The three general types of merit rating plans are

1 Schedule rating
2 *Experience rating*
3 Retrospective rating

Schedule rating

Schedule rating has been abandoned in all states except California, but at one time was generally used Basically, it was a method of recognizing variations in physical items and in administrative items among risks of the same classification, based on an engineering inspection

First, a so-called "standard" risk for a particular classification was established, then the individual risk was compared with that standard risk After the physical and administrative items had been checked by engineering inspection, a credit or charge was applied to the rate depending upon whether the risk was found to be better or worse than standard Credits or debits were assigned to each item, and the total credit or debit was usually limited to a maximum percentage

Experience rating

Experience rating recognizes good loss experience on the part of the better-than-average risk and penalizes the worse-than-average risk This method relies on experience rather than on the physical characteristics of the risk

The manual rate is supposed to provide sufficient premium to cover the average loss and expense within a classification This average loss experience is created by good, average, and bad risks, and if there were no further modifications to the rating procedure, the employer with good experience would have to pay the same rates as would an average or poor experience employer.

In experience rating, on the one hand there is the manual rate and on the other hand there is the experience of the individual risk from which a rate may be determined The evidence must be weighed in order to arrive at a compromise between the manual and the risk rates. In general, the greater the payroll, the more dependable becomes the experience

Experience rating is not appropriate for the small risk whose experience possesses little credibility As risks decrease in size, their credibility also decreases, and the differentials do not accurately reflect the real hazards of the risks In such cases, the manual rate is the most accurate rate to apply As risks increase in size, more and more recognition is given to their own experience until the point of self-rating is reached and experience determines rates

Experience rating is not applied unless the premium exceeds a minimum figure, which varies by state Generally, only risks that develop a minimum premium of $1,500 for the latest year or an average of $750 in premiums in two or more of the three years immediately preceding application for experience rating are eligible for this type of rating

The manual rate is increased or decreased in accordance with the risk's loss record over a period of 36 months However, the latest year's experience is not available for use because a large proportion of the losses in that year would not have been settled, and the rate is developed six months prior to the inception date of the policy If the policy for a risk expires on January 1, 1964, the experience for the renewal effective January 1, 1964, would be modified based on the experience during the 1960, 1961, and 1962 policy years

Under experience rating, the experience of each year has equal weight Thus, the accident record of each of the three years past is just as important as that of the most recent year

Retrospective rating

In experience rating, three years' experience is the basis upon which a rate that will be adequate and equitable for the future is determined Retrospective rating requires a review of the latest year's experience upon expiration of the policy, and *the premium then is revised to correspond* with the current loss experience.

Certain deficiencies under an experience rating plan are overcome by retrospective rating The first deficiency is that experience rating considers only past experience. Thus, a risk that has improved its experience through effective safety programs and training will receive limited benefit for this effort until the years of unfavorable experience have passed from the three-year experience period Second, the current year