NEW JERSEY
COMPENSATION RATING & INSPECTION BUREAU

HOW TO DETERMINE THE COST OF A WORKERS COMPENSATION INSURANCE POLICY

INTRODUCTION

This booklet provides a basic explanation of how the cost of a New Jersey Workers Compensation and Employers Liability Insurance policy is determined. There is discussion of the principal components that affect cost as well as information regarding the classification system and manual rates. For ease of understanding and reference, a sample Policy Information Page is included.

TABLE OF CONTENTS

APPENDIX

COVERAGE

There is a broad market through which an employer should be able to satisfy the statutory requirement for obtaining workers compensation insurance. There are over 200 active insurers and several thousand brokers and agents engaged in the workers compensation insurance marketplace. Insurers write most policies on a voluntary basis. However, in instances where an employer is unable to secure workers compensation coverage voluntarily, the New Jersey Workers Compensation Insurance Plan, (PLAN) administered by NJCRIB, is available for employers to meet their insurance obligations.

The PLAN affords a means by which the insurance can be provided to all qualified employers. The PLAN is the vehicle for distributing the insurance for such employers among certain insurers licensed to write workers compensation insurance in New Jersey. The primary function of NJCRIB with respect to the PLAN is the designation of an insurer to provide coverage. The PLAN is intended as a means of last resort.

BENEFITS THE POLICY PROVIDES

Every workers compensation insurance policy is standard and affords the same basic coverage. The policy provides lifetime weekly cash benefits to permanently and totally disabled workers and to spouses of deceased workers. The policy also provides weekly cash benefits for disabilities partial in nature based on the degree of impairment and body member involved and cash benefits for time lost from work. Additionally, the policy provides unlimited hospital and medical benefits without co-payments or deductibles. Vocational rehabilitation benefits, where authorized, also are provided. Employers Liability Insurance is also provided by the policy. This coverage protects the policyholder from legal liabilities usually involving bodily injury that are not covered by the Workers Compensation Law.

The weekly benefit is subject to a maximum and minimum amount for all types of injuries. The maximum and minimum weekly benefits are adjusted annually each January 1. They are determined from the state average weekly wage (SAWW) of workers covered under the New Jersey Unemployment Compensation Law for the latest complete year available. The maximum weekly benefit for all injury types is set at 70% of the SAWW. The minimum weekly benefit is set at 20% of the SAWW for all injuries except for disabilities partial in nature where the minimum is fixed at $35.

Lastly, in the event of insurer insolvency, all claims for benefits are processed through the Workers Compensation Security Fund. The New Jersey Property-Liability Insurance Guaranty Association handles all Security Fund claims. In instances where the insurer is declared insolvent, the policyholder is relieved of any liability to an injured worker.

CLASSIFICATION SYSTEM

The cost of a New Jersey workers compensation insurance policy is, in large measure, based on the type of business conducted by the employer. For this purpose, there are approximately 550 classifications describing various business activities. In most instances, each classification is intended to describe a type of business venture. The purpose of the classification system is to bring together a similar group of employers usually engaged in the same business and in competition with one another. This process permits the cataloging of incurred losses, premiums and payrolls for each classification. At the same time, each group of employers has the opportunity through loss control to impact the premium rate associated with the classification describing the business of the particular group. By combining payrolls and losses of employers with similar exposure to loss, the total required cost of the system is distributed in a fair manner among the various employer groups within the business community.

A unique four digit numeric code is assigned to each of the approximately 550 classifications. The class description and code number are shown in the Information Page of each workers compensation insurance policy. Codes 3632-Machine Shop and 8810-Clerical are shown in the sample Information Page in the Appendix.

BASIS OF PREMIUM

With few exceptions, the total payroll expended by classification is the basis upon which the premium for a workers compensation insurance policy is determined. Payrolls have traditionally been considered an ideal reflection of exposure to hazard with the advantage of not requiring additional record keeping on the part of employers. Additionally and most importantly, payrolls are verifiable thus assuring consistency of application.

