NAIC NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Adopted: Nov. 8, 2022, by the Casualty Actuarial and Statistical (C) Task Force

NAIC LOSS COST MEMORANDUM
ALL LINES OF PROPERTY & CASUALTY INSURANCE

Loss Cost Filing Procedures

This memorandum specifies the framework under which advisory organizations and insurers participating in advisory organizations operate in a loss cost system.

Loss Cost Environment

In general, a rating system for property & casualty insurance includes the rates to be charged along with rating relativities, rules, and supplementary rating information. Such supplementary rating information may include any manual or plan of rates, classification, rating schedule, minimum premium, policy fee, rating rule, rate-related underwriting rule, experience rating plan, statistical plan, and any other similar information needed to determine the applicable rate to be charged.

For many states and lines of business, insurers elect to be a participating insurer of an advisory organization, whether it be as a member, subscriber, or service purchaser. (Such advisory organizations can also serve as the insurer's statistical reporting agent.)

Starting in the early 1990's, most advisory organizations ceased promulgating advisory final rates and moved to a loss cost environment. Under this system, advisory organizations do not develop or file advisory final rates, but instead develop advisory prospective loss costs (hereinafter "loss costs"). The advisory organization files these loss costs and supporting data with the department of insurance (hereinafter "DOI") for the state or jurisdiction in which the loss costs will be used. Advisory organizations also develop and file rating relativities, rules, and most supplementary rating information on behalf of its participating insurers. Based on these loss costs, each participating insurer must use its own decision-making processes to determine and file with the DOI the final rates that it will charge.

Loss Cost Components

The rating organization's loss costs represent the expected claims costs per exposure unit, exclusive of expenses and profit. Here, "expenses" generally include:

- Commission and brokerage
- Other acquisition, field supervision, and collection expenses
- General expenses
- A provision for taxes, licenses, and fees (TL&F)

"Profit" here is more specifically underwriting profit. It generally includes a provision for contingencies and considers expected investment income.

For most states and lines of business, the advisory organization's loss costs include loss adjustment expenses (LAE), so that LAE is excluded from the above list of expenses. When LAE is not included in the advisory organization's loss costs, it must be loaded in by the insurer along with the other expenses and profit. In addition, for workers' compensation, some states have loss-based assessments (LBA's) and these may or may not be included in the loss costs. As with all portions of the rate, the provisions that are not included in the loss costs must be loaded in by the insurer, and the provisions that are included in the loss costs should not be considered by the insurer, or a double-count will result.

Advisory Organization's Reference Filing

Using standard actuarial techniques, the advisory organization uses past loss experience to develop its loss costs to an ultimate value over time, considering changes to known claim values or incurred but not reported claim values. The advisory organization also uses trend adjustments to project the developed ultimate losses to the average date of loss for the period during which the policies are to be effective.

Advisory organizations develop and file for approval (or acknowledgement) with the DOI, a loss cost reference filing (hereinafter "reference filing"). The reference filing contains the advisory organization's proposed loss costs along with supporting actuarial and statistical data.

After the advisory organization has filed its reference filing with the DOI and received approval, the advisory organization provides its participating insurers with notice of such approval. The advisory organization normally prints and distributes a manual of loss costs as well as rules and other supplementary rating information. However, such supplementary rating information provided by the advisory organization normally does not include expense constants or minimum premiums. (In workers' compensation, the advisory organization often promulgates premium discount table alternatives from which the insurer can select to reflect differing expense levels by size of risk.)

Loss Cost Multiplier

Based on the advisory organization's loss costs, the insurer needs to develop final rates, and does so using multiplicative factors. The overall multiplicative factor to get from a loss cost to a rate is the "loss cost multiplier" or LCM. (In many states, such LCM's can vary by subline, coverage, class, territory, tier, etc.) The LCM is generally the product of two factors which are themselves multipliers with distinct purposes. These two multipliers are the "loss cost modification factor" and the "expense multiplier."

The loss cost modification factor represents any needed adjustment to the advisory organization's loss cost to reflect the quality of business and past experience which the insurer finds necessary to reflect. For example, if no adjustment is needed, this factor is 1.000; if the insurer anticipates better-than-average experience by 10%, the factor is 0.900 (= 1.000 – 0.100).

The expense multiplier provides for the expenses enumerated above (commission, other acquisition, field supervision, collection expenses, general expenses, TL&F) as well as the needed profit provision. For example, if these expenses and profit total 33.3% relative to premium, the expense multiplier is 1.500 (= 1.000 / (1.000 – 0.333)).

If the loss cost modification factor were 0.900 and the expense multiplier were 1.500, the LCM would be 1.350 (= 0.900 x 1.500). This is the multiplier relative to loss costs that would result in the needed rate. When 33.3% of that rate is taken for expense and profit, 90% of the advisory organization's promulgated loss cost is left to pay claims.

As stated above, if LAE or LBA's are not already in the advisory organization's loss costs, the insurer must factor them into the LCM calculation as well. In addition, if an expense constant and/or minimum premium provisions are to be used, the insurer will probably want to adjust the final LCM accordingly for off-balance, so that the proper amount of revenue is collected.

Automatic Adoption

In many states, the insurer may request to have its LCM remain on file and to automatically adopt all subsequent reference filings made by the advisory organization. As a new reference filing is approved by the DOI, the insurer will do one of the following:

No action. If the insurer wishes to use the advisory organization's effective date and does not wish to change its LCM, it does not need to make a filing with the DOI. (In addition, in most states, the insurer need not develop or file its final rate pages with the DOI.) The insurer's rates will be the combination of the new loss costs and the insurer's LCM already on file with the DOI.

File with the DOI. If the insurer wishes to delay or non-adopt the reference filing, or modify its LCM on file, it must make a filing with the DOI. This should generally be before the effective date of the advisory organization's reference filing.

Insurer Filing

As discussed above, the advisory organization is responsible for filing the following with the DOI:

- Loss costs
- Rating relativities
- Rules
- Supplementary rating information, except for:
  - Expense constant
  - Minimum premium
  - Premium discount table (for workers' compensation)
    (The advisory organization often promulgates multiple premium discount table alternatives)

As such, the insurer is responsible for filing the following with the DOI:

- Effective date (if different from the advisory organization's)
- LCM
- Expense constant
- Minimum premium
- Premium discount table selection (for workers' compensation)
- Automatic adoption (intent to use or not use)
- Any other exceptions or deviations it wishes to use

Loss Cost Filing Document

The NAIC's "Loss Cost Filing Document" is a form in Excel and PDF which performs the LCM calculations described above. This multistate form, or a similar state-specific form, should be included in the insurer's own filing which it submits to the DOI. Many states will also require support in the form of data, actuarial analysis, and an explanatory memorandum.

The "Loss Cost Filing Document" form can be used for workers' compensation as well as most other property & casualty lines. For workers' compensation, where an expense constant and premium discount table are normally used, the form accommodates these. For other lines, where these values are often not applicable, the expense constant and average premium discount values can simply be zero so as to have no effect on the calculations.

Further Information

All inquiries concerning this memorandum should be directed to the property and casualty division of the particular DOI in which the insurer intends to file.

