost that is the best indicator of the employer's own potential for incurring claims. This means that the insurance premium will be appropriate for the coverage being provided by using sound insurance principles and the employer's own payroll and loss data.

What Does Experience Rating Do?

Insurance spreads, or shares, the cost of a loss with members of a group who are likely to experience similar losses. While the cost and probability of injuries for the *whole* group can be predicted with a fair degree of accuracy, it is impossible to determine which member of the group will actually be responsible for these costs.

This is why insurance exists. If predictability were perfect, the members of the group who do not expect to experience a loss would have no incentive to pay premium, while the premium charge for the members who do experience the loss would, of necessity, equal the value of the loss. Historically, we know that serious individual injuries generally are rare and that the cost could vary from very minor amounts to millions of dollars.

The simplest rating method for workers compensation and employers liability insurance is "manual rating." Under manual rating, all insureds are grouped according to their business operation or classification. The estimated losses of the group are added together and an average cost is obtained. The rates determined for manual rating are averages reflecting the normal conditions found in each classification. An employer is assigned to a classification to ensure that the rates reflect the costs of all employers with similar characteristics. Although each classification contains "similar" risks, each risk in a class is different to some extent. Experience rating is designed to reflect these differences in loss potential.

If the rating system went no further than manual rating, insurance carriers could seek employers with lower than expected costs and possibly avoid employers with higher than expected costs. To avoid this scenario, the rating system must be further refined. Experience rating is one such refinement.

In workers compensation experience rating, the actual payroll and loss data of the individual employer are analyzed over a period of time. Usually, the latest available three years of data are compared to similarly grouped risks to calculate the experience modification.

In general, an employer with better than average costs receives a credit, while an employer with worse than average experience carries a debit rating. Experience rating takes the average loss experience and modifies it based on the individual's own loss experience.

The two primary benefits of experience rating are:

- It tailors the cost prediction and final net premium cost to the individual insured more closely than does manual rating alone
- It provides added incentives for loss reduction that are absent from manual rating alone

Characteristics of Experience Rating

We have already mentioned the need to modify the premium based on manual rates, but what are the characteristics that the Plan recognizes?

A significant feature of experience rating is that it recognizes the *cost* of a specific accident is often left to chance and is statistically less predictable than the fact that the accident *occurred.*

For example, the survivor benefits for a young worker in his 20s leaving a widow and three children would be considerably greater than the survivor benefits for a worker in his 50s leaving no dependents. The important fact is that the accident did occur, so *the Plan gives greater weight to accident frequency than to accident severity.*

This reliance on accident frequency also measures risk differences. For example, compare two similarly sized employers from the same classification:

Employer A
1 loss totaling $50,000

Employer B
10 losses totaling $50,000

Which employer would you expect to incur the higher workers compensation costs in the future? Statistically, Employer A with the one very large claim is more stable, particularly when you consider that any one of the 10 small accidents of Employer B could incur higher costs than the $50,000 amount given the proper combination of circumstances. In other words, similar risks with a higher frequency of claims will generally have higher future workers compensation costs.

However, the fact that an employer may have a small number of very costly injuries should not be ignored. The final measure must be a blend of both the occurrence and the individual *cost* of each injury.

The Experience Rating Plan recognizes and measures both accident frequency and severity. Although severity of losses is also recognized in experience rating, very large losses are less likely to occur and are seen as more fortuitous than smaller claims. In fact, very large losses are so infrequent that including the entire portion of the claim beyond a certain level in the experience period reduces the predictive ability of the Plan. One very large claim does not imply a pattern of claim frequency. So each individual claim is capped by a state accident limitation.

For many states, the state accident limitation is approximately $100,000. In other words, an individual loss of $1,234,567 would be capped at $100,000 for experience rating purposes. These limited losses used in the Plan are *ratable losses*. The amount of loss above the state accident limitation is excluded from the calculation of the employer's experience rating modification and is a *nonratable loss*.

