



NORTH CAROLINA RATE BUREAU
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January 24, 2003

CIRCULAR LETTER TO ALL MEMBER COMPANIES

Re: Workers Compensation Insurance

Item RM-01-NC-02

Assigned Risk Adjustment Program

The Rate Bureau has adopted and the North Carolina Commissioner of Insurance has approved a proposal to amend the current Assigned Risk Adjustment Program (ARAP) rules to clarify the application of the surcharge in premium calculations.

The attached Filing Memorandum describes the changes which have been approved to become effective January 1, 2003.

Very truly yours,

Jerry G. Hamrick

Workers Compensation Manager

JGH:dg

Attachment

C-03-4

FILING MEMORANDUM

ITEM RM-01-NC-02—AMENDED ASSIGNED RISK ADJUSTMENT PROGRAM (ARAP)

(To be effective 12:01 a.m. on January 1, 2003, applicable to new and renewal assigned risk business only.)

PURPOSE

The purpose of this filing is to change the current Assigned Risk Adjustment Program (ARAP) rules to clarify the application of the surcharge in premium calculation.

BACKGROUND

ARAP was approved by the North Carolina Commissioner of Insurance effective January 1, 1991.

Questions have arisen regarding the correct application of the ARAP surcharge in premium calculation. This filing will change:

1. The **Basic Manual** to clarify how the surcharge is to be applied in premium calculation.
2. The North Carolina Assigned Risk Workers Compensation Premium Algorithm to clarify that the ARAP factor applied is a surcharge.
3. The **Policy Forms and Endorsement Manual** to correspond with the ARAP program and Assigned Risk Premium Algorithm changes.

PROPOSAL

Effective January 1, 2003, it is proposed that the North Carolina ARAP Rules and Assigned Risk Workers Compensation Premium Algorithm located in the **Basic Manual for Workers Compensation and Employers Liability Insurance** be changed to clarify the application of the ARAP surcharge in premium calculation.

It is also proposed that the Assigned Risk Adjustment Program Endorsement WC 00 04 15 A located in the **Policy Forms and Endorsements Manual** be changed to correspond with the ARAP program and Assigned Risk Workers Compensation Premium Algorithm changes.

IMPACT

There is no premium impact as a result of this filing.

IMPLEMENTATION

Exhibits 1 and 2 outline the changes required in the **Basic Manual for Workers Compensation and Employers Liability Insurance**.

Exhibit 3 provides a revised Assigned Risk Adjustment Program Endorsement WC 00 04 15 A, which will be included in the **Policy Forms and Endorsements Manual**.

ITEM RM-01-NC-02—AMENDED ASSIGNED RISK ADJUSTMENT PROGRAM (ARAP)

EXHIBIT 1

BASIC MANUAL

MISCELLANEOUS RULES

ASSIGNED RISK ADJUSTMENT PROGRAM (ARAP)

1. **Eligibility**— A risk shall be eligible for the Assigned Risk Adjustment Program if it is eligible for an experience rating modification. The application of this program is mandatory for all eligible insureds and shall apply to all assigned risk policies written for such insureds.
2. **ARAP Surcharge Formula**
 - a. After the calculation of the experience modification factor (M) for a particular risk, the weighted test ratio (R) is calculated.

$$R = \frac{(0.5 - 0.5W)A_p}{M \cdot E_p} + \frac{(0.5 + 0.5W)A}{M \cdot E}$$

where:

- W** is the weighting value
- A** is the actual losses, as limited on a per accident basis
- A_p** is the actual primary losses
- E** is the total expected losses
- E_p** is the expected primary losses
- M** is the experience modification

All values are those used in the experience modification calculation.

- b. If R is greater than 1.0, a surcharge factor S will be calculated using the following formula:

$$S = 1 + \frac{(0.08)\hat{E}(R - 1)^{1.25}}{(\hat{E} + 3)^{0.5}}$$

where:

- Ê** is the total expected losses of the particular insured shown in thousands. Ê shall not exceed 40.
- R** is the weighted test ratio calculated in 2.a. R shall not exceed 2.0.

- c. The surcharge factor S will appear on all rating forms. This surcharge factor will be applied to the ~~standard premium~~ **total modified premium** developed in the state(s) where effective.
3. The surcharge is limited to a maximum of 49% of ~~standard premium~~ **total modified premium**. Only insureds with expected losses of \$40,000 and over will be subject to the maximum surcharge. The following table shows sample maximum surcharges by risk expected loss size.

Risk Expected Losses	Maximum Surcharge
\$2,500	9%
5,000	14%
10,000	22%
\$25,000	38%
\$40,000 and over	49%

4. ARAP Definitions

For the purposes of this program, the following definitions apply:

- a. **Weighted Test Ratio**—A comparison of the risk's actual losses to the modified expected losses. A ratio greater than 1.00 is subject to the ARAP surcharge. This test ratio is limited to 2.00.
 - b. **ARAP Surcharge Factor**—The factor is applied to the ~~normal standard premium~~ **total modified premium** when the insured is an assigned risk. This factor is determined by a formula using the weighted test ratio.
5. Experience rated risks with multistate operations shall be subject to the Assigned Risk Adjustment Program in states that have approved it. For risks with interstate exposure, the R (test ratio) and the S (surcharge) values will be computed on a full interstate basis. In ARAP states, S will be used to develop the surcharged premium in those states only.

