STATE OF ALASKA
DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT
Alaska Division of Insurance

Sean Parnell, Governor
Susan K. Bell, Commissioner
Linda S. Hall, Director

ORDER NUMBER R 10-08 **November 15, 2010**

APPROVAL WITH MODIFICATION OF THE 2011 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 25, 2010, the Division of Insurance (division) received the 2011 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 2.1 percent decrease in voluntary loss costs and an overall 0.0 percent change in assigned risk rates from the current approved levels.

On August 6, 2010 the director issued Notice of Public Hearing H 10-03 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on September 14, 2010. 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.

Alaska National Insurance Company provided the division with written testimony prior to the hearing on September 7, 2010. Testimony was received at the hearing. NCCI responded to Alaska National Insurance Company's written testimony on September 16, 2010. No other additional written comments were received after the hearing. The division asked for and received additional supporting information from NCCI. On September 28, 2010, the division asked for an extension as provided for in AS 21.39.043(e) and on October 11, 2010, the division asked for additional supporting information as allowed under AS 21.39.043(e). NCCI responded to the divisions interrogatories on October 26, 2010. On November 10, 2010, the division asked for additional supporting information to which NCCI responded on November 12, 2010.

DISCUSSION OF FILING METHODOLOGY

1. Consistent with the 2010 filing, NCCI again

    - based the overall indication on three policy years of experience;
    - used limited losses in the loss development factor selection and incorporated an excess provision to adjust the losses to an unlimited basis; and
    - used a 5-year average of paid-plus-case loss development factors.

2. NCCI is proposing to increase the loss adjustment expense (LAE) provision from 19.3 percent to 19.5 percent. This small increase is due to an increase, from 11.5 percent to 11.7 percent, in the defense and cost containment portion of the LAE while the adjusting and other provision remains at 7.8 percent as in the in 2010 filing. NCCI bases the selection of LAE on experience obtained through a special data call. Consistent with the change in the 2010 filing, NCCI included only private carrier data, and excluded state fund data.

3. For the tail loss development factors, NCCI used an 8-year average, rather than the 6-year average used in 2010 and 2009, or the 5-year average as had been used in filings prior to 2009. The addition of two more years is to smooth the impact of one unusually large indemnity tail factor and two unusually large medical tail factors.

4. NCCI selected a minus 5.5 percent indemnity loss ratio trend and a 0.0 percent medical loss ratio trend. This is a change in assumption from the 2010 filing which used a minus 4.0 percent indemnity loss ratio trend and a plus 0.5 percent medical loss ratio trend. NCCI states that the selected trends are largely driven by the continuing decline in frequency which declined significantly between 2001 and 2005 and continues to decline through 2008 but at a slower rate. Indemnity loss ratio trends continue to decline, but NCCI has selected an indemnity trend factor which is slightly higher than the indicated trend factors because the indemnity severity is volatile and large trend factors can increase the leverage on the overall indication. Medical severity continues to increase at about 3.5 percent annually, which is largely offset by the decline in frequency. The selected medical trend factor is also slightly higher than the indicated factors which are negative. The volatility of the medical severity from year to year and the fact that the medical fee schedule will sunset on December 31, 2010 are reasons that NCCI gives to support trend factor that are slightly higher than the indications.

5. Under Alaska Statute 23.30.097, the fee schedule for medical treatment or service based upon the December 1, 2004 fee schedule and adjusted for changes from 2004 to 2008 in the medical care component of the Consumer Price Index for all urban consumers compiled by the United States Department of Labor, Bureau of Labor Statistics will no longer be applicable after December 31, 2010. At the time of the 2011 filing there was no replacement fee schedule. Therefore, NCCI included an increase in benefit costs of 3.3 percent into the 2011 filing.

6. NCCI revised the experience rating off-balance procedure this year by excluding the experience of large deductible policies to more closely match the data used in the overall indication which also excludes large deductible experience. This change is made possible by system enhancements that allow NCCI to identify large deductible policies. The off-balance factors excluding large deductible experience are larger than the off-balance factors including large deductible experience.

7. NCCI calculated the excess ratio for the large loss procedure using the average cost per case by injury type and injury type weights from the 2010 filing. The changes made to the class ratemaking methodology implemented in 2010 impact the calculation of average cost per case by injury type and injury type weights. NCCI is in the process of evaluating whether changes need to be made to these calculations as a result of the class methodology changes.

