THE STATE
of ALASKA
GOVERNOR BILL WALKER

Department of Commerce, Community, and Economic Development

DIVISION OF INSURANCE

550 West Seventh Avenue, Suite 1560
Anchorage, Alaska 99501-3567
Main: 907.269.7900
Fax: 907.269.7910

REGULATORY ORDER NUMBER R 15-07

APPROVAL OF THE 2016 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 17, 2015, the Division of Insurance (division) received the 2016 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 2.6% decrease in voluntary loss costs and an overall 2.7% decrease in assigned risk rates from the current approved levels.

On June 10, 2015 the director issued Notice of Public Hearing H 15-02 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on September 10, 2015. 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.

No written testimony or questions were received by the division prior to the hearing. At the hearing, testimony and supporting exhibits were provided on behalf of Alaska National Insurance Company. No written comments were received after the hearing.

DISCUSSION OF FILING METHODOLOGY

1. Consistent with the 2015 filing, NCCI again based the overall indication on three policy years of experience (2011, 2012, and 2013).

2. NCCI proposes to implement a Large Loss Procedure (LLP), intended to stabilize indications in the presence of large individual losses while maintaining overall adequacy. Accordingly, the indicated changes are based on loss experience in which losses have been limited by the LLP. NCCI discussed this proposal with the division prior to the filing date and the division agreed to its inclusion within the filing.

3. NCCI proposes to use a combination of paid and paid-plus-case loss development factors.

4. As introduced in the 2013 filing, for the tail loss development factors, NCCI proposes to use paid-plus-case experience. To accommodate the LLP, the tail loss development factor is adjusted to be on a limited basis.

5. NCCI proposes to decrease the loss adjustment expense (LAE) provision from 17.3% to 16.8%. This change is due to a decrease, from 10.0% to 9.7%, in the defense and cost

containment (DCC) portion of the LAE and a decrease in the adjusting and other provision from 7.3% to 7.1%.

6. NCCI selected a -5.0% indemnity loss ratio trend and a 0.0% medical loss ratio trend. These trends are in the middle of the range of all trend fits from 5-point to 15-point, based on experience data limited by the LLP. This results in no change in loss ratio trends from the 2015 filing.

7. The assigned risk portion of the filing includes

   - an excess of loss reinsurance expense;
   - an uncollectible premium provision;
   - the assigned risk plan administration expenses; and
   - the servicing carrier allowance based on the 2015 – 2017 servicing carrier bid process.

   NCCI proposes a decrease of 0.3% in assigned risk expenses, as a percent of premium. This change is due to:

   a) a small decrease (less than 0.1%) in the excess of loss reinsurance provision;
   b) a 0.5%decrease in administrative expenses; and
   c) a 0.3% increase in average commission percentage due to the change from a sliding scale commission structure to a flat commission.

8. Consistent with the 2015 filing, NCCI proposes to use a 10-year average to determine assigned risk administrative expenses, with adjustment to reflect a recent change in allocation of general expenses to products and services that carriers are responsible for paying.

9. NCCI proposes to replace the current sliding commission scale for assigned risk policies with a flat percentage commission rate.

INTERESTED PARTY'S REQUESTED MODIFICATIONS AND COMMENTS

Alaska National Insurance Company (ANIC) provided testimony at the hearing which included questioning whether the estimated -3.5% frequency trend is too aggressive for the current experience. ANIC provided exhibits showing that frequency in Alaska has been relatively flat over the most recent 5-year period (-2.3% average) and stated that NCCI should consider giving more weight to more recent data points when making trend selections. ANIC described their understanding of NCCI's trend selection process as beginning with the prior year's trend selection, then looking at trend indications that incorporate the newer year of data and deciding if there is enough evidence to move the selection up or down in increments of 0.5%. ANIC believes this process leads to potential instability in the overall loss cost indication and increases the possibility of a need for a large corrective adjustment to loss costs in the future, and noted generally that the trend selection should not be used as the primary tool to attain overall loss cost stability. ANIC suggested that NCCI change their procedure to one that does not use the prior year's selection as the starting point and to allow the trend selection to change from one evaluation to the next in intervals less than 0.5%.

