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**MASSACHUSETTS WORKERS' COMPENSATION
ASSIGNED RISK POOL**

SPECIAL BULLETIN NO. 4-94

**MASSACHUSETTS SERVICING CARRIER
PAID LOSS RATIO INCENTIVE PROGRAM**

The Paid Loss Ratio Incentive Program included in the new *Pool Plan of Operation* Appendix will be applied to Servicing Carrier Fees effective with Policy Year 1993. This program will not alter the total amount paid out in servicing carrier fees, but will affect the amounts paid to individual servicing carriers. Those with higher loss ratios will get lower servicing carrier fees and vice versa. The actual effects for any Policy Year will be gradually implemented over a five-year period. An example for Policy Year 1993 is included in the *Pool Plan of Operation* Appendix at Pages 19 and 20. Attached for your convenience are Pages 19 through 21 of that Pool Plan of Operation.

In this regard and in many other important respects, the Massachusetts Program operates in the same manner as the NCCI Paid Loss Ratio Incentive Program applicable in many other states.¹ However, there are some significant differences in the formula used to determine the servicing carrier fees. Generally, the Massachusetts Program promulgated by the Commissioner is far more responsive to the loss ratios of individual servicing carriers.

Under the NCCI Program, the maximum DECREASE is 2½ % of the applicable premium with no maximum increase. Under the Massachusetts Program, the maximum swing is ±9%.

Under both plans there is a band around the average loss ratio where the servicing carrier fee is not affected. In both plans, these bands depend on the size of the servicing carrier.² The Massachusetts bands are much narrower.³

¹The program promulgated by the Commissioner differs in important respects from that proposed by the WCRB in February 1993. It also differs from that proposed by the SRB that was the subject of the November 3, 1993 hearing.

²In 1992, all Massachusetts servicing carriers wrote more than \$30 million in residual market business.

³See the attached summary of formulas.

Under the NCCI Program, outside the band around the average loss ratio, each change in loss ratio results in a change in servicing carrier fee 1/5 as great, (in the opposite direction). In the Massachusetts Program, such a change results in a change in servicing carrier fee equal in size.

The Massachusetts Program contains an off-balance feature. This guarantees no change in the average servicing fee paid due to the paid loss ratio incentive program. The NCCI Program contains no such feature. Thus the NCCI Program may not actually balance in any single year.

Another difference is that the Massachusetts Program uses the average paid plus case reserve loss ratio where the NCCI uses the average paid loss ratio in the formula. Since the paid plus case reserve loss ratio is higher, this also produces a somewhat more responsive plan.

Attached find the Massachusetts and NCCI formulas. As previously stated, the Massachusetts Program will result in much more variation in Servicing Carrier Fees between servicing carriers than would the NCCI Program.

HOWARD C. MAHLER
Vice President and Actuary

HCM/pw/16
Enclosure

FORMULA FOR CALCULATING INCENTIVES AND DISINCENTIVES

<u>Definition of Variables</u>		
MR	=	Maximum Relativity Factor
mR	=	Minimum Relativity Factor
P	=	Carrier Written Premium Minus Uncollected Premium
SLR	=	State Average Paid Plus Case Loss Ratio
Carrier Rel	=	Carrier Paid Loss Relativity
	=	Carrier Paid Loss Ratio/State Average Paid Plus Care Loss Ratio

Disincentive

If $MR < \text{Carrier Rel}$,

$$= P \times SLR \times (\text{Carrier Rel} - MR)$$

Incentive

If $mR > \text{Carrier Rel}$,

$$= P \times SLR \times (mR - \text{Carrier Rel})$$

Premium Size Group	Minimum Relativity Factor	Maximum Relativity Factor
Less than \$2.5m	None	None
\$2.5m - \$10m	.900	1.100
>\$10m - \$30m	.925	1.075
>\$30m - \$50m	.950	1.050
Over \$50m	.975	1.025

Note: The maximum Incentive/Disincentive is capped at 9% of premium subject to this program.

NCCI

FORMULA FOR CALCULATING INCENTIVES AND DISINCENTIVES

Definition of Variables		
MR	=	Maximum Relativity Factor
mR	=	Minimum Relativity Factor
P	=	Carrier Written Premium Minus Uncollected Premium
SLR	=	State Average Paid Loss Ratio
Carrier Rel	=	Carrier Paid Loss Ratio Relativity = Carrier Paid Loss Ratio in State/SLR

Disincentive

If $MR < \text{Carrier Rel} \leq 1.40 \times MR$
 $= 20\% \times P \times SLR \times (\text{Carrier Rel} - MR)$

If $1.40 \times MR < \text{Carrier Rel}$
 $= 20\% \times P \times SLR \times (1.40 - MR)$

Incentive

$= 20\% \times P \times SLR \times (mR - \text{Carrier Rel})$

Premium Size Group	Minimum Relativity Factor	Maximum Relativity Factor
Less than \$2,500,000	None	None
\$ 2,500,001 - 5,000,000	0.75	1.25
\$ 5,000,001 - 10,000,000	0.80	1.20
\$10,000,001 - 20,000,000	0.85	1.15
\$20,000,001 - 30,000,000	0.85	1.15
Over \$30,000,000	0.90	1.10

Note: The maximum disincentive is capped at 2½% of premiums subject to this program.

APPENDIX TO THE MASSACHUSETTS ASSIGNED RISK POOL PLAN OF OPERATION

MASSACHUSETTS WORKERS' COMPENSATION ASSIGNED RISK POOL PAID LOSS RATIO INCENTIVE PROGRAM

The following incentive program for servicing carriers in Massachusetts has been developed based on paid loss ratio relativities. For each servicing carrier, paid loss ratio relativities will be calculated by policy year for Massachusetts assigned risks by dividing the servicing carriers' paid loss ratio (to written minus uncollectible premium) by the average paid loss ratio for all servicing carriers in the Massachusetts Pool.

Program Applicability

A servicing carrier with premium less than \$2.5 million in the Massachusetts Pool is not subject to any incentive or disincentive in this state. This is meant to reduce the administration cost in dealing with a relatively small servicing carrier.

This program will be effective beginning with policy year 1993. In other words, the first year of paid loss ratios evaluated will be policy year 1993.

Calculation of Incentives and Disincentives

There is an aggregate limit on incentives/disincentives of 9% of premium subject to the program. The formulas for calculating the incentives and disincentives are in Exhibit 1.

Annual Evaluation of Paid Loss Ratios

Each policy year will have five annual evaluations. The first evaluation will be at the completion of the policy year (policy year 1993 at 12/31/94, etc.). The final evaluation for policy year 1993 will be based on experience reported as of 12/31/98.

Incentives/disincentives will be calculated on an annual basis in accordance with the page entitled "Determining the Servicing Carrier Fee." To avoid the back and forth transfer of funds and to consider the fact that more immature data is less reliable, not all of the calculated incentive/disincentive will be dispensed/billed for preliminary adjustments. The portion of the incentive/disincentive dispensed will depend upon the evaluation number. See the chart below as an example for policy year 1993.

Massachusetts Assigned Risk Pool Plan of Operation

<u>Evaluation Number</u>	<u>Date</u>	<u>Portion of Incentive/ Disincentive Dispersed</u>
1	December 31, 1994	20%
2	December 31, 1995	40%
3	December 31, 1996	60%
4	December 31, 1997	80%
5 (Final)	December 31, 1998	100%

Each evaluation for a policy year considers losses paid since the beginning of the policy year. Because of this, the incentive/disincentive calculated on a subsequent evaluation will net out any payments made or received from earlier evaluations.

Experience Used

The experience data referred to is the assigned risk portion of business for servicing carriers. The data used for calculating incentives will be servicing carrier paid losses, written premium, and uncollectible premium as reported quarterly.

Written premium and paid losses for USL&H and Maritime will be excluded because these coverages are not written by all servicing carriers. This experience is not currently reported separately. Servicing carriers will be required to report it quarterly by policy year. Reporting forms and instructions are being developed and will be distributed to servicing carriers as soon as available.

Loss ratios will be calculated to written premium minus uncollectible premium. However, to the extent that Massachusetts Pool rules for a given policy year allow appeals, any uncollectible premium which the servicing carrier appeals to obtain servicing carrier allowance and wins, will be included.

Medical Cost Containment Expenses/Allocated Loss Adjustment Expense

To the extent Massachusetts pool rules for a given policy year provide for reimbursements of servicing carriers for medical cost containment, allocated loss adjustment expenses, etc., reimbursed expenses will be added to paid losses to calculate the relativities. Since such expenses should serve to lower losses, the addition of any such reimbursed expenses should not adversely impact a servicing carrier. The average pool paid loss ratios would also be adjusted to include any such reimbursed expenses. The purpose of including reimbursed expenses would be to discourage servicing carriers from requesting reimbursement of costs which are not effective in reducing losses. The statewide average servicing carrier fee will be adjusted to the extent that any reimbursements are made for such expenses. [See items 1 and 2 on the page entitled "Determining the Servicing Carrier Fee."]

Capping of Losses

In order to limit the impact of very large losses, paid losses will be capped at \$250,000 per claim/\$500,000 per occurrence. Losses will be capped at \$100,000 per claim/\$200,000 per occurrence for preliminary adjustments at the first and second evaluations.

For several reasons, the limit on large losses used in the calculation is lower for earlier evaluations of a policy year. Very large losses are not considered in earlier evaluations to avoid discouraging servicing carriers from making lump sum payments. Additionally, a very large paid loss could have a bigger impact on a servicing carrier's paid loss ratio when the policy year is immature.

Since cumulative paid loss amounts are not reported by claim, this would require servicing carriers to report losses which should be capped. The loss cap was selected large enough so that the administrative burden of reporting individual large paid loss amounts is not burdensome.

Carriers

This program will be applied on a group basis. The definition of a group is to be found in the Pool Plan of Operation.