8. The large loss base year threshold was recalibrated in the 2010 filing so that it was 1 percent of the experience period loss cost premium. This 1 percent target was selected in the 2005 filing when the large loss procedure was implemented. For the 2011 filing, the

base year large loss threshold was not recalibrated (as it was in 2010). The threshold for 2011 was determined by applying the change in average weekly wage for 2008 – 2012 to the 2008 large loss threshold taken from the 2010 filing. A wage index is assumed to reflect the impacts of inflation on claim values. The 2011 threshold is $4,597,429 compared to $4,427,975 in 2010.

9. In the order approving the 2010 filing, the director asked NCCI to address the phenomenon that was observed in which the limited indications have consistently resulted in larger decreases and smaller increases than the comparable indications based on unlimited losses. NCCI's review concluded that because Alaska has a high tail factor but a low excess ratio, this unusual combination was affecting the overall indications when limited losses were used. To address this, NCCI calculated the tail adjustment factor using Alaska-specific excess ratios rather than the standard procedure which uses all countrywide data.

10. The underground coal mine class methodology was revised to use the actual payroll and loss experience for the class instead of the previous methodology that updated the underlying pure premiums for experience, trend, benefit and other industry group factors.

11. The assigned risk portion of the filing includes

    - an excess of loss reinsurance expense;
    - an uncollectible premium provision; and
    - the assigned risk plan administration expenses.

    The 2.6 percent increase in assigned risk expenses is due, primarily, to the decreasing premium in the assigned risk market; for example, the excess of loss reinsurance provision is the same dollar amount as for 2010, but a higher percentage of the premium. The uncollectible premium provision is reduced by 0.2 percent. The increase in assigned risk expenses offsets the decrease in the underlying loss costs, resulting in the 0.0 percent overall change.

12. The assigned risk terrorism rate was incorrectly revised in the 2010 filing from $0.02 to $0.01 due to an error in the filing. The rate is being corrected to $0.02 for 2011.

13. In the past, NCCI applied the same swing limits to the F-classes as to the industrial classes. In 2010 NCCI changed the swing limits from +/-25 percent to +/-15 percent for the F-classes due to relatively low exposure and the potential for large swings in loss costs for these classes. NCCI proposes to continue to use +/-15 percent for the F-classes to mitigate large swings in the class loss costs due to low exposure.

14. NCCI proposes to revise the procedure used to determine the premium basis for partners and sole proprietors. The current procedure is a formula approach based on the average annual wage in the state multiplied by a fixed state factor. The state factor was introduced when the premium basis was revised from a fixed amount of payroll to the formula approach. NCCI states that the state factor is no longer needed. Removing the state factor will align the premium paid more closely to the benefits provided. NCCI proposes using the state average weekly wage multiplied by 52 as the annual partner and sole proprietor payroll.

15. NCCI proposes to revise the procedure used to determine the minimum individual payroll limitation for executive officers. The current procedure for calculating the minimum payroll limitation is a formula approach based on half of the average weekly wage.

NCCI states that only a small portion of executive officers' payroll is written at the weekly minimum individual payroll and the current minimum payroll formula no longer reflects adequate payroll exposure for executive officers since their salaries and bonuses continue to increase. NCCI proposes to use the state average weekly wage used for determination of benefits as the weekly minimum individual payroll for executive officers.

INTERESTED PARTY'S REQUESTED MODIFICATIONS AND COMMENTS

Alaska National Insurance Company (ANIC) provided testimony at the hearing and asked for five modifications to the filing:

- The adjusting and other expense provision should be increased from 7.8% to 8.0%;
- The assigned risk uncollectible premium provision should remain unchanged;
- The division should evaluate the impact of the wage trend assumptions and NCCI should be required to include a discussion of these assumptions in the filing;
- The trend factor used in the analysis of the impact of the sunset of the medical fee schedule should be closer to the Anchorage medical consumer price index; and
- The division should evaluate the reasonableness of using exposure for calculating the large loss threshold rather than premium.

The following rationale for these modifications was provided.

Even though frequency continues to decrease, insurers have some fixed costs associated with handling claims. The adjusting and other percentage for 2008 seems to be an outlier, so using an average of the last two years, 2008 and 2009, understates the required adjusting and other provision.

Decreasing the uncollectible premium provision assumes that there is less uncollectible premium and ANIC questioned whether this was a reasonable assumption in today's economic environment.

