

November 02, 2016

CIRCULAR LETTER TO ALL MEMBER COMPANIES

Re: Workers Compensation Insurance

North Carolina Basic Manual Update
NCCI Item B-1429 – Establishment of Audit
Noncompliance Charge

Effective January 1, 2017, the North Carolina Basic Manual for Workers Compensation and Employers Liability (NCBM) will be updated to reflect rule changes related to NCCI Item B-1429 - Establishment of Audit Noncompliance Charge. The approval of a modified version of NCCI B-1429 was announced by way of NCRB circular C-15-21, dated November 5, 2015. The approved changes are applicable to all new and renewal voluntary and assigned risk policies becoming effective on or after January 1, 2017.

Item B-1429 updates North Carolina rules related to audit noncompliance for Workers Compensation and Employers Liability Insurance and the Assigned Carrier Performance Standards. Item B-1429 also creates an endorsement for the Audit Noncompliance Charge (ANC), revises the North Carolina premium algorithms to include ANC, and establishes a statistical code for reporting of the ANC.

A summary of the updated ANC rules for North Carolina are as follows:

- For employers that do not allow the carrier to complete an audit, the ANC may be applied.
- The ANC is optional for both assigned risk and voluntary policies and is applied to estimated annual premium.
- The ANC can only be applied if the carrier has attached the ANC Endorsement at the inception of the policy.
- The ANC Endorsement is mandatory for assigned risk policies.
- The ANC Endorsement is optional for voluntary policies.
- For assigned risk, if an employer pays the ANC, but is not compliant with the audit, they are still considered ineligible for assigned risk coverage until the audit is completed.
- If an employer pays the ANC and later allows the audit, the ANC would be refunded to the employer or applied to any outstanding balance on the policy.
- The ANC is considered premium but is not part of standard premium, and is to be reported by the carrier using Statistical Code 9757.

For additional information on the ANC please review the following attachments:

- NCRB Exhibit 1 – NCBM Rule 3.A.12
- NCRB Exhibit 2 – ANC Endorsement (WC 00 04 24)
- NCRB Exhibit 3 – ANC FAQ's
- NCRB Exhibit 4 – ANC Charge Example
- NCRB Exhibit 5 – ANC Reporting Example

If you have questions, contact the NCRB Information Center at 919-582-1056 or via email at wcinfo@ncrb.org.

Sincerely,

Joanna Biliouris

Chief Operating Officer

JB:dms

Attachments

C-16-29

North Carolina Basic Manual

Part 1 – Rules

Rule 3 – Ratings and application of Premium Elements

3. A – Explanation and Application

12. Final Earned Premium

a. Determination

1. Final earned premium is the total premium earned during the policy period. It is calculated using actual payrolls multiplied by the rate for each classification. Final earned premium includes the application of premium elements applicable to the employer.
2. Determination of final earned premium is governed by the approved rules, classifications and rates, subject to modification by applicable rating plans.
3. The carrier has the right to calculate final earned premium based on an examination and audit of all records related to the policy.
4. The rules, classifications, and rates in this manual govern the audit of payrolls and adjustments of premiums. Final earned premium for the policy must be determined on actual payroll as determined by the carrier at audit, instead of on estimated payroll or other premium basis, subject to the following requirements:
 - a. For each risk producing an annual premium of less than \$50,000, the carrier must complete a mail/email or telephone, computer (remote access) audit of the employers' records each year.
 - b. For each risk producing an annual premium of \$50,000 or more, the carrier must make a final physical audit of the employer's records at least once a year.
5. Audited information must coincide with the effective and expiration dates of the policy. Reasonable deviations from this standard that do not affect the earned premium are permitted to coordinate the audit with the first of the nearest month.

Example of acceptable deviation to rule that audited information must coincide with the effective and expiration dates of the policy:

The policy period is 1/1/2014 – 1/1/2015. The insured's payroll records begin on 1/7/2014 and are produced every two weeks. The auditor may use the payroll records to audit the premium from 1/7/2014 – 1/7/2015.

b. Audit Noncompliance Charge

1. If the employer does not comply with Part Five – Premium, Section G. (Audit) of the policy, the employer will be considered noncompliant with the policy terms and conditions. When this occurs, the carrier may apply an Audit Noncompliance Charge (ANC) subject to the conditions in this rule. The charge is determined by applying the ANC multiplier to the ANC basis shown below:

ANC Basis		ANC Multiplier	Endorsement	Other
Estimated Premium	Annual	Up to three times	Audit Noncompliance Charge Endorsement	For assigned risk policies, the ANC Endorsement must be attached to the policy when NC is shown in 3.A of the Information Page. For voluntary policies, the ANC endorsement is optional.

