

## **Workers Compensation Experience Rating – Questions and Answers**

### *What is Workers Compensation Experience Rating?*

Experience rating is mandatory process that modifies the published rates for rating classifications by taking into account the actual reported losses and payrolls of an individual business. It is a financial incentive to employers to minimize the financial cost of workplace injuries.

### *How Is Workers Compensation Experience Rating Administered?*

All insurance companies provide their reported losses and payrolls in a common format and at scheduled times to a licensed statistical agent such as the National Council on Compensation or The North Carolina Rate Bureau. This allows for all the losses and payrolls of a business to be used in the experience rating process, even if different insurers provided coverage during the experience rating period. Experience modifications are calculated by the approved rating organization and delivered to the insurer of each business.

### *What Time Period is Used in Workers Compensation Experience Rating?*

The experience period is usually three full policy years, ending one year prior to the effective date of the modification. To illustrate, a modification effective January 1, 2005 uses payrolls and losses for the policies effective January 1, 2001; January 1, 2002; and January 1, 2003. The length of the experience rating period may be as little as one year or as great as three years and nine months, depending on how long the insured has been in business and whether policies have been issued for a coverage period different than a full year.

### *How Does the Experience Rating Formula Work?*

The experience rating modification is affected by small losses more than by large ones because small losses are more frequent and predictable than large losses.

The portions of all losses that are less than \$5000, which are termed “primary losses”, have the greatest influence in determining the experience modification. Losses in excess of \$5,000 are capped at levels that vary by state. To illustrate, single claimant losses in North Carolina were capped at \$131,000 and multi-claim accidents were capped at \$262,000 in April 2004. The amounts of each loss over \$5,000 and below the cap are termed “ratable excess losses” and given increasing importance in experience rating for larger employers based on the level of their expected losses.

### *Should Small Losses Not Be Reported to the Insurer in Order to Reduce the Experience Modifier?*

Most states, including North Carolina and South Carolina, have approved a 1998 adjustment to experience rating that now uses only thirty percent of ratable, “medical-only” claims in the experience rating formula. This change was made to increase the incentive to report all claims by decreasing the sensitivity of experience rating to small claims that involve no lost work time. Key Risk requires all claims except routine first aid to be reported to us. This facilitates our ability to manage medical costs and to have timely involvement in an injury that may be more serious than is apparent at first.

It is illegal in many states to not report all lost-time claims.

What Determines the Loss Valuation Dates for Experience Rating?

Key Risk and all other insurers must comply with a common statistical reporting plan that determines when losses are valued. The initial report of losses must be valued in the eighteenth month after the effective date of the policy and filed with the rating organization not later than the twentieth month after the effective date of the policy. Second, third, fourth and fifth reports are required if any claims are not closed at the time the last report was filed. These subsequent reports, if needed, are filed thirty, forty-two, fifty-four and sixty-six months after policy inception.

Statistical reports may not normally be filed at other than these scheduled valuation points except in limited instances. These circumstances will generally involve the need to correct a classification or payroll, a clerical error, an aggravated inequity or a subrogation recovery that exceeds 10% of the gross claim.

Who is Eligible to Be Experience Rated?

An employer is eligible to be experience rated when the payrolls develop premium that meets or exceeds a premium level established for eligibility in each state. The required premium level requirements are:

State	Average Annual Premium for More Than Two Years	Payrolls in The Last Year or Two Years of the Experience Rating Period Develop Premium That Exceeds:
Georgia	\$5,000	\$10,000
North Carolina	\$2,500	\$5,000
South Carolina	\$4,500	\$9,000
Virginia	\$3,500	\$7,000

How Does Experience Rating Apply to an Employer With Exposures in Multiple States?

The National Council on Compensation Insurance administers an interstate experience rating plan. All jurisdictions are included except for California, Delaware, Michigan, New Jersey and Pennsylvania. To qualify, an employer must be subject to intrastate experience rating in at least one jurisdiction and have premiums in another jurisdiction that is included in the interstate plan.

What Is the Best Way for an Employer to Favorably Influence an Experience Modification Factor?

Remember that losses remain in the experience rating formula for three years and that the experience modification is influenced more by small frequent losses than by large, infrequent ones. Thus, the short answer is to implement and sustain a comprehensive workplace safety program. Effective self-inspection program and accident investigation programs are particularly pertinent to managing claim frequency. Key Risk's Loss Control professionals are available to help employers to establish these programs.

It is also advisable to not use subcontractors that do not have their own workers compensation insurance. Losses developed from uninsured subcontractors' work are reported as experience of the primary contractor or principal!

What Conclusions Do Key Risk Underwriters Draw From Experience Rating Modification Factors?

We believe that the experience rating modification, whether a credit or debit, is an equitable adjustment to our published rates for the involved rating classifications, assuming that the operations, hazards and

hazard controls during the experience rating period are unchanged. Underwriters will adjust pricing using available pricing tools such as schedule rating factors to recognize risk-specific factors that are not taken into account by experience rating.

#### Do Businesses with Common Ownership Share a Common Experience Modification Factor?

The majority ownership of the organization will determine if multiple entities can be combined for experience rating purposes. Common majority exists when one person or a common group of people or corporations owns 50% or more of each entity; or when one entity owns a majority interest in another entity, which in turn owns a majority interest in a third entity.

Majority ownership considers the greatest number of entities that can be combined by considering: 1) the majority of issued voting stock; 2) the majority of members if there is no voting stock; 3) the majority of the Board of Directors or other governing body if neither of the foregoing apply; or 4) participation of general partners in the profits of a partnership.

#### What Should Happen to an Experience Rating When the Ownership of a Business Changes?

Workers Compensation policies issued by Key Risk contain a form captioned "Notification of Change in Ownership Endorsement" which requires the insured employer to report any change of ownership to the underwriter within ninety days of the change.

Changes in ownership should be provided on a simple form "ERM-14 Confidential Request for Information" that is available from your Key Risk underwriter. The form is designed to determine if a nominal or material change of ownership has occurred.

#### To What Extent is the Payroll and Loss Experience of a Business Used after a Change of Ownership?

The past experience may continue to be attributed to the seller's experience modifier, added to the experience modification of the acquiring entity or excluded from both. A determination must be made as to whether the change of ownership was nominal or material.

A nominal change of ownership happens when the final owner(s) collectively owned one third or more of the insured entity before the change and half or more after the change. A nominal change of ownership does not affect the experience modification of the business.

A material change of ownership usually causes the experience of the seller to be transferred to the buyer. In the case of a material change of ownership, the past experience will be excluded from the future experience ratings of both the buyer and seller only if there is a change in the governing classification and a change in the process and hazard of the business.

#### Can my Loss Experience While a Member of a Group Self Insured Fund Be Used in Determining an Experience Modification?

Yes. Payroll and loss data submitted by the self-insurer fund administrator may be used, subject to verification of data by the experience rating organization.

#### How Does Experience Rating Apply to Joint Ventures?

The policy issued to the joint venture will be issued with the arithmetic average of the experience modifiers of the participants until the joint venture develops its own experience modification factor.