ORDER NUMBER R 06-06 **October 31, 2006**

APPROVAL WITH MODIFICATIONS OF THE 2007 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 28, 2006, the Division of Insurance (division) received the 2007 Alaska Workers' Compensation Filing for Voluntary Loss Costs and Assigned Risk Rates from the National Council on Compensation Insurance, Inc. (NCCI). This filing proposed an overall 10.5 percent decrease in voluntary loss costs and assigned risk rates from the current approved levels.

On August 28, 2006, the director issued Notice of Public Hearing H 06-03 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on September 19, 2006. The purpose of the hearing was to allow interested parties to provide testimony or evidence as to whether the filing's prospective loss costs meet the requirements of AS 21.39. Interested parties were also invited to include a recommendation for approval, disapproval, or modification of the filing.

After the hearing, the Alaska District Council of Laborers provided additional written testimony to the division that included recommendations to modify the filing. The division also asked for and received additional supporting information from NCCI. The division also received two written comments related to the assigned risk portion of the filing and one written comment on the loss cost portion of the filing.

DISCUSSION OF FILING METHODOLOGY

1. Consistent with the 2006 filing, NCCI again

    - based the overall indication on three policy years of experience;
    - used a five-year average of paid losses plus case reserves to select the loss development factors;
    - used limited losses in the loss development factor selection and incorporated an excess provision to adjust the losses to an unlimited basis; and
    - excluded maritime class experience from the overall indication but included it in the class ratemaking data.

2. NCCI proposed to increase the loss adjustment expense provision from 15.6 percent to 16.4 percent. NCCI based the selection of loss adjustment expense on experience obtained through a special data call.

3. In this filing, NCCI reverted to selecting a zero percent assigned risk market share rather than the five percent market share the director asked NCCI to use in the 2006 filing as a transition value. NCCI's rationale for reverting to the zero percent assumption is that assuming an assigned risk market share other than zero percent artificially suppresses the voluntary loss costs and does not reflect the fluid nature of the assigned risk pool.

4. For the assigned risk portion of the filing, a change in methodology for the commission was included based on a recommendation from the Alaska Workers' Compensation Review and Advisory Committee. This recommendation was to use a fixed five percent commission for all policies rather than the current sliding scale that bases the commission percentage on the premium size of the policy.

5. Other items in the assigned risk portion of the filing that are consistent with the 2006 filing include

   - no change to the minimum premium methodology;
   - no change to the servicing carrier allowance;
   - inclusion of an excess of loss reinsurance expense; and
   - an uncollectible premium provision.

6. The major contributors to the overall indicated loss cost level decrease are a continuing decline in frequency of accidents and the deletion of policy year 2001, which was a year with poor experience, and the inclusion of policy year 2004, which had better experience. In addition, while medical costs continue to increase, the rate of increase has slowed, which NCCI has recognized by selecting a three percent medical loss ratio trend compared to the four and one-half percent medical loss ratio trend in the 2006 filing.

INTERESTED PARTY'S REQUESTED MODIFICATIONS

The Alaska District Council of Laborers requested that the division review the filing to determine whether NCCI should be requested to modify the filing to provide a further rate reduction based on changes to the workers' compensation statutes enacted in SB 130 and to remove the proposed 0.7 percent increase in loss adjustment expenses.

NCCI REBUTTAL

NCCI elected not to include the proposed modifications based on the provisions of SB 130. Although NCCI found that those provisions may ultimately produce cost savings, the amount of the cost savings cannot be determined at this time since the impact of many of the reforms are dependent upon the behavior of the parties involved.

NCCI also provided additional documentation for the proposed 16.4 percent provision for loss adjustment expenses.

FINDINGS

After fully reviewing and considering the supporting documentation and testimony, both written and oral, the director finds:

1. The five-year paid loss plus case reserve loss development method is acceptable. The use of the five-year average is appropriate as it helps to stabilize the loss development due to changes over time and differences in case reserve setting procedures by insurer. Both the paid loss development and the paid loss plus case reserve loss development were lower than anticipated. Since NCCI's analysis showed that the paid loss development declined

faster than the paid loss plus case reserve loss development, they elected to continue using paid loss plus case reserve loss data. The use of paid loss plus case reserve data to select loss development factors is acceptable.

2. NCCI selected an indemnity trend factor of minus one percent, consistent with the indemnity trend factor selection in the 2006 filing. NCCI selected a medical trend factor of plus three percent compared to a medical trend factor of plus four and one-half percent in the 2006 filing. The selected medical trend of three percent is acceptable. While the medical trend selection is a significant decrease over the four and one-half percent medical trend in the 2006 filing, the policy year medical loss ratios for the last five years are fairly stable, thereby moderating the significant growth in medical loss ratios over the last 13 policy years.

3. NCCI appropriately elected not to include modifications based on the provisions of SB 130, because the effect of those provisions cannot be accurately estimated at this time.

4. The premium on-level methodology includes a projected assigned risk market share percentage. In this filing, NCCI reverted to selecting zero percent for the projected assigned risk market share. The reason NCCI gives for selecting a zero percent assigned risk market share is that this assumption calculates loss costs that are appropriate for the whole market, not just the voluntary market, and that it is a means to reduce the size of the assigned risk market. NCCI has used statewide data in the Alaska loss cost filings for many years. Only in the last couple of years has the assigned risk market share assumption been zero percent. The division is accepting the zero percent assumption for this filing; however the division will continue to monitor this assumption in future filings.

5. NCCI's method of calculating the loss adjustment expense load is acceptable and adequate support has been provided for the proposed loss adjustment provision of 16.4 percent. The defense and cost containment expense has been steadily growing as a percentage of loss by about two percent per year. The adjusting and other expense is volatile from year to year but overall exhibits an annual trend of about minus two percent. The proposed loss adjustment expense is acceptable.

6. The division received comments from producers about the proposed flat five percent commission for assigned risk policies. This change would negatively impact those producers that primarily work with employers that have premium less than $10,000. Since approximately eighty-five percent of the assigned risk market consists of policies in this premium range, the change to the flat commission rate will not be approved.

ORDER

For the reasons set forth above and in accordance with AS 21.39.043, the director orders that the assigned risk flat five percent commission be removed and that the sliding commission scale continue to be used with assigned risk policies.

The filing incorporating this revision is approved and the voluntary loss costs and assigned risk rates will decrease by 10.5 percent.

This order is effective October 31, 2006.

Linda S. Hall

Linda S. Hall
Director