A *split rating* approach is used to reflect both the frequency and severity of losses. The split of individual ratable losses is made as follows:

- The amount of any ratable individual loss in excess of $5,000 is known as *excess loss,* which reflects severity.
- The amount up to $5,000 is known as *primary loss*, which reflects frequency.
- For an individual loss of $1,234,567 and a state accident limitation of $100,000, the ratable individual loss used in the calculation is $100,000; the excess loss is $95,000; and the primary loss is $5,000. (If the state accident limit had been $150,000, the excess would have been $145,000 and primary would again be $5,000.)
- For individual claims below $5,000, the entire amount is primary loss and the excess loss is $0.

Under this split method, primary losses are given a greater weight in the formula than excess losses. Primary losses have a greater impact on the experience rating modification. Although excess losses have less weight, they're still relevant since total excess claim dollars can be high. The Plan includes an incentive for employers to not only reduce frequency of claims, but to also provide an incentive for employees to return to work as soon as reasonably possible. This type of involvement by the employer can reduce the severity of claims once they have occurred.

The weights or credibilities assigned to primary or excess losses are calibrated to ensure that the modification best reflects the loss history of the particular insured relative to its classification.

These credibilities vary by size of insured. The larger an employer, the more its experience rating calculation is influenced by its own experience. By contrast, a small employer may be covered for years without a claim and then incur an injury where the cost exceeds the total premium paid many times over. An equitable Plan must recognize this fact and temper the debit due to such a loss, as well as the credit for no losses.

For example, an employer with 10 small losses of $5,000 each has a much larger primary loss total than the single-loss employer, although each would have a loss total of $50,000. An employer with a single claim of $50,000 has $5,000 in primary loss, and the rest is excess. Because of the relative weightings, the 10-injury employer receives a much higher modification than the 1-injury employer, even though its total losses are the same.

Medical-only claims do not have as much of an impact on the experience modification, because most states have approved a procedure that limits the amount of such claims in the experience modification calculation.

Only 30% of the actual primary and excess portions of an individual medical-only claim is included in the calculation of the modification factor. As a result, medical-only claims are reduced by 70%.

For example, consider a single medical-only claim of $7,000. The primary portion of the loss is $5,000 and the excess portion is $2,000. After the adjustment, the primary portion of the loss included in the experience modification calculation is $1,500 (30% x $5,000), and the excess portion of this claim is $600 (30% x $2,000).

How the Plan Operates

Experience rating is a *mandatory* plan that applies to all employers that meet a state's premium eligibility criteria for the Plan. Experience rating calculations are computed by NCCI.

Experience rating is a standard measure not impacted by individual carrier pricing programs. An employer qualifies for experience rating if, in the most recent 24 months of the experience period, the subject premium exceeds a premium eligibility point. (Eligibility criteria differ by state. Refer to NCCI's ***Experience Rating Plan Manual for Workers Compensation and Employers Liability Insurance*** for further details.) Because experience rating is based on past loss experience, each risk is evaluated based on its own period of prior experience.

Since the modification is calculated during the term of the current policy, it is not applied to the renewal policy. The experience period could range from 21–57 months, ending one year *prior* to the modification effective date.

For example, an employer with a policy that renews on January 1, 2005 will generally have an experience rating that uses the loss experience that occurred during policies that were effective 1/1/01–12/31/01, 1/1/02–12/31/02, and 1/1/03–12/31/03.

Because loss data for the 2004 policy period is not yet valued or reported by the carrier, it is not used when the 2005 modification is being calculated. The next renewal, on January 1, 2006, will use the 2004 claims, while dropping the oldest of the three-year period mentioned above.

This constant updating ensures a stable historical record for the individual employer, while also using the most recent available reflection of operating characteristics. In this way, meaningful changes in safety programs or improved technology can be reflected in the costs paid by an employer.

Once the employer meets the qualifications for rating, the Plan formula is applied and a credit or debit modification is published by the rating organization. The experience modification factor must be used by any carrier insuring the business. Generally, it applies for one year, and a new modification is calculated for the next year (as long as eligibility requirements are met).

A detailed explanation of the experience rating calculation, including identification of the source of all factors used, is shown on the following pages.

Ownership Changes and Combination of Entities

Another component that may affect your experience rating modification is the change in ownership of your individual risk. When a change in ownership occurs, your carrier must be notified in writing within 90 days of the change. The best method of notifying your carrier of these ownership changes is to complete an ERM-14 Form. Upon receipt of this form, your carrier will forward this information to NCCI.