ITEM RM-01-NC-02—AMENDED ASSIGNED RISK ADJUSTMENT PROGRAM (ARAP)

EXHIBIT 2

NORTH CAROLINA ASSIGNED RISK WORKERS COMPENSATION PREMIUM ALGORITHM

The following algorithm provides the framework for premium charges and credits. Where not specified, the premium base would be the result from the prior line.

	PREMIUM ELEMENTS	EXPLANATORY NOTES
	MANUAL PREMIUM	[(PAYROLL / 100) * RATE]
+	Supplementary Disease (foundry, abrasive, sandblasting)	[(SUBJECT PAYROLL / 100) * DISEASE RATE]
+	USL & H Exposure for non-F classification codes	[(SUBJECT PAYROLL/100) * (RATE * USL&H FACTOR)]
	TOTAL MANUAL PREMIUM	
+	Employers Liability (E/L) increased limits factor	[% applied to Total Manual Premium]
+	Employers Liability increased limits charge	[Balance to E/L increased limits minimum premium]
+	Employers Liability increased limits factor (Admiralty, FELA)	[Factor applied to the portion of Manual Premium where Admiralty/FELA coverage is applicable]
+	Employers Liability/Voluntary Compensation flat charge	[Coverage in Monopolistic State Funds]
-	Small Deductible credit	[% applied to Total Manual Premium]
	TOTAL SUBJECT PREMIUM	
×	Experience Modification (Exp Mod)	
	TOTAL MODIFIED PREMIUM	
×	Assigned Risk Adjustment Program (ARAP) Surcharge	
+	Supplemental Disease Exposure (Asbestos, NOC)†	
+	Atomic Energy Radiation Exposure NOC†	
+	Charge for nonratable catastrophe loading†	
+	Aircraft Seat Surcharge	
+	Balance to Minimum Premium (State Act)	[Balance to minimum premium at Standard Limits]
+	Balance to Minimum Premium (Admiralty, FELA)	
	TOTAL STANDARD PREMIUM‡	
+	Coal Mine Disease Charge	[Underground, surface, surface auger]
+	Expense Constant	
+	Terrorism Risk Insurance Act of 2002—Certified Losses	[(PAYROLL / 100) * TERRORISM RATE]
	ESTIMATED ANNUAL PREMIUM	

† Non-Ratable Element Premiums generated by nonratable portion of manual rate are subject to all applicable premium elements applied to the policy, however not subject to experience rating or retrospective rating.

‡ Statistical calls for ratemaking data contain a different definition of "Standard Premium." Refer to the *Reporting Guidebook for the Annual Calls for Experience*.

NOC = Not Otherwise Classified

Note: For short rate cancellations, short rate percentage/short rate penalty premium factor is subject to experience rating, included in Total Subject Premium, and applied prior to Experience Modification.

All North Carolina assigned risk policies with total estimated annual standard premium or total audited standard premium that equals or exceeds \$200,000 are subject to the mandatory Loss Sensitive Rating Plan (LSRP).

ITEM RM-01-NC-02—AMENDED ASSIGNED RISK ADJUSTMENT PROGRAM (ARAP)

EXHIBIT 3

WORKERS COMPENSATION AND EMPLOYERS LIABILITY INSURANCE POLICY WC 00 04 15 A

ASSIGNED RISK ADJUSTMENT PROGRAM ENDORSEMENT

This endorsement is added to Part Five (Premium) because one or more of the states shown in Item 3.A. of the Information Page have approved the Assigned Risk Adjustment Program. The Program adds a surcharge to the premium of insureds who are eligible for an experience rating modification, are assigned risks, and meet the other requirements of the Program.

A. Eligibility

1. You are eligible for the Assigned Risk Adjustment Program if you are eligible for an experience rating modification. The application of this program is mandatory for all eligible insureds and shall apply to all assigned risk policies written for such insureds.
2. The adjustment program period is the one-year period beginning with the effective date of the policy. If during the adjustment program period your experience rated modification changes, the Assigned Risk Adjustment Program surcharge factor may also change.

B. Surcharge Application

You must pay a surcharge if your actual losses exceed your modified expected losses, as determined using values from the experience rating modification calculation. The surcharge factor will be applied to by multiplying your ~~manual premium multiplied by the experience rating modification~~ total modified premium by the surcharge factor. Total modified premium is defined as premium determined by multiplying the total subject premium by the experience modification factor.

C. Interstate Risks

Experience rated risks with multi-state operations shall be subject to the Assigned Risk Adjustment Program in states that have approved it. See the Schedule below.

D. Cancellation

1. If you cancel, the standard premium for the adjustment plan period will be based on our short rate table and procedure. This short rate premium will be used to determine the Assigned Risk Adjustment Program surcharge.
2. Section D.1. will not apply if you cancel because:
 - a. all work covered by the insurance is completed;
 - b. all interest in the business covered by the insurance is sold
 - c. you retire from all business covered by the insurance; or
 - d. coverage is obtained through the voluntary market.

Schedule

State