ANIC did not propose any specific recommendations for modifying the filing during the hearing.

No other testimony was received and no other questions were posed to NCCI during the hearing. NCCI did not respond to ANIC's testimony during the hearing.

No written testimony or proposed modifications to the filing were received by the division within the 10-day timeframe after the hearing date, during which the hearing record remained open in accordance with AS 21.39.043(d)(7).

The questions and concerns raised during the hearing were incorporated by the division into an interrogatory letter sent to NCCI on September 17, 2015, which requested additional supporting information and required a rebuttal to the evidence provided in support of applicable proposed modifications, in accordance with AS 21.39.043(e) and (f). NCCI responded with the requested information and rebuttal on October 2, 2015.

NCCI REBUTTAL

NCCI explained, as they did at the hearing and have done in previous filings, that they select trends at the loss ratio level and that frequency trends are implicit estimates provided pursuant to the division's request in previous approval orders. Therefore, the estimated frequency does not have any direct bearing on the loss cost indications. NCCI explained that frequency in Alaska has historically fluctuated significantly with periods of moderate change being short-lived and not necessarily indicative of the frequencies following these periods; the shortest term trend indications are the most subject to changing from one filing to the next. Further, the losses in the experience period underlying the filing's overall indication already reflect the recent claim frequency results, so more heavily weighting the most recent data points puts additional leverage on these few data points. Thus relying on short-term trends may not be the best predictor of future experience in Alaska. The selected frequency trend considers both short- and long-term trend indications and attempts to balance stability in the trend selection and overall loss cost indication. NCCI also noted that the selected -3.5% frequency trend is increasing from last years' estimated -4.0% frequency trend, recognizing the fact that frequency decreases have flattened in the past few experience years.

NCCI clarified that ANIC's description does not accurately reflect the operation of their trend selection process. Instead, their estimated trend starts "fresh" each year with the most recent data available and they make a selection within the range of trend indications in each filing.

NCCI acknowledged their trend selections are generally made to the nearest 0.5%. They explained that trend indications are generally volatile and projecting trends accurately is, by its nature, difficult. Accordingly, selecting loss ratio trends to the nearest 0.5% strikes a balance between accuracy and stability.

FINDINGS

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

1. The use of a combination of paid and paid-plus-case loss development is acceptable.

    a. Paid-plus-case loss development factors can be volatile over time due to differing reserve philosophies and as insurers adjust the adequacy of their case reserves, particularly with the uncertainty surrounding the impacts of the medical fee schedule which was last revised December 31, 2010. Using a longer time period over which to average these loss development factors (e.g. 5 years) helps control the volatility. The use of paid-plus-case data takes into account adjusters' best estimates of ultimate claim amounts including expected impacts of any applicable benefit changes.

b. Orders R13-04 and R14-05 ordered NCCI to use only paid-plus-case loss development for the 2014 and 2015 loss costs, respectively, because of concerns that the low paid loss development factors from the first years of experience under the revised medical fee schedule would understate the ultimate amount. Since the paid experience now includes three full years under the new fee schedule, it is reasonable to once again incorporate a paid loss development method in the calculation. Review of the data and various diagnostics confirms this. Paid loss development factors are not as volatile as are the paid-plus-case loss development factors. Using a shorter time period over which to average the paid loss development factors (e.g. 3 years) strikes a reasonable balance between responsiveness and stability.

2. The proposed LAE provision of 16.8% is acceptable.

   a. Order R14-05 ordered NCCI to address the differences in the types of expenses included in DCC in Alaska compared to countrywide, such as the lack of medical cost containment in Alaska, and evaluate whether there is a significant difference that impacts the DCC-to-loss ratios used in selecting the DCC percentage. NCCI explained that they do not collect LAE data at a more specific level of detail than DCC, so they are unable to determine differences in the level of cost of medical cost containment between Alaska and countrywide.

   b