The final cost of the policy cannot be determined until it has expired and the actual payroll amounts audited. At the time the policy is written, the payrolls for each applicable classification must be estimated. Usually, the estimated payrolls are consistent with the latest audited amounts recorded from expired policies with appropriate adjustment to accommodate for any variances that may apply to the policy being written. The total estimated annual payroll for each class code is shown in the Information Page of each policy. The sample Information Page in the Appendix shows payroll estimates of $2,000,000 and $200,000 for class codes 3632 and 8810, respectively.

The deposit premium for the policy is dependent on the payroll estimates and the frequency of interim premium audits. A final audit of the payroll records of the policyholder by the insurance carrier following policy expiration determines the actual payroll to be used in determining the final cost of the policy.

CLASSIFICATION MANUAL RATES

What is the Manual Rate?

The classification manual rate is the starting point in determining the ultimate cost of the insurance. A manual rate accompanies each of the approximately 600 classifications. The manual rate provides coverage for workers compensation claims in accordance with the provisions of the Workers Compensation Law. The manual rate also provides coverage for employers liability claims, however, there is a standard limit of liability for coverage of this kind. Limits above the standard limits are available at an additional cost. The sample Information Page in the Appendix shows manual rates of $4.29 and $0.26 per one hundred dollars of payroll for codes 3632 and 8810, respectively. Each manual rate reflects the realized loss experience of the classification. The manual rate when applied to the corresponding classification payroll in units of $100 produces the classification manual premium. In the sample Information Page in the Appendix, these premiums are shown as $85,800 and $520 for codes 3632 and 8810, respectively. The sum of the manual premiums from all classifications included in the policy results in the total manual premium of $86,320. The manual premium may also include a charge for increased limits of employers liability coverage.

The adequacy of manual rates is reviewed annually. This is necessary so that the money required to operate the system will be generated and that each employer will pay a fair share of the total need. New rates become effective on January 1 and apply to policies that become effective between January 1 and December 31 of that year. Except for unusual circumstances, the new rates are not applied to policies that are in force as of the date the rates are changed.

The workers compensation benefit system is pre-funded. This means that premiums from policies written during the year in which the manual rates are effective are intended to meet the ultimate cost of all claims generated from these policies. Therefore, the price that the employer must pay for the insurance must be determined before accidents to employees happen and before the final cost of these accidents is known. Ratemaking thus becomes a matter of forecasting the accident occurrences and estimating the cost they will produce. The premium and loss experience of the most recent past provides the base from which to cast this prediction.

How is the Manual Rate Determined?

In determining new manual rates there are two objectives that must be met. The first is to estimate as closely as possible the total cost of the system for the future period during which the rates will be effective. The second is to apportion that total cost among the approximately 600 classifications. The overall premium required to meet the total cost of the system is referred to as *"premium level"* and the apportionment of the overall premium level among the classifications is identified as *"class relativity."* The required overall State *"premium level*" is comprised of a number of considerations, most notably the analysis of the latest premium and loss experience. This experience is obtained from individual insurer year-end financial reports. Experience collected in this manner is the very latest that can be obtained and provides a reasonable basis for predicting the overall future need. Consideration also must be given to changes in benefit levels and expenses, such as commissions paid to agents, premium taxes, cost of settling claims and insurer operating expenses. Once the overall *premium level* has been determined, it is then necessary to apportion that total among the approximately 600 classifications.

The Law requires that a copy of every workers compensation insurance policy be filed with the Rating Bureau. This requirement is designed to establish a record of the insurance coverage and give opportunity to supervise the proper application of the pricing system. The requirement also provides a basis upon which to collect statistical information for each of the approximately 550 classifications.

Each insurance company is required to file a series of statistical reports for each policy with the Rating Bureau. Each report includes the name of the policyholder, the policy number, the policy term, audited payrolls by classification, the rates charged and the standard premium that has been earned. Further, the report must document every claim involving indemnity loss and certain claims involving only medical costs by identifying the classification, claim number, date of accident, and the amounts of the incurred indemnity and medical. The receipt of these statistical reports is controlled by the dates of the policies filed with the Rating Bureau. To recognize continuous changes in loss values and to provide equitable treatment among all policyholders, the receipt of these reports is governed by a specific time schedule. To support claim information, in certain cases supplemental reports also are required.

