Assigned Risk Adjustment Program (ARAP)

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Did You Know . . .

- The ARAP surcharge factor applies only to employers in the assigned risk market?
- Effective loss prevention and safety programs may reduce the impact of ARAP?
- ARAP applies to experience rated employers with less favorable loss experience to share in the underwriting losses of the residual market?
- The ARAP surcharge factor is calculated using the same experience (data) that is used in the experience rating modification calculation?
- The ARAP formula gives more weight to the severity of total losses rather than the frequency of individual losses?

This brochure is based on a multistate program, located in NCCI's ***Residual Market Manual for Workers Compensation and Employers Liability Insurance (Residual Market Manual)***. State exceptions may apply. This brochure does not replace any ARAP-related provisions for the applicable states in the ***Residual Market Manual.*** If there is a conflict between the ***Residual Market Manual*** and this brochure, the provisions in the ***Residual Market Manual*** will govern.

Why ARAP?

NCCI's Assigned Risk Adjustment Program (ARAP) was developed to collect additional premium from experience rated assigned risk employers with less favorable loss experience under NCCI's ***Experience Rating Plan Manual for Workers Compensation and Employers Liability Insurance (Experience Rating Plan Manual)***. ARAP requires these employers to share in the underwriting losses of the residual market by applying an ARAP surcharge factor, which may result in an increase in assigned risk premium.

ARAP works in conjunction with NCCI's ***Experience Rating Plan Manual***—a plan that adjusts premium for employers with above average experience by issuing credit experience rating modifications, while employers with below average experience receive debit modifications. ARAP utilizes the same data used to calculate the experience rating modification, but ARAP provides more weight to the severity of the total losses rather than the frequency of individual losses.

It is imperative that residual market programs tailor the cost of insurance for assigned risk employers with less favorable loss experience. ARAP makes it economically undesirable to ignore workplace safety and loss prevention. Employers should be encouraged in every way possible to improve their safety records, and ARAP provides this encouragement.

In summary, ARAP

- applies to those assigned risk policyholders generating losses greater than expected
- promotes the importance of safety in the workplace, and
- encourages employers to aggressively pursue voluntary market coverage by providing financial disincentives in the residual market.

How ARAP Works: The Formula

After the calculation of the experience rating modification factor (*M*) for a particular risk, the modification is reviewed to determine if it is greater than or equal to 1.01. If *M* is greater than or equal to 1.01, then a weighted test ratio (*R*) is calculated. *R* compares a risk's actual losses to the modified expected losses.

$$R = \frac{(0.5 - 0.5W)Ap}{M \times Ep} + \frac{(0.5 + 0.5W)A}{M \times E}$$

If *R* is greater than 1.00, then an ARAP surcharge factor (*S*) is calculated. *R* is limited to 2.00.

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

All elements and values used to calculate *R* and *S* values are those used in an individual risk's experience rating modification. Losses are limited in accordance with NCCI's ***Experience Rating Plan Manual*** or other applicable experience rating plan.

Here are what the variables in the formula stand for:

- *W* represents weighting value.
- *Ap* represents actual primary losses.
- *A* represents actual losses.
- *M* represents the experience rating modification factor for a particular risk.
- *Ep* represents expected primary losses.
- *E* represents total expected losses.
- $\hat{E}$ represents the total expected losses of the particular risk shown in thousands; Ê is limited to 40.

The ARAP surcharge factor is limited to a maximum amount, which may vary by jurisdiction. Refer to NCCI's ***Residual Market Manual***, Assigned Risk Adjustment Program (ARAP) for any state exceptions.

Your Questions Answered

1. **May I see an example of ARAP?**
   Company A had three-year total *expected* losses of $21,968 and an experience rating modification of 1.13; however, the company's total *actual* losses were $81,780. Since actual losses exceeded expected losses, the ARAP formula yields an ARAP surcharge factor of 1.25 for this company.

2. **Why is ARAP calculated for every employer in all ARAP-approved jurisdictions if it applies only for assigned risk employers?**
   When NCCI calculates experience rating modifications and ARAP surcharge factors, it is not known whether an employer will be able to obtain voluntary market coverage or must obtain coverage in the residual market. Therefore, an ARAP surcharge factor must be available for employers that meet specific criteria if that employer secures assigned risk coverage in an ARAP-approved jurisdiction.