2. On a multistate policy, the ANC applies only to the exposure in the states where an employer is noncompliant with an audit and where this ANC rule is approved for use.
3. The ANC is a premium charge and is applied in accordance with the applicable state premium algorithm. The ANC is not part of the standard premium.
4. The application of the ANC is subject to the following conditions:
 - a. Carriers must comply with all applicable state laws and/or regulations related to audits of workers compensation policies.
 - b. The Audit Noncompliance Charge Endorsement and/or applicable state-specific endorsement must be attached to the policy at inception of policy term being audited.
 - c. The carrier must make two attempts to obtain the audit information and/or complete the audit. At each attempt, the carrier must notify the employer regarding the specific, required records and the amount of the ANC to be applied if the employer continues to refuse to comply with the audit.
 - d. The carrier must adequately document the audit file regarding the above attempts to obtain the required audit information.
 - e. When a carrier applies an ANC to the policy, and cancellation for audit noncompliance is permissible under state law, the carrier may cancel the policy and must issue a cancellation notice in accordance with applicable state laws

and/or regulations and **NC Basic Manual** rules and **Assigned Carrier Performance Standards (ACPS)**.

5. This ANC rule applies to mail/email, telephone, computer (remote access), and physical audits, unless otherwise prohibited by state law.
6. The ANC may be applied to guaranteed cost policies as well as retrospectively rated policies.
7. The scenarios listed below may occur and are treated as follows:

If an ANC is applied and the employer...	Then the carrier...
Pays the ANC and later allows the audit	<ul style="list-style-type: none"> • Performs the final audit and determines the final policy premium based on the results of the audit; and • Refunds the ANC to the employer, or applies the ANC amount to any outstanding balance on the policy
Does not pay the ANC but later allows the audit	Performs the final audit and determines the final policy premium based on the results of the audit
Pays the ANC but does not later allow the audit	Does not change the previously reported: <ul style="list-style-type: none"> • Unit statistical data • Noncompliance transactions
Does not pay the ANC and does not later allow the audit	Does not change the previously reported: <ul style="list-style-type: none"> • Unit statistical data • Noncompliance transactions

8. Reinstatements of cancelled policies must be in accordance with all applicable state laws and/or regulations and **NC Basic Manual** rules or **ACPS**.
9. The ANC must be reported, including applicable corrections, in accordance with the NC Statistical Plan. Assigned carriers must also comply with NCCI’s ACPS noncompliance and compliance reporting for assigned risk policies.
10. For assigned risk policies, if an assigned carrier has applied an ANC, the employer will be considered noncompliant with the audit and will remain ineligible for assigned risk coverage until the employer allows the audit to be performed and/or provides the required records. This applies even if the employer has paid the ANC.

AUDIT NONCOMPLIANCE CHARGE ENDORSEMENT

Part Five—Premium, Section G. (Audit) of the Workers Compensation and Employers Liability Insurance Policy is revised by adding the following:

If you do not allow us to examine and audit all of your records that relate to this policy, and/or do not provide audit information as requested, we may apply an Audit Noncompliance Charge. The method for determining the Audit Noncompliance Charge by state, where applicable, is shown in the Schedule below.

If you allow us to examine and audit all of your records after we have applied an Audit Noncompliance Charge, we will revise your premium in accordance with our manuals and Part 5—Premium, E. (Final Premium) of this policy.

Failure to cooperate with this policy provision may result in the cancellation of your insurance coverage, as specified under the policy.

Note:

For coverage under state-approved workers compensation assigned risk plans, failure to cooperate with this policy provision may affect your eligibility for coverage.

Schedule

State(s)	Basis of Audit Noncompliance Charge	Maximum Audit Noncompliance Charge Multiplier
----------	-------------------------------------	---

This endorsement changes the policy to which it is attached and is effective on the date issued unless otherwise stated.

(The information below is required only when this endorsement is issued subsequent to preparation of the policy.)