If a change in ownership occurs, recalculation of experience rating modifications may be required. Changes in ownership may affect the use of an individual risk's experience in future calculations of experience ratings.

NCCI may issue, retract, and/or revise the current modification and up to two preceding modifications due to ownership or combination changes. Generally, the past experience of the business will be transferred to the new owner. These changes may also result in a change in the rating effective date.

In addition, the experience of businesses with more than 50% common ownership is combined into one experience rating modification. Combinability of the experience of entities with the same ownership is based upon the premise that the owner is responsible for safety and loss prevention programs within the businesses.

For additional information on the impact of ownership changes to the modification factor, please refer to NCCI's ***Experience Rating Plan Manual.***

Summary of the Plan

The essentials of experience rating are:

- It is mandatory for all insureds that meet the premium eligibility requirements
- The formula measures how the performance of an employer differs predictably from similarly classified employers

The formula is designed to tailor the cost of coverage to a particular employer. Two basic statistical principles underlie the formula.

First, the larger the premium size, the more reliable the actual record is in predicting future losses. Integral to the Plan is a credibility scale so that the actual historical record is given more weight/credibility as the size of the employer increases. Even the smallest risks have some credibility, but for practical purposes, it is necessary to have a threshold, or a minimum point, for eligibility.

The second statistical concept is that the cost of an injury may vary over a very large range. Therefore, cost is less predictable than the fact that an injury occurred; this is accomplished through the use of the primary and excess components.

Experience Rating Example

Exhibit A illustrates the data collected for use in the experience rating formula, as well as the calculation of a modification on NCCI's Experience Rating Worksheet.

In this example, an experience rating modification is calculated for "Any Insured's" policy, which becomes effective January 1, 2005. In our calculation, we use the insured's experience under the three policies that were effective January 1, 2001, January 1, 2002, and January 1, 2003.

Exhibit A—Unit Statistical Report

UNIT STATISTICAL REPORT

POLICY INFORMATION

Report No.	Corr. No.	Corr. Type	Replace Rpt. Ind.	Carrier Code	Policy Number	Policy Effective Date	Policy Expiration Date	Expos. State	State Effective Date	Certificate No.	Card Serial No.	Risk ID Number	Page No.	Last Page No.
1				99999	98 98 98	01-01-03	01-01-04	55				551234567	1	1

Insured's Name: **Any Insured**

Insured's Address: **Any Address 1 Main Street Anycity USA 00001-000**

F.E.I.N.	Pending File No.
123456789	

Mod Effective Date	Rate Effective Date	Policy Conditions: 3 Yr F/R Policy	Multistate Policy	Interstate Rating	Estimated Exposure	Retro Policy	Canceled Mid-Term	MCO Indicator	Policy Type I D: Type Cov.	Plan Ind.	Non-Std.	Deduct. Type 1	2	Deduct. Percent	Deductible Amount Per Claim/Accident	Deductible Amount Aggregate	Reserved	For Carrier Use	For Bureau Use
		N	N	N	N	N	N	N	01	01	01	0	0						

EXPOSURE INFORMATION

Upd Type	Exp. Cov.	Class Code	Exposure Amount	Manual Rate	Premium Amount
	01	3507	3868379	3.56	137714
	01	7380	107322	2.80	3005
	01	8742	132507	0.48	636
	~~01~~	~~8810~~	~~502408~~	~~0.13~~	~~653~~
	A.	Total Subject Premium			142008
	B.	Experience Mod (XX.XX)			0.85
	C.	Total Modified Premium			120707
	D.				
	E.				
	F.				
	G.	Total Standard Exposure 4610616		Total Standard Premium 120707	
	H.	0063	Premium Discount Amt.		17716
	I.	0900	Expense Constant Amt.		120
	J.				
	K.				
	L.				