In addition to the effect of the overall *premium level,* each manual rate also is influenced by the experience collected by classification via the statistical reports. It should be noted that the final schedule of classification manual rates must produce a total premium amount that balances to the overall *"premium level*". Dependent on the actual individual classification experience, it is possible that when the overall *premium level* is lowered some classification manual rates may be increased. Conversely, and for the same reason, when the overall premium level is increased some rates may decrease.

As stated at the beginning of this Section, the manual rate is but the starting point for determining the cost of the policy. The final cost will depend on a number of other considerations. Some of these considerations are applicable on a mandatory basis and others are optional.

EXPERIENCE RATING

The manual rate is a reflection of the average loss performance of the employers comprising a particular classification. Within any classification, however, no two employers will conduct their businesses in exactly the same manner. For example, there will be differences in how operations are performed, type of equipment used and safety programs in place. These differences may lead to variations in loss costs among employers within a single classification. The Workers Compensation Law requires recognition of these differences so as to encourage employers to control the frequency and severity of workplace injuries. Such recognition is accomplished by the application of experience rating.

Experience rating is a mandatory program applied to employers that meet a certain premium eligibility criterion. Experience rating provides for adjustment of the manual premium by comparison of the actual loss record of an individual employer with the average loss performance expected from a business of like size and kind. Experience rating is not intended to recover the cost of previous losses or to refund prior premiums. Instead, the purpose is to use previous loss occurrences as a predictor of future losses.

The premium size of an employer will affect the results of the experience rating. As premium size increases so does the probability that the past experience of the individual employer will be a better indicator of future costs. For employers who are not of significant size to qualify for experience rating, the manual rate is appropriate.

An experience modification factor is determined annually for each eligible employer. It is effective for the ensuing twelve months period. Referencing the sample Information Page in the Appendix, when the experience modification factor, 0.900, is applied to the total manual premium of $86,320, a modified premium of $77,688 is produced. The modified premium may subsequently be adjusted by other considerations as discussed below.

OTHER PRICING CONSIDERATIONS

The Approved Managed Care Program offers the policyholder a reduction in premium for using a managed care organization specified by the insurer to provide medical services to injured workers. This program is available only from insurers that have filed with the Rating Bureau to use managed care credits and only upon agreement between the policyholder and insurer. It is not applicable to policies written through the New Jersey Workers Compensation Insurance Plan. In the sample in the Appendix, a managed care credit of $7,769 serves to reduce the modified premium. The result is a standard premium of $69,919.

The New Jersey Construction Classification Premium Adjustment Program applies to most employers in the construction industry and offers the policyholder a reduction in premium when average wage levels for applicable construction classes exceed a predetermined amount. Employers must file for the credit every year after notification of eligibility is forwarded by the Rating Bureau.

A Schedule Rating Plan is available for the purpose of adjusting the premium of a policy to reflect individual risk characteristics of the employers operations that may not be reflected by its experience. The Schedule Rating adjustment may increase or decrease the policy premium. The Schedule Rating adjustment is offered by the insurer and is applicable only after agreement between the policyholder and insurer. It is not applicable to policies written through the New Jersey Workers Compensation Insurance Plan.

The Approved Managed Care Program, the New Jersey Construction Classification Premium Adjustment Program and the Schedule Rating Plan are all functions of the modified premium.

PREMIUM DISCOUNT

Premium Discount is mandatory for policies developing standard premiums above $10,000 except for those policies written through the PLAN. There is no premium discount for PLAN policies. Monies for the overhead expenses of the insurer are generated through the manual rates. Since the dollar amounts available for expenses are determined as a function of premium, the larger policies produce excessive expense dollars. Conversely, the smaller policies produce inadequate expense dollars. A program of premium discounts is used to reduce the expense dollars generated from the larger policies. Premium discount percentages, graded on the basis of premium size, are applied to the standard premium to determine the amount of discount applicable. In the sample Information Page in the Appendix, the premium discount works out to $6,083.