Endorsement Effective
Insured

Policy No.

Endorsement No.
Premium

Insurance Company

Countersigned by _____

Audit Noncompliance Charge (ANC) FAQs

1. Is ANC new for North Carolina?

No. Rule 3.A12.b.2 of the North Carolina Basic Manual Basic Manual allows carriers to impose a charge on employers that refused to allow an audit of records for the purpose of determining final premium.

2. Is the application of the ANC mandatory?

The application of the ANC is not mandatory. Some carriers may opt not to use the ANC rule at all. To apply the rule, the carrier must follow the conditions provided in the ANC rule.

3. Is the ANC Endorsement (WC 00 04 24) mandatory in North Carolina?

The ANC Endorsement (WC 00 04 24) is not mandatory for policies written in the voluntary market. The ANC Endorsement (WC 00 04 24) is mandatory for all Assigned Risk policies issued on or after January 1, 2017. Failure to attach the endorsement at the inception of the policy term being audited voids the carrier's right to impose the charge. See NC Basic Manual Rule 4.b.

4. Who determines if an employer is noncompliant for audit purposes?

The carrier will determine if the employer is noncompliant with the policy terms and conditions in accordance with the filed and approved rules, subject to state law. Employers are deemed noncompliant if they do not adhere to the provisions of the policy. The policy states that the employer must keep records and provide those records to the carrier upon request. Examples of records listed in the policy include ledgers, journals, registers, vouchers, contracts, tax reports, payroll and disbursement records, and programs for storing and retrieving data. Employers must allow carriers to examine and audit all records during the policy period and within three years after policy expiration.

5. If the ANC is applied to a policy, how is the ANC portion of the policy premium reported?

Statistical Code 9757 is to be used to report the ANC in North Carolina (if applied) as defined in the NC Statistical Plan.

6. How will the ANC rule, endorsement, and statistical code apply to multistate policies?

The ANC applies only in the state(s) where the audit was not permitted and the rule is approved for use. Carriers are required to comply with the approved rule in each state.

7. The ANC rule is to become effective for new and renewal policies effective on and after 12:01 a.m. on January 1, 2017. Are carriers permitted to delay implementation of this rule?

The application of the ANC rule is on a voluntary basis, carriers are not required to implement the rule.

8. How is the ANC amount determined?

The basis of the charge is estimated annual premium. For example, consider a policy that was estimated to develop \$15,000 in premium in a state where the maximum ANC is two times a policy's estimated annual premium. Assume the carrier attached the applicable ANC endorsement at policy inception and made two unsuccessful audit attempts in accordance with the ANC rule. The carrier could then apply a charge of up to \$30,000 and bill the employer for a total of \$45,000.

The goal of the ANC rule is to encourage the employer to provide access to the records needed to conduct the audit. Once that happens, the \$30,000 ANC charge is removed and the premium is billed at the amount based on the actual audited payroll.

9. Are there examples of how the ANC is to be determined and reported?

- For an ANC calculation example, refer to NCRB Exhibit 4.
- For an ANC reporting example, refer to NCRB Exhibit 5.

10. In most states, the ANC multiplier equals up to one or two times the estimated annual premium. For a few states, the ANC multiplier equals a flat amount of one or two times the estimated annual premium. Can a carrier apply an ANC multiplier that is less than those amounts?

- For states with an ANC multiplier of "up to" a specific amount, a carrier can apply an ANC multiplier that is less than the maximum multiplier
- For states with an ANC multiplier that is a flat amount, a carrier cannot apply a different ANC multiplier

11. Is the ANC subject to state-specific assessments, surcharges, and taxes?

The ANC is a premium charge; therefore, it is subject to state-specific premium-based assessments, surcharges, and taxes.

12. What happens if an employer pays the ANC and later allows the audit?

For an employer that has paid the ANC, but later allows an audit or provides the required records to the carriers, the ANC would be refunded to the employer and/or applied to any

outstanding balance on the policy. Refer to *Basic Manual* Rule 3-A-13-b for more information.

For data reporting, if the 1st unit statistical report had already been reported with the ANC, a correction report is required to be reported. This correction report will remove Statistical Code 9757 and the associated charge and update the exposure and premium. The Estimated Audit Code would not be changed and must remain "N."