LOSS INFORMATION

*Upd Type	Claim Number	Acc. Date/ No. Claims	Incurred Indemnity	Incurred Medical	Class Code	Injury	Status	Loss Conditions: Act	Type	Recov	Cov	Settl	Jurisdic State	Cat. No.	MCO Type
	980001	01/01/03	50000	12500	3507	02	0	01	01	01	01	00			00
	980002	01/02/03	418	4408	8810	05	1	01	01	01	01	00			00
	980003	01/03/03	3034	2378	3507	05	1	01	01	01	01	00			00
		4	0	562	8810	06	1	01	01	01	01	00			00

Claim Number	Social Security Number	Part	Nature	Cause	Occupation Description	Voc.	Lump	Fraud	Deduct	Paid Indemnity	Paid Medical
980001		30	04	06		N	N	00		24876	9512
980002		35	52	97		N	N	00		418	4408
980003		36	40	18		N	N	00		3034	2378
										0	562

Claim Number	Claimant's Attorney Fees	Employer's Attorney Fees	Deductible Reimbursement	Reserved for Future Use	ALAE Paid	ALAE Incurred
980001					4882	7506
980002						
980003						

LOSS TOTALS

Reserved for Future Use	Total No. Claims	Total Incurred Indemnity	Total Incurred Medical	Reserved for Future Use	Total Paid Indemnity	Total Paid Medical
	7	53452	19848		28328	16860

Tot. Claimant's Attny. Fees	Tot. Employer's Attny. Fees	Reserved for Future Use	Total ALAE Paid	Total ALAE Incurred
			4882	7506

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USR-ASWG FORM-A (STANDARD) 1/1/96 NC2957

Example of Data Collected for Experience Rating

The payroll and claim information used in experience rating comes from unit statistical reports. Insurance carriers are required to file a unit report with the rating organization for each policy they issue in accordance with NCCI's ***Unit Report Expansion (URE) Workers Compensation Statistical Plan Manual***. The format for reporting data is on file with the regulatory authorities in each state. As many as four subsequent annual reports are required if any changes in exposure or claims take place after the initial report.

Although most units are reported electronically, for purposes of this booklet, they are portrayed on hard copy.

Exhibit A (on the facing page) shows a unit statistical report for "Any Insured" for the 01/01/03 policy. Two corresponding units are reported for the 01/01/01 and 01/01/02 policies. A description of each item follows:

1. *Insured* is the name of the employer.
2. *State* in which the insured conducts its business. Each state is assigned a unique identification number.
3. *Effective Date* and *Expiration Date* of the policy being reported on.
4. *Risk Identification Number* is a unique number issued to each employer by the rating organization so that the employer's past experience can be isolated.
5. *Class Code* describes the insured's type of business (e.g., Code 3507 is Construction or Agricultural Machinery Manufacturing).
6. *Exposure* is a measure of the size of the insured operations. Payroll is usually used as the exposure base in workers compensation.
7. *Manual Rate* is the cost of insurance per $100 of payroll (exposure) before the application of experience rating.
8. *Premium* (Manual Premium) is obtained by multiplying the units of exposure (payroll divided by $100) by the manual rate (e.g., for Code 3507, Units of Exposure = 3,868,379 ÷ 100 = 38,683.79; Premium = 38,683.79 x 3.56 = 137,714.
9. *Claim Number* is issued by the carrier to identify the claim. Each claim with total incurred loss (indemnity and medical combined) greater than $2,000 must be coded separately.
10. *Accident Date* is the date the injury occurred. It is shown for each claim over $2,000. For claims under $2,000, the *number of claims* is shown in this column for each class code.
11. *Incurred Losses* are split between indemnity and medical and include both amounts already paid and reserves for anticipated future payments on open claims.
12. *Claim Status* of each loss is denoted in this column. The "0" indicates that the claim is still *Open;* the "1" indicates that a final payment has been made and the claim is *Closed.*