   For interstate experience rated risks, the experience rating modification must include data from at least one ARAP-approved jurisdiction for the ARAP surcharge factor to be calculated.

   An ARAP surcharge factor is **not** calculated if
   - a risk's experience rating modification is equal to or less than 1.00 in an ARAP-approved jurisdiction, and/or
   - there is no data from an ARAP-approved jurisdiction used to calculate the experience rating modification.

3. **Does ARAP apply to multistate employers?**
Yes. Experience rated assigned risk employers with multistate operations are subject to ARAP in approved jurisdictions.

4. **Does that mean that an intrastate ARAP surcharge factor calculated for one state applies to other state assigned risk premiums?**
Yes. If an employer is intrastate-rated in one ARAP-approved jurisdiction, and begins operations in another ARAP-approved jurisdiction, then the additional ARAP-approved jurisdiction will have the same intrastate ARAP surcharge factor applied to the total modified premium for that policy.

   However, the ARAP surcharge factor is limited to a maximum amount, which may vary by jurisdiction. Therefore, assigned carriers are responsible for limiting additional specific jurisdictions' maximum surcharge factors if they vary among the employer's multistate operations subject to ARAP.

5. **What data is used to calculate ARAP surcharge factors?**
For intrastate and interstate experience rated employers, the ARAP surcharge factor calculation uses the same data used to calculate the corresponding experience rating modification factor.

6. **What happens when data for more than one ARAP-approved jurisdiction is included in an ARAP surcharge factor calculation?**
For interstate ARAP surcharge factors, like experience rating, a single ARAP surcharge factor is calculated based on total experience for all jurisdictions included in the interstate experience rating modification. Then, the interstate ARAP surcharge factor is limited to the jurisdiction with the highest maximum surcharge factor.

   However, the resulting ARAP surcharge factor is applied only to the total modified premiums developed in the ARAP-approved jurisdiction(s). Also, assigned carriers must
   - apply each specific jurisdiction's maximum surcharge factor, if the factors vary among the jurisdictions used in the calculation, and
   - limit each specific jurisdiction's maximum surcharge factor, if the factors vary among the employer's multistate operations subject to ARAP.

   Consider Company XYZ, which has assigned risk coverage in three jurisdictions:
   - Company XYZ has an ARAP surcharge factor of 1.49, as shown on the experience rating modification sheet.
   - The maximum ARAP surcharge factor is 1.25 for jurisdictions A and B.
   - Jurisdiction C's maximum ARAP surcharge factor is 1.49.
   - In jurisdictions A and B, the assigned carrier must limit the 1.49 to 1.25 and apply a 1.25 ARAP surcharge factor individually to the total modified premium for jurisdictions A and B.
   - In jurisdiction C, the assigned carrier must apply the 1.49 ARAP surcharge factor to jurisdiction C's total modified premium.

7. **Is an ARAP surcharge factor calculated for any type of experience rating modification (e.g., preliminary, final, contingent, etc.)?**
Yes. An ARAP surcharge factor is calculated for qualifying employers each time an experience rating modification is calculated. It is subject to the same rules that govern the application of experience rating modifications.

8. **Does the ARAP surcharge factor replace the experience rating modification factor? Or does the ARAP surcharge factor apply in addition to the experience rating modification?**
The ARAP surcharge factor does not replace the experience rating modification. It is applied, in addition to the experience rating modification, to the total modified premium of an assigned risk policy in ARAP-approved jurisdictions and in accordance with the applicable state assigned risk premium

algorithm or any other applicable programs or statutory requirements. The ARAP surcharge factor is included in standard premium.

9. **Do producers collect commission on premium before or after the ARAP surcharge factor is applied?**
   In general, producers are paid commission based on the total standard premium collected, which includes the application of an ARAP surcharge factor.

Still Need Help?
If you have any additional questions, call 800-**NCCI**-123 (800-622-4123) or visit **ncci.com**.

For North Carolina, contact the North Carolina Rate Bureau at 919-783-9790.