

DELAWARE COMPENSATION RATING BUREAU, INC.

NCCI Filing Memorandum

Attached is an NCCI Filing Memorandum (ITEM R-1388-2004 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS).

The DCRB is filing the Table of Expected Loss Ranges as shown on page 4 of ITEM R-1388.

FILING MEMORANDUM

ITEM R-1388—2004 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS

(To be effective 12:01 a.m. on July 1, 2004, applicable to new and renewal business only.)

PURPOSE

The purpose of this item is to update the Expected Loss Ranges and State Hazard Group Relativities in the *Retrospective Rating Plan Manual for Workers Compensation and Employers Liability Insurance*.

BACKGROUND

Retrospective Rating is a plan for adjusting the risk premium of 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 carriers. It also includes a net insurance charge, which contains a charge to compensate for the possibility that R will exceed the maximum premium amount. Similarly, there is a 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

The Table of Insurance Charges contains the excess ratios needed to quantify the insurance charge and savings described above. The ratio of actual losses to expected losses, the entry ratio, is used to look up the values in the Table. The charges depend not only on the maximum and minimum subject losses, but also on the size of the insured. The variation in the loss ratios, hence the charges, of the larger employers that expect many losses should be much lower than the variation for smaller 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 the 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 2003 (Item R-1385—2003 Update to Retrospective Rating Plan Parameters). The current Table of Expected Loss Ranges is based on a projected annual increase in severity of 5% from January 14, 2000 to December 1, 2004. We have since observed an actual annualized growth in severity of 10.9% from January 14, 2000 to June 22, 2000, and we project an annual growth in severity of 6% from June 22, 2000 to July 1, 2005. The new table incorporates both these observed and projected changes in severity.

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ITEM R-1388—2004 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS

State Hazard Group Relativities

The variation in the loss ratios of employers in the lower hazard groups should be smaller than the variation for employers in the higher hazard groups. The State Hazard Group Relativity Factors adjust for this difference by placing lower hazard group employers in a higher Expected Loss Size Range and higher hazard group employers in a lower Expected Loss Size Range than would otherwise be the case. This adjustment affects the column selection in the Table of Insurance Charges, which then impacts the basic premium portion of the retrospective policy premium.

The State Hazard Group Relativities should be updated regularly due to changes in the circumstances (changes in state statutory benefit levels, inflation, etc.) underlying each state's severity.

PROPOSAL

It is proposed that the *Retrospective Rating Plan* be amended as contained in the attached exhibits.

Expected Loss Ranges

This filing updates the Table of Expected Loss Ranges for entry into the Table of Insurance Charges. The proposed ranges are found in Exhibit 2.

State Hazard Group Relativities

This filing also updates the State Hazard Group Relativities of the *Retrospective Rating Plan* for each state. Exhibit 1 provides a description of the development of the relativities. As explained in the exhibit, individual state severities, as well as countrywide severities, are used in the calculation of the relativities.

The proposed relativities are found in Exhibit 3.

IMPACT

Expected Loss Ranges

The proposed 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.

State Hazard Group Relativities

Retrospective rating should produce premium that is equitably distributed to all insured employers, but on average close to the guaranteed cost in the approved rate. The object of this change is to maintain the aggregate expected balance, but the impact will vary slightly for individual insured employers. Thus, insurance charges and premiums will be higher for some insureds and lower for others. For most of the insured employers electing retrospective rating, the impact on final premium from these changes will be quite small.

The improved equitability from this change will result in slightly lower average insurance charges for some states, and slightly higher for others. However, the statewide impact will be negligible. The program is designed to be revenue-neutral countrywide.

IMPLEMENTATION

Exhibit 1 displays the development of State Hazard Group Relativities. Exhibits 2 and 3 detail the changes made to the *Retrospective Rating Plan Manual for Workers Compensation and Employers Liability Insurance*.

ITEM R-1388—2004 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS

EXHIBIT 1

DEVELOPMENT OF STATE HAZARD GROUP RELATIVITIES

Step 1. Individual state severities are calculated for each hazard group.

Step 2. The severities are weighted with the countrywide severities by hazard group using a credibility that varies by state. For this purpose, we regard 155,000 claims as fully credible, and use the square root rule to compute partial credibilities.

Step 3. Credibility weighted severities for each state hazard group are produced. A new countrywide average severity is calculated by taking the weighted average of the formula for state severities using claim counts as weights.

Step 4. The relativities are calculated by dividing the countrywide severity by the individual state hazard group severities.

Example: State X

Step 1	Hazard Group	State X	Countrywide
Severities	1	21,361	25,738
	2	23,085	28,311
	3	33,771	45,018
	4	45,265	65,042

Step 2	Claim Count	59,672	
	Credibility	=	$(59,672 / 155,000)^{0.5} = 0.62$

Step 3	Hazard Group	State X	
Cred. Wtd. Severities	1	23,024	= 0.62 x 21,361 + 0.38 x 25,738
	2	25,071	
	3	38,045	
	4	52,780	

Countrywide Overall 35,289

Step 4	Hazard Group	State X	
Relativities	1	1.53	= 35,289 / 23,024
	2	1.41	
	3	0.93	
	4	0.67	

Note: The underlying data source for the above calculations is the *Workers Compensation Statistical Plan (WCSP)*, excluding medical-only claims. The *WCSP* data for each state is adjusted accordingly, as reflected in the data underlying the Excess Loss Factor (ELF) calculation.

