

August 9, 2012

ALL ASSOCIATION MEMBERS

Circular Letter No. 12-1620

RE: Frequently Asked Questions Regarding NCCI Item E-1402–Revisions to the Experience Rating Plan Primary/Excess Split Point Value and Maximum Debit Modification Formula

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: 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.)

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 employer experience rating modifications have gravitated toward the all-employer average over time. To address this issue, a transition plan to increase the split point amount over time will be implemented.

3. What is the experience rating split point transition plan?

The transition plan is:

- Year 1: The split point will initially be increased to \$10,000, effective January 1, 2013
- Year 2: Effective January 1, 2014 the split point will further increase to \$13,500
- Year 3: Effective January 1, 2015 the split point will further increase to \$15,000, adjusted for inflation.

4. What will happen to the experience rating split point after the transition plan?

After the transition plan, MWCIA will examine the changes in both the Minnesota and countrywide total average costs per case on an annual basis. Annual adjustment factors will then be judgmentally selected and multiplied with the previous split point.

5. What will be the premium impact of increasing the experience rating split point?

There will be no measurable change in the overall average statewide experience modification level in 2013 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 employer-specific and will vary from employer to employer depending on individual employer loss experience.

6. 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 employers, 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.

7. When will the experience rating split point begin to increase?

The change will become effective in Minnesota on January 1, 2013, coinciding with the effective date of the 2013 MWCIA Ratemaking Report.

8. Are there any other changes to the Experience Rating Plan?

Yes, MWCIA is changing the maximum debit modification formula.

9. 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 the *Minnesota Experience Rating Plan Manual*. The cap varies by the size of an employer. The smaller the employer, the lower the cap, and the larger the employer, the larger the cap.

10. What are the revisions to the maximum debit modification formula?

MWCIA will be increasing the cap slightly for very small employers, but reducing the cap for other employer sizes. Only 3% of experience-rated employers reach this cap.

11. Why is the maximum debit modification formula being changed?

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 new cap is less restrictive and approaches a maximum debit modification of 10% for the smallest employers.

12. Will there be any impact to employers in the Merit Rating Plan?

No, employers in the Merit Rating Plan will not be affected by the implementation of E-1402.

Please direct any questions you may concerning this item to MWCIA's Actuarial Department at (952) 897-1737, option 3, or email at actuarial@mwcia.org.