A wage trend is used in several places in the filing, but the filing does not explicitly state what this trend is and it appears to vary depending on where it is used. ANIC believed that these trends varied from 2.4 percent to 5 percent and stated that the current economy does not suggest that wages are going to increase this much. ANIC asked that the wage trend be discussed separately since the indication is sensitive to this trend assumption.

The calculation of the impact of the sunset of the medical fee schedule selects a 3.0 percent trend factor based on various regional and countrywide medical consumer price indices ranging from 2.5 percent for the western region to 4.3 percent in Anchorage. ANIC stated that the trend assumption should be closer to the Anchorage medical consumer price index than to other regional or countywide indices since most medical procedures are likely to occur in Anchorage.

ANIC stated that it is appropriate for the large loss threshold to change with exposure but not with loss costs. When there are large changes in loss costs, as has occurred in Alaska over the last several years, the large loss threshold may be impacted simply due to changing loss costs. A decrease in frequency, which is the driver of the recent loss cost decreases, does not necessarily correlate to an improvement in the excess experience.

NCCI REBUTTAL

The adjusting and other expense percentage is a countrywide provision since adjusting and other encompasses expenses that are not easily allocated on a state-by-state basis by insurers. The provision proposed for 2011 is the same as that used in the 2010 filing and is calculated using the same procedure, an average of the most recent two years of experience. Adjusting and other expenses have generally increased over a long period of time, although there have been a few years of decreases, so a two year average is appropriate to balance stability and responsiveness. In addition, all expenses included in adjusting and other expenses are not fixed, and so the provision should be allowed to reflect recent experience.

NCCI stated they were unable to verify the values for wage trend that were raised during the hearing. NCCI uses wage information from the Quarterly Census of Employment and Wages from the United States Bureau of Labor Statistics, except when calculating the increase in minimum and maximum benefits. This change is calculated using the Alaska state average weekly wage. NCCI also stated that the wage trend assumption would not affect the selected loss ratio trend, since the wage trend cancels out of the numerator and denominator in the loss ratio calculation and, therefore, the wage trend does not affect the overall indication. Wage trend is used in class ratemaking only to distribute the overall indication of minus 2.1 percent to the industry groups by accounting for differences in wage trend by industry group when compared to the state average weekly wage. NCCI states they have not compared alternate sources of wage information, but believes that any differences would not have a significant impact.

NCCI states that medical procedures are done all over Alaska as well as other states, so cost indices other than just the Anchorage medical consumer price index must be considered. NCCI also stated that if they had used a 4 percent trend, based on an average of the latest two years of the Anchorage medical consumer price index, the overall impact would be 3.4 percent instead of 3.3 percent, so the trend assumption does not affect the overall cost impact significantly.

NCCI states that since premium is defined as payroll multiplied by loss costs, calculating the threshold based on premium does reflect exposure. When the large loss procedure was implemented in 2005, NCCI explored several alternatives and determined that the threshold was most appropriate at an amount where a claim of that amount would impact the overall aggregate indication by 1 percent or more, so the threshold was calculated as 1 percent of the experience period ultimate on-leveled loss costs.

FINDINGS

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

1. The use of paid-plus-case loss development is acceptable. However, for the 2012 filing NCCI should consider whether the factors that indicated paid-plus-case data is appropriate still exist or whether paid data is appropriate. The 2012 filing should contain documentation related to the selection of paid or paid-plus-case data.

2. The proposed LAE of 19.5 percent has been adequately supported. The use of a two year average for calculating the adjusting and other expense portion of the LAE is acceptable.

3. The use of an eight year average rather than six to calculate the loss development tail factors is acceptable. In the 2012 filing NCCI must demonstrate why it is appropriate to continue use of the unusually large tail factors instead of letting the older years drop out of the experience period used in the calculation.

4. The NCCI selected indemnity trend factor of minus 5.5 percent and the selected medical trend factor of plus 0.0 percent are acceptable. The strong decreasing trend in medical loss ratios beginning in 2000 appears to be flattening out. In spite of the leveling off of the medical loss ratios, the medical severity continues to be a fairly steady upward trend. In the 2012 filing, NCCI should include additional supporting information demonstrating how the medical severity trend is considered in the selection of the medical loss ratio trend.