Exhibit B—Payroll and Actual Loss Data

3

NCCI WORKERS COMPENSATION EXPERIENCE RATING

1 ANY INSURED
Name of Risk

Date 01/01/05 4

Risk Ident No 551234567

2 State XYZ

CODE	ELR	D-RATI	PAYROLL	EXPECTED LOSSES	EXP PRIM LOSSES	CLAIM DATA	IJ	OF	ACT INC LOSSES	ACT PRIM LOSSES
CARRIER 99999			POLICY NO. 2001UNIT			EFF-DATE 01/01/01			EXP-DATE 01/01/02	
3507	446	18	2807260	125204	22537	010001	1	O	20000	5000
7380	344	15	93870	3229	484	010002	5	F	12847	5000
8742	058	14	127430	739	103	NO. 12	5	*	7422	7422
8810	036	16	425480	1532	245	NO. 6	6	*	2449	2449
POLICY-TOTAL			3454040 (SUBJECT PREMIUM = 103695)						42718	
CARRIER 99999			POLICY NO. 2002UNIT			EFF-DATE 01/01/02			EXP-DATE 01/01/03	
7380	344	15	102618	3530	530	NO. 4	5	*	3600	3600
3507	446	18	3232201	144156	25948	NO. 28	6	*	13243	13243
8810	036	16	462375	1665	266	020027	5	F	9477	5000
8742	058	14	135368	785	110					
POLICY-TOTAL			3932562 (SUBJECT PREMIUM = 153335)						26320	
CARRIER 99999			POLICY NO. 2003UNIT			EFF-DATE 01/01/03			EXP-DATE 01/01/04	
3507	446	18	3868379	172530	31055	030001	2	O	62500	5000
7380	344	15	107322	3692	554	030002	5	F	4826	4826
8742	058	14	132507	769	108	030003	5	F	5412	5000
8810	036	16	502408	1809	289	NO. 4	6	*	562	562
POLICY-TOTAL			4610616 (SUBJECT PREMIUM = 12617)						73300	

Callout labels: 5, 6, 7, 8, 9, 10, 11, 12, 13, 14

RATING REFLECTS A DECREASE OF 70% MEDICAL ONLY PRIMARY AND EXCESS LOSS DOLLARS WHERE ERA IS APPLIED.

17

(A)	(B)	(C) EXPECTED EXCESS (D-E)	(D)	(E)	(F) ACTUAL EXCESS (H-I)	(G)	(H)	(I)
032		377411	459640	82229	85236	64800	130961	45725

16

15

* Total by Policy Year of all cases $2,000 or less.
# Limited Loss.
C Catastrophic loss.

PAGE NUMBER 1

DATE

	(11) PRIMARY LOSS	(12) STABILIZING VALUE	(13) RATABLE EXCESS	(14) TOTALS	(15) EXP MOD
ACTUAL	(I) 45725	(C) X (1-W) + (G) 321439	(A) X (F) 27276	(J) 394440	
EXPECTED	(E) 82229	321439	(A) X (C) 120772	(K) 524440	(J) / (K) 0.75

Example of Experience Rating Worksheet

The **first step** in the experience rating process is to transfer payroll and loss information from the unit statistical reports to the experience rating worksheet. Exhibit B, shows NCCI's Experience Rating Worksheet for "Any Insured."

Payroll and Loss Data

The top section of Exhibit B contains the basic identifying information, such as the name of the insured **(1),** the state in which the insured is located **(2),** and the risk identification number **(3).** In addition, it shows that the experience modification will be used for the policy that becomes effective January 1, 2005 **(4).**

The payroll and loss information is shown separately for each of the three policies under review. On the left-hand side, we have the payroll (exposure) **(5)** for each classification code **(6).** On the right-hand side, we have the actual incurred losses **(7)** and the indicator of whether the claim is open or closed **(8)** and the respective claim number for losses over $2,000. Individual claims of $2,000 or less will show a blank in the claim data column **(9).**

Note that in transferring the losses from the unit report to the experience rating worksheet, the indemnity and medical amounts are combined since we are only concerned with the total amount of the claim.

For example, claim number **03 0001 (10)** has an indemnity cost of **$50,000** and a medical cost of **$12,500** for a total of **$62,500** as is shown at **(11)** on the experience rating worksheet. The claim just below this one has an indemnity cost of **$418** and a medical cost of **$4,408** for a total of **$4,826 (12).** Medical-only claims (Injury Type 6) are listed separately on the worksheet because these are reduced by 70%. The reduced losses are shown in the foot totals only; the claim detail shows the entire actual amounts **(13).**

As previously noted, an important consideration in experience rating is the frequency of injuries or how often they occur. Another component is the severity or seriousness of the injuries. The severity may have little or no significance for small employers, and becomes more of a factor as the size of the employer increases.