ITEM R-1388—2004 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS

EXHIBIT 2

RETROSPECTIVE RATING PLAN MANUAL
 2004 EXPECTED LOSS RANGES
 EFFECTIVE 7/1/04

Expected Loss Group	Range Rounded Values	Expected Loss Group	Range Rounded Values	Expected Loss Group	Range Rounded Values
95	643— 1,003	65	53,905— 58,219	35	672,306— 754,844
94	1,004— 1,486	64	58,220— 62,880	34	754,845— 847,519
93	1,487— 1,962	63	62,881— 67,914	33	847,520— 966,428
92	1,963— 2,594	62	67,915— 73,350	32	966,429— 1,110,847
91	2,595— 3,375	61	73,351— 79,222	31	1,110,848— 1,276,849
90	3,376— 4,075	60	79,223— 85,580	30	1,276,850— 1,467,659
89	4,076— 4,919	59	85,581— 92,534	29	1,467,660— 1,744,627
88	4,920— 5,710	58	92,535— 99,909	28	1,744,628— 2,086,194
87	5,711— 6,628	57	99,910— 107,646	27	2,086,195— 2,494,638
86	6,629— 7,688	56	107,647— 115,984	26	2,494,639— 3,075,371
85	7,689— 8,695	55	115,985— 124,969	25	3,075,372— 3,913,499
84	8,696— 9,829	54	124,970— 135,124	24	3,913,500— 4,980,041
83	9,830— 11,100	53	135,125— 146,146	23	4,980,042— 6,363,618
82	11,101— 12,351	52	146,147— 158,070	22	6,363,619— 8,142,851
81	12,352— 13,742	51	158,071— 170,961	21	8,142,852— 10,419,549
80	13,743— 15,287	50	170,962— 184,485	20	10,419,550— 13,332,799
79	15,288— 17,008	49	184,486— 199,046	19	13,332,800— 17,060,577
78	17,009— 18,769	48	199,047— 214,861	18	17,060,578— 23,402,105
77	18,770— 20,663	47	214,862— 233,758	17	23,402,106— 34,611,525
76	20,664— 22,751	46	233,759— 254,315	16	34,611,526— 51,190,173
75	22,752— 25,001	45	254,316— 276,681	15	51,190,174— 75,709,857
74	25,002— 27,372	44	276,682— 302,352	14	75,709,858— 111,974,276
73	27,373— 29,966	43	302,353— 330,838	13	111,974,277— 165,609,059
72	29,967— 32,811	42	330,839— 362,010	12	165,609,060— 259,241,432
71	32,812— 35,815	41	362,011— 399,071	11	259,241,433— 410,223,772
70	35,816— 39,068	40	399,072— 441,013	10	410,223,773— 649,138,303
69	39,069— 42,611	39	441,014— 487,363	9	649,138,304— & over
68	42,612— 46,201	38	487,364— 538,584		
67	46,202— 49,903	37	538,585— 598,787		
66	49,904— 53,904	36	598,788— 672,305		

ITEM R-1388—2004 UPDATE TO RETROSPECTIVE RATING PLAN PARAMETERS

EXHIBIT 3

RETROSPECTIVE RATING PLAN MANUAL
 STATE HAZARD GROUP RELATIVITIES
 EFFECTIVE 7/1/04

State	Hazard Group			
	I	II	III	IV
AK	1.23	1.14	0.71	0.48
AL	1.24	1.18	0.74	0.50
AR	1.54	1.40	0.89	0.62
AZ	1.31	1.18	0.72	0.49
CO	1.24	1.13	0.74	0.50
CT	1.54	1.40	0.88	0.59
DC	1.36	1.22	0.75	0.51
FL	1.16	1.03	0.60	0.39
GA	1.20	1.10	0.70	0.48
HI	1.62	1.50	0.96	0.66
IA	1.40	1.30	0.85	0.58
ID	1.38	1.27	0.83	0.58
IL	1.36	1.27	0.89	0.62
IN	1.68	1.57	1.08	0.76
KS	1.56	1.42	0.93	0.64
KY	1.21	1.09	0.68	0.46
LA	1.32	1.25	0.77	0.53
MD	1.33	1.20	0.74	0.50
ME	1.37	1.26	0.80	0.55
MI	1.47	1.38	0.87	0.61
MO	1.52	1.41	0.96	0.66
MS	1.39	1.26	0.81	0.56
MT	1.34	1.21	0.76	0.51
NC	1.05	0.94	0.59	0.40
NE	1.30	1.18	0.75	0.50
NH	1.44	1.30	0.80	0.53
NM	1.41	1.28	0.82	0.57
NV	1.26	1.11	0.67	0.44
OK	1.70	1.54	0.99	0.69
OR	1.41	1.28	0.79	0.52
RI	1.70	1.54	0.95	0.64
SC	1.33	1.20	0.78	0.54
SD	1.44	1.31	0.82	0.56
TN	1.13	1.03	0.67	0.47
UT	1.56	1.42	0.90	0.60
VA	1.24	1.14	0.70	0.48
VT	1.34	1.24	0.79	0.55
WI	1.69	1.56	1.02	0.73