5. The inclusion of a provision to account for the sunset of the medical fee schedule on December 31, 2010, was acceptable at the time the filing was submitted to the division. However, on October 27, 2010 the Lieutenant Governor filed regulation 8 AAC 45.082(i) that becomes effective on December 31, 2010, putting in place a medical fee schedule that is the same as the medical fee schedule in AS 23.30.097 that sunsets on December 31, 2010. The medical fee schedule regulation affects medical treatment or services provided on or after December 3, 2010, but before July 1, 2011. NCCI provided support showing that the pro-rated effect of the new sunset date is an additional minus 0.4 percent on the overall indication.

6. The exclusion of large deductible experience in the calculation of the experience rating off-balance factors is acceptable.

7. The large loss procedure as filed by NCCI is acceptable. However, in the 2012 filing NCCI must demonstrate that the continued use of the large loss procedure in Alaska is appropriate. NCCI attempted to address the pattern of overall indications in which the limited indications have consistently resulted in larger decreases and smaller increases than the comparable indications based on unlimited losses by using Alaska-specific excess ratios in calculating the tail adjustment factor. Whether this adjustment is sufficient to make the large loss procedure responsive to the Alaska market is unknown. There are few losses that get excluded by the large loss threshold and it is not clear that the stated benefits of the large loss procedure, "to stabilize loss cost level indications and to help achieve overall long-term loss cost adequacy", are being met. The justification for continued use of the large loss procedure must be more than just general statements related to the rationale for using a large loss procedure or that it is NCCI's standard countrywide procedure and must specifically address how and why it benefits Alaska to continue to use limited losses rather than unlimited losses.

8. If NCCI demonstrates that continued use of limited losses is appropriate for 2012, then additional support must be provided to support the calculation of the large loss threshold. NCCI stated that when the large loss procedure was implemented, several alternatives for this calculation were considered and it was determined that a threshold in which a claim would impact the overall aggregate indication by 1 percent was the appropriate threshold. The additional support should discuss these various alternatives, why they were rejected and why NCCI determined that 1 percent of the experience period ultimate on-leveled loss costs is the appropriate threshold.

9. The revision to the underground coal mine class methodology is acceptable.

10. ANIC, questioning whether the current economic environment supported the assumption that there would be less uncollectible premium, requested that the uncollectible premium provision in the assigned risk rates not be reduced as proposed by NCCI. The only support provided for the uncollectible premium provision was the NCCI analysis comparing gross premium with collected premium. While the most recent data in the analysis is 2008, there does not appear to be an upward trend in the data that suggests the selected provision should be something other than the five year average as used in previous filings.

11. The correction of the assigned risk terrorism rate is acceptable.

12. The +/-15 percent swing limits for the F-classes is acceptable.

13. NCCI provided 2003-2007 undeveloped loss ratios, 41 percent for sole proprietors and 33 percent statewide, to demonstrate that the current formula approach for calculating the premium basis used for partners and sole proprietors results in inadequate rates. Based on the January 1, 2011 state average weekly wage of $888.24 estimated in Appendix F of the filing, the premium basis should increase from $29,200 in the 2010 filing to $46,188. To mitigate the impact of this change, NCCI proposes to increase the premium basis by 25 percent until 52 times the state average weekly wage is reached. But NCCI has not provided support to demonstrate that using the state average weekly wage multiplied by 52 does not result in excessive rates.

14. NCCI provided no support for the proposed change in the minimum individual payroll limitation for executive officers. NCCI stated that they are unable to determine which policies are written for executive officers, so they surveyed major workers compensation carriers. The survey results indicated that only 3 percent of executive officers are written at the minimum. NCCI also stated that when the policy is written at the minimum and payroll cannot be determined, benefits are often paid on the applicable state average weekly wage. NCCI was unable to demonstrate the applicability of these results to Alaska, that the current minimum payroll results in inadequate rates or that the proposed minimum payroll does not result in excessive rates.

ORDER

For the reasons set forth above and in accordance with AS 21.39.043, the director approves a voluntary loss cost change of minus 2.5 percent and assigned risk rate change of minus 0.4 percent to incorporate the impact of the revised medical fee schedule sunset date. To obtain the revised overall changes, each class loss cost will decrease by a uniform percentage.

The proposed changes in premium basis for partners and sole proprietors and the revision to the minimum weekly wage for executive officers is disapproved.

This order is effective November 15, 2010.

Linda S. Hall

Linda S. Hall
Director