13. The ANC has been applied to an employer's assigned risk policy and the employer pays the ANC but does not allow the audit to be completed. Is the employer deemed to be compliant because they paid the ANC or they subsequently scheduled an appointment to complete the final audit of their policy?

An assigned carrier may apply the ANC in accordance with *Basic Manual* rules. When the ANC has been applied to an assigned risk policy and the employer has paid the ANC, the employer is not deemed to be compliant until the audit requirements are met. The employer must allow the audit to be completed, not just schedule the audit appointment, to be deemed compliant. Refer to NCCI's *Assigned Carrier Performance Standards*—PS 1-C-(6) (d) for more information.

14. If the ANC has been applied to an employer's assigned risk policy and the employer pays the ANC, should the ANC amount be included in the premium basis for determining producer commissions?

For assigned risk in NC, refer to the *NC Basic Manual* Rule 4-G for information about the premium basis for determining producer commissions.

15. If a servicing carrier applies the ANC to a policy and the premium becomes uncollectible, is the carrier reimbursed from the Residual Market Reinsurance Pool for that premium? Do the servicing carriers receive the servicing carrier allowance (SCA) on the uncollectible premium?

If the ANC was billed and becomes uncollectible, the servicing carrier would be entitled to reimbursement of ceded premium for the uncollectible portion on the same basis as other uncollectible premium. However, servicing carriers do not receive SCA on uncollectible premium.

Audit Noncompliance Charge Calculation Example

The following example shows the ANC calculation for a policy subject to an ANC of three times the estimated annual premium.

- \$100,000 Estimated Annual Premium (basis) x 3 (multiplier) = \$300,000 Audit Noncompliance Charge
- \$300,000 is reported to Statistical Code 9757—Audit Noncompliance Charge—Not Part of Standard Premium (charge to policyholder)

\$100,000 Estimated Annual Premium
+ \$300,000 Audit Noncompliance Charge
\$400,000 Total Amount Due

Audit Noncompliance Reporting Rules

For policies effective January 1, 2017, and subsequent, the new Audit Noncompliance Charge endorsements and rules will be implemented in the *NC Basic Manual* and *NC Statistical Plan* (Part 3-F—Exposure Amount).

Audit Noncompliance—Unit Statistical Reporting Overview

For policies that include an Audit Noncompliance Charge Endorsement and the employer does not allow a final audit to be conducted after at least two requests, the carrier may apply the Audit Noncompliance Charge. The charge is reported using Statistical Code 9757.

If the employer subsequently allows the final audit, the Audit Noncompliance Charge must be removed.

When the Audit Noncompliance Charge is applicable to the policy, the Estimated Audit Code is reported “U”, to indicate the employer is uncooperative or “Y” to indicate the audit is estimated. If the final audit is subsequently allowed, then a correction is required to update the exposure and premium, and the Estimated Audit Code should be updated to report “N” to indicate the premium and exposure is not estimated.

Unit Statistical Reporting Example

A policy effective January 1, 2017, includes the national Audit Noncompliance Charge Endorsement (WC 00 04 24), which provides advance policyholder notification of potential Audit Noncompliance Charge if the employer does not allow the carrier to examine and audit its records.

Subsequently, the employer did not respond to the carrier’s requests for an audit and the policy remained unaudited as of the 1st unit report valuation. The carrier applies an Audit Noncompliance Charge in the amount of \$1,000. In September 2018, the 1st unit statistical report is submitted to include the following information:

- Estimated Audit Code: U or Y
- Class Code 6834
 - Exposure Amount: \$50,000 (Estimated)
 - Rate: 7.69
 - Premium Amount: \$3,845 (Estimated)
- Statistical Code 9757 (Audit Noncompliance Charge)
 - Premium Amount: \$1,000

Subsequent to the 1st unit report, but before the 2nd unit report valuation, the employer allows the final audit to be conducted, which results in audited exposure of \$65,060. This requires an Exposure correction to be reported to adjust the Exposure Amount and Premium Amount and to remove Statistical Code 9757. The correction report includes the following Revised Exposure Record information:

- Class Code 6834
 - Exposure Amount: \$65,060 (Audited)
 - Manual Rate: 7.69
 - Premium Amount: \$5,003 (Final)

Also, in accordance with the reporting rules, the Estimated Audit Code is updated to report “N.”