INFORMATION MEMO

Experience Rating in LMCIT’s Liability and Workers’ Compensation Premiums

Understand the League of Minnesota Cities Insurance Trust’s (LMCIT or Trust) experience rating formula, which compares members’ actual loss history with the amount of losses that would be expected for a member of that size, if the member were a perfectly average Trust member. Learn how the comparison is used to adjust members’ future premiums above or below the average.

RELEVANT LINKS:

I. Experience rating
The Trust uses an experience rating component for workers’ compensation, municipal liability, auto, optional no-fault sewer backup, and liquor liability coverages. The underlying premise of experience rating is to look at members’ past loss experience to project members’ future losses. It compares members’ actual loss history with the amount of losses that would be expected for a member of that size, if the member were a perfectly average member. This comparison is used to adjust members’ future premiums above or below the average.

II. Qualifying for experience rating
Experience rating is only used for members above a certain size. For very small members, there isn’t enough volume and claims activity to predict future losses.

A. Workers’ compensation coverage
Experience rating applies to any member whose annual premium is over $3,000. For members with premiums under $3,000, the Trust uses a simple credit/debit system. If the member has had no losses during the three-year rating period, the member receives a 10 percent premium credit. If the member has two or more losses, the member receives a 10 percent premium debit.

B. Municipal liability coverage
Experience rating is used for any member with expected losses above $15,000 during the three-year experience rating period. For members with losses under $15,000, the Trust uses a simple credit/debit system. If the member has had no losses during the three-year rating period, the member receives a 10 percent premium credit. If the member has two or more losses, the member receives a 10 percent premium debit. If the member has two or more of any combination of land use, police liability or employment losses, the member receives a 20 percent debit.
C. Auto coverage
Experience rating applies to any member whose annual auto physical damage and auto liability premium is over $3,000. Members with premiums under $3,000 are not experience rated. Only those claims that have a total net loss of greater than $1,000 during the three-year rating period are used in the calculation. Members’ premiums are adjusted based on experience, and the amount credited or debited is capped at 15 percent.

D. Optional no-fault sewer backup coverage
For members who carry the Trust’s optional no-fault sewer backup coverage, there is a 10 percent credit if no losses have been incurred within the three-year rating period. Members who have incurred losses within the rating period at a per-connection frequency that is higher than the program average receive a 10 percent debit.

E. Optional liquor liability coverage
For members who carry the Trust’s optional liquor liability coverage, a 10 percent rate debit applies if the member has had a liquor liability claim in the past five years.

III. Experience rating elements
There are a few specific elements worth noting about the experience rating formula.

- The formula calculates members’ expected losses by applying an “expected loss rate” to members’ exposure bases, which includes things like payrolls in various classes for workers’ compensation and annual expenditures for municipal liability.
- The loss figures used in the formula consider incurred claim costs (claims paid plus claim reserves), which are gross of deductibles and “as of” three months prior to the coverage effective date.
- The formula looks at losses for the past three years, excluding the most recent year.
- The formula reacts more to loss frequency than to loss severity, meaning that several small losses will affect a member’s experience rating much more than having a single large loss of the same dollar amount.
- Members are not penalized in experience rating if they report an incident that might or might not become a claim. Merely reporting an injury or incident or opening a claim file won’t affect experience rating. Experience rating is only affected if actual loss or defense costs are incurred.
In the workers’ compensation formula, medical-only claims are heavily discounted, which means small and medium-sized indemnity claims have a proportionally greater effect on the experience modification.

IV. Change in experience rating

If higher experience rating is noted compared to previous years, look to the following for a potential explanation.

- Compare losses in the fifth year back with those in the second year back. Experience rating looks at a rolling three-year experience period. Each time a member’s experience rating is re-calculated, there’s a new year of claims rolling on and an old year rolling off. All else being equal, if the fifth year back (which rolls off the formula) was good, and the second year back (which rolls onto the formula) was not so good, the experience rating will increase.
- Look for changes in claim costs in the third and fourth years back. These two years’ losses affect both last year’s and this year’s calculation. Look for changes in reserves on open claims, or for claims that closed for more than what was reserved.
- Look for a pattern of a several little claims. Large claims are heavily discounted.
- Look for employment, police liability, and land use claims on the municipal liability loss runs, and for indemnity claims on the workers’ compensation loss runs. Employment, police liability and land use claims weigh heavier in the municipal liability formula. Medical costs are discounted in the workers’ compensation formula.

V. Further assistance

The Trust’s underwriting staff is available to assist you with questions about experience rating.