The **second step** is to separate the actual losses into primary and excess components. The actual primary losses are shown at **(14).** For losses under $5,000, the whole amount is taken as the primary value. For losses greater than $5,000, only the first $5,000 is primary. In this example, we have total losses of **$130,961 (15)** and primary losses of **$45,725 (16).** By subtracting the primary from the total losses, we obtain excess losses of **$85,236 (17).**

Now that primary and excess losses have been identified, the next step is to calculate the expected losses for the insured. The actual losses will be compared with the expected losses to determine whether a credit (decrease) or debit (increase) modification is in order.

Exhibit C—Expected Losses

22

WORKERS COMPENSATION EXPERIENCE RATING

19

ANY INSURED
Name of Risk

Date 01/01/05

Risk Ident No 551234567
State XYZ

18 21

CODE	ELR	D-RATI	PAYROLL	EXPECTED LOSSES	EXP PRIM LOSSES	CLAIM DATA	IJ	OF	ACT INC LOSSES	ACT PRIM LOSSES
CARRIER	99999		POLICY NO.	2001UNIT		EFF-DATE 01/01/01			EXP-DATE 01/01/02	
3507	446	18	2807260	125204	22537	010001	1	O	20000	5000
7380	344	15	93870	3229	484	010002	5	F	12847	5000
8742	058	14	127430	739	103	NO. 12	5	*	7422	7422
8810	036	16	425480	1532	245	NO. 6	6	*	2449	2449
POLICY-TOTAL			3454040	(SUBJECT PREMIUM = 103695)					42718	
CARRIER	99999		POLICY NO.	2002UNIT		EFF-DATE 01/01/02			EXP-DATE 01/01/03	
7380	344	15	102618	3530	530	NO. 4	5	*	3600	3600
3507	446	18	3232201	144156	25948	NO. 28	6	*	13243	13243
8810	036	16	462375	1665	266	020027	5	F	9477	5000
8742	058	14	135368	785	110					
POLICY-TOTAL			3932562	(SUBJECT PREMIUM = 153335)					26320	
CARRIER	99999		POLICY NO.	2003UNIT		EFF-DATE 01/01/03			EXP-DATE 01/01/04	
3507	446	18	3868379	172530	31055	030001	2	O	62500	5000
7380	344	15	107322	3692	554	030002	5	F	4826	4826
8742	058	14	132507	769	108	030003	5	F	5412	5000
8810	036	16	502408	1809	289	NO. 4	6	*	562	562
POLICY-TOTAL			4610616	(SUBJECT PREMIUM = 12617)					73300	

RATING REFLECTS A DECREASE OF 70% MEDICAL ONLY PRIMARY AND EXCESS LOSS DOLLARS WHERE ERA IS APPLIED.

27 24 20 23 29

(A)	(B)	(C) EXPECTED EXCESS (D-E)	(D)	(E)	(F) ACTUAL EXCESS (H-I)	(G)	(H)	(I)
032		377411	459640	82229	85236	64800	130961	45725

* Total by Policy Year of all cases $2,000 or less.
\# Limited Loss.
C Catastrophic loss.

PAGE NUMBER 1

DATE

25 32

	(11) PRIMARY LOSS	(12) STABILIZING VALUE	(13) RATABLE EXCESS	(14) TOTALS	(15) EXP MOD
ACTUAL	(I) 45725	(C)X(1-W)+(G) 321439	(A)X(F) 27276	(J) 394440	
EXPECTED	(E) 82229	321439	(A)X(C) 120772	(K) 524440	(J)/(K) 0.75

34

30

28

26 31 33

Expected Losses

In Exhibit C, the ELR **(18)** is the Expected Loss Rate. It is the amount of expected losses for the classification for each $100 of payroll. Therefore, to obtain the expected losses, multiply the ELR by the payroll divided by $100.

Taking the first line of the worksheet as an example, with an ELR of **4.46** and payroll of **$2,807,260,** the calculation is **4.46** x **($2,807,260 ÷ 100) = $125,204.**

The **$125,204** is entered in the Expected Losses column **(19).** The total for expected losses is shown at the bottom of the column **(20).**

The D-ratio **(21)** is the Discount Ratio. It represents the portion of the expected losses that are expected *primary* losses **(22).** Multiply the expected losses by the D-ratio to get the expected primary losses. The calculation is **$125,204** x **0.18 = $22,537.** The total for expected primary losses is shown at the bottom of the column **(23).**

The expected *excess* losses **(24)** are then obtained by subtracting the expected primary losses **(23)** from the total expected losses **(20).** The calculation is **$459,640 – $82,229 = $377,411.**

The **final step** is to calculate the experience modification factor. The actual primary losses **(25)** and expected primary losses **(26)** are entered in the appropriate boxes at the bottom of the page.

The term "ballast" is defined as something that gives stability, such as heavy material in the hold of a ship to keep it from shifting too far one way or the other. Similarly, the ballast factor in the experience rating formula helps prevent the experience modification from shifting too far above or below unity. It is part of the Stabilizing Value. The ballast value increases as expected losses increase.

The "W" factor **(27)** is the Weight given to the excess losses and expected losses. "W" is a small percentage for small insureds and increases with the size of the insured. The complement of "W" or "1 – W" is assigned to the expected excess losses to produce another part of the Stabilizing Value.

The Stabilizing Value **(28)** is calculated by multiplying the expected excess losses **(24)** by **(1 – W),** then adding tabular ballast value **(29).** The calculation is **$377,411** x **(1 – 0.32) + $64,800 = $321,439.** The weighted ratable excess losses entering the formula are obtained by multiplying the excess by the "W" value:

(30) Weighted Actual Excess = **$ 85,236** x **0.32 = $27,276**
(31) Weighted Expected Excess = **$377,411** x **0.32 = $120,772**

Adjusted actual losses (the numerator of the fraction) used in the calculation are obtained by adding across and are equal in this case to **$394,440 (32).** The adjusted expected losses are **$524,440 (33).**

The experience modification **(34)** is derived by dividing adjusted actual losses by the adjusted expected losses or **$394,440 ÷ $524,440 = 0.75.**

This **0.75** is applied to the employer's manual premium at the renewal, effective January 1, 2005.

EXPERIENCE RATING
FREQUENTLY ASKED QUESTIONS

Q. I just purchased a competitor's business. How does this affect my experience rating modification?

A. If the same person, group of persons or corporation owns more than 50% of each entity, the entities are usually combinable for experience rating purposes. As a result, the experience rating modification may be revised to include the experience of the newly acquired business.

Q. I just received my experience rating modification and believe it is incorrect. What should I do?

A. If unable to resolve this with your agent, contact NCCI's Customer Service Department at 800-622-4123. A representative will be able to help determine whether further action is necessary.

NCCI determines the applicability of its ***Experience Rating Plan Manual*** rules, and calculates, issues, and if necessary, revises experience rating modifications.

Q. Why might the data contained on an experience modification factor be longer or shorter than the referenced three-year period?

A. A risk's experience can range from containing less than 12 months of data up to the inclusion of 45 months of data. Some reasons for this are:

Short-term policies
Cancellations
Gaps in coverage
Changes in ownership
Rating effective date changes
Multiple policy effective dates
Policies longer than 1 year, 16 days
Wrap-up policies
Interstate policies

Q. I just received my experience rating modification and there is a comment of "preliminary" listed on the rating. What does this mean?

A. A preliminary modification uses existing rating values that are expected to change pending regulatory action on a rate filing. Another comment frequently seen on the experience rating modification is "contingent." Contingent ratings are missing some data, but still meet the minimum data requirements for the calculation of experience rating (see the Minimum Data Requirements Table located in NCCI's ***Experience Rating Plan Manual*** for further details).

EXPERIENCE RATING
FREQUENTLY ASKED QUESTIONS (CONT'D)

Q. I've been in business for 10 years. Why is this the first year my company is experience rated?

A. In the past, the company's subject premium was most likely less than the premium eligibility threshold. In order to qualify for experience rating, you must meet minimum premium requirements, which differ by state. The State Table of Subject Premium Eligibility Amounts can be found in NCCI's ***Experience Rating Plan Manual.***