PLAN PREMIUM ADJUSTMENT PROGRAM

Most policies written through the Plan are subject to the Plan Premium Adjustment Program (PPAP). The only Plan policies to which PPAP is not applicable are those written at minimum premium. Policies written through the PLAN have generally had poorer experience than policies written voluntarily. As such, the PPAP charge serves as a means to equalize the experience for policies written voluntarily and written through the PLAN. The PPAP charge varies by employer and can change from year to year. It is established in accordance with the experience of the employer but is never less than 20%. The PPAP charge is determined by applying the PPAP adjustment factor to the standard premium.

EXPENSE CONSTANT

The policy premium also includes a separate provision for certain costs to the insurance carrier in preparing the policy. An expense constant is included in the price of the policy because the provision for expenses on the small premium size employer does not provide adequate premiums to cover the minimum cost of issuing and servicing a policy. The expense constant distributes this minimum cost as a flat dollar amount among all policies. Application of the expense constant in this manner recognizes that these minimum costs are the same for all employers, regardless of premium size. An expense constant of $200 is included in the sample Information Page in the Appendix.

CATASTROPHE CHARGES

The manual rates for each classification do not include any provisions for losses from acts of foreign terrorism and for losses from acts of domestic terrorism, earthquakes and catastrophic industrial accidents. All policies are subject to premium charges for these catastrophe exposures. The premium charges for foreign terrorism and for domestic terrorism, earthquakes, and catastrophic industrial accidents are determined by applying separate catastrophe rates for each exposure to every $100 of policy payroll. The charge for foreign terrorism can vary by insurer. The charges for both exposures can be negotiated for policies that have opted for certain Retrospective Rating agreements or the Large Risk – Large Deductible Program. A foreign terrorism charge of $660 and a domestic terrorism, earthquakes and catastrophic industrial accidents charge of $220 (referred to as DTEC) are included in the sample Information Page in the Appendix.

POLICY MINIMUM PREMIUM

As noted earlier, the basis of premium is payroll. In many cases the final audited payrolls do not generate sufficient premium to assure that the employer is making a fair contribution to the expected loss costs and expenses of the insurer. Accordingly, each policy provides for a minimum premium. A minimum premium is published for each of the approximately 550 classifications. The minimum premium for the policy is the minimum premium for the classification with the highest estimated premium in the policy. The minimum premium included in the sample Information Page in the Appendix is $629, which represents the minimum premium associated with class code 3632.

SURCHARGES

The Second Injury Fund provides benefits to a worker who is totally disabled as a result of experiencing a subsequent permanent injury when such worker had previously been permanently and partially disabled. This Fund also provides special adjustments and supplemental benefits for permanently and totally disabled workers and dependents of deceased workers where the occurrence was prior to January 1, 1980. The Uninsured Employers Fund is used to provide benefits in those situations where a claim is filed against an employer that is uninsured.

The New Jersey Department of Labor and Workforce Development administers the Second Injury and Uninsured Employers Funds. Legislation enacted in 1989 requires surcharges to all Workers Compensation and Employers Liability policies to support both Funds. Surcharge rates are determined annually and applied to the modified premium of each policy to determine the surcharge amounts. As shown in the sample Information Page in the Appendix, $4,902 is required to accommodate the needs of the Second Injury Fund. There is no surcharge applicable to the Uninsured Employers Fund in the sample.

OPTIONAL RATING PROGRAMS

The policy premium resulting from application of the manual rates and the considerations previously discussed may be referred to as the *"guaranteed cost"* of the policy. This cost is shown as $69,818 in the sample Information Page in the Appendix.

The premium under a *"guaranteed cost"* policy is not affected by the losses that result from that individual policy. Some employers, however, believe that recognition of such losses may be advantageous. For those employers, there are optional rating programs that provide for this activity. There are two programs available to afford employers the opportunity to recognize the loss data from the current policy in the determination of their final cost. Both programs are optional and require certain levels of standard premium.

The Retrospective Rating Plan is available to employers developing annual standard premiums of $25,000 or more. This program requires written agreement between the employer and insurance carrier. Retrospective Rating uses a formula to determine the premium cost of the policy. It utilizes the losses incurred and premiums audited during the term of the policy. The employer ultimately will pay premium on the basis of the losses incurred under the policy. Retrospective Rating differs from Experience Rating in that Experience Rating adjusts premiums at policy inception by recognizing previous claim experience.

The Large Risk - Large Deductible Program is available to employers with $200,000 or more of standard premium. The eligibility premium may include premium from other states. This program requires written agreement between the employer and insurance carrier. With this program the employer is obligated to reimburse the carrier for some portion of the cost from each claim in exchange for a reduction in premium. The reduction in premium usually referred to as the deductible premium, as well as the portion of the cost from each claim to be retained by the employer, is determined prior to policy inception.

NET COST

Workers Compensation policies are written by stock companies, mutual companies and reciprocal exchanges. The mutual companies and reciprocal exchanges may declare dividends to policyholders. Many of the stock companies also operate on a participating basis and may declare dividends to policyholders. Policyholder dividends depend upon the program, the underwriting results of the individual insurance company and a declaration by its Board of Directors. Dividends cannot be guaranteed at the time the policy is written. Dividends can be determined and paid only following policy expiration or termination.

Although every insurance company is required to provide standard benefit protection, there are competitive variations in cost and services that afford New Jersey employers the opportunity to purchase their insurance in accordance with their needs and preferences.

APPENDIX

POLICY INFORMATION PAGE

POLICY NO. **WC 34567**

ABC Insurance Company

N.J. Taxpayer Identification No. **123456789056**

PRIOR POLICY NO. **WC 34566**

1. The Insured: **XYZ Machine Shop**
   Mailing Address: **123 Main Street**
   Anytown, NJ 12345

   ____ Individual ____ Partnership
   _X_ Corporation or _______

   Other workplaces not shown above:

2. The policy period is from __**1/1/2007**__ to __**1/1/2008**__ at the insured's mailing address.

3. A. Workers Compensation Insurance: Part One of the policy applies to the Workers' Compensation Law of the States listed here: **New Jersey**

   B. Employers Liability Insurance: Part Two of the policy applies to work in each state listed in Item 3.A. The limits of our liability under Part Two are:
   Bodily Injury by Accident $ **100,000** each accident
   Bodily Injury by Disease $ **500,000** policy limit
   Bodily Injury by Disease $ **100,000** each employee

   C. Other States Insurance: Part Three of the policy applies to the states, if any, listed here: **NONE**

   D. This policy includes these endorsements and schedules: **WC 29 03 06 A**, **WC 29 04 06 T, WC 00 01 13, WC 00 04 21 A, WC 00 04 22**

4. The premium for this policy will be determined by our Manuals of Rules, Classifications, Rates and Rating Plans. All information required below is subject to verification and change by audit.

Classifications	Code No.	Premium Basis Total Estimated Annual Remuneration	Rate Per $100 of Remuneration	Estimated Annual Premium
Machine Shop	**3632**	**$2,000,000**	**$4.29**	**$85,800**
Clerical	**8810**	**200,000**	**0.26**	**520**

Total Manual Premium	**86,320**
Experience Modification	**0 .900**
Modified Premium	**77,688**
Managed Care Credit **(10%)**	**(7,769)**
Standard Premium	**69,919**
Premium Discount **(8.7%)**	**(6,083)**
Expense Constant	**200**
Foreign Terrorism Charge **($0.03)** **660**	
DTEC Charge **($0.01)** **220**	
Total Premium	**$64,916**
Second Injury Fund Surcharge **(6.31%)**	**4,902**
Uninsured Employers Fund Surcharge **(0.00%)**	**0**

Minimum Premium $ **629**

Total Estimated Cost $ **69,818**

Deposit Premium **$12,000**