February 15, 1996

CIRCULAR LETTER NO. 1739

To All Members and Subscribers of the Bureau:

REVISION TO CAPS ON DEBIT EXPERIENCE MODIFICATIONS

The Division of Insurance has approved the above Item, adopted by our Committees, to become effective 12:01 A.M., April 1, 1996, on new and renewal policies only.

The purpose of this Item is to revise the current caps on debit Experience Modifications. With the introduction of Revised Experience Rating, effective January 1, 1991 in Massachusetts, a cap was introduced on debit modifications for smaller insureds as follows:

<table>
<thead>
<tr>
<th>Expected Losses</th>
<th>Maximum Modification</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to $5,000</td>
<td>1.6</td>
</tr>
<tr>
<td>$5,000 to $10,000</td>
<td>1.8</td>
</tr>
<tr>
<td>$10,000 to $15,000</td>
<td>2.0</td>
</tr>
</tbody>
</table>

These caps have served their intended purpose of mitigating the potential impact on experience modifications of extreme fluctuations in the reported experience of smaller insureds. However, there were two problems that have become apparent over time. These caps do not vary by state, while various features of the Experience Rating Plan are indexed to each state's average claim cost via its "G" value. Secondly, the discontinuous nature of these caps have created some undesirable situations. An insured with a small change in expected losses can find its maximum debit increased by .20 or even find that a maximum debit no longer applies.

In order to eliminate these undesirable situations, this Item provides for a continuous formula for the cap that depends on the average claim cost:

\[ CAP = 1 + 0.00005 \times (E + 2E/G) \]
Where $E = \text{the expected losses used in experience rating; } G = \text{the State Specific \"Indexing Value.\" For Massachusetts, } G \text{ is currently 7, corresponding to an average claim cost of } \$7,000. \text{ This is the same formula being filed by the National Council on Compensation Insurance, Inc. [NCCI] in its states.}$

In addition, since caps will now vary by state, the following rule, which is the same as NCCI’s rule, is being introduced to deal with interstate rated risks:

Debit modifications for an interstate rated insured will be limited by the effective cap for the state with the largest expected losses.¹

As shown in Exhibit 1 attached, the new cap will only benefit insureds in Massachusetts compared to the current cap. In every case, an insured’s modification will either stay the same or decline compared to what it would have been if this Item were not approved.

Currently, risks with more than $15,000 in expected losses have no maximum debit. All risks will now have a maximum debit, with that maximum increasing for larger risks.

The number of insureds affected by the change in caps will vary from year to year. However, the Bureau estimates that in Massachusetts, in the vicinity of 200 to 300 insureds per year will have their modifications lowered compared to the prior situation, with an overall premium impact of .05% or less. No insured’s premium will increase because of this Item.

NORMAN R. FONTAINE
Vice President of Industry Affairs

¹ The calculation of ARAP will continue to depend solely on Massachusetts data; the Massachusetts intrastate experience modification used in the calculation of ARAP shall be capped using the Massachusetts limitation.
Experience Rating, Maximum Debit Mods
New Caps, Massachusetts Workers Compensation

Experience Modification

- Prior Cap
+ New Cap, effective 4/1/96

Massachusetts $G = 7$, New Cap $= 1 + .00005(E + 2E/G)$

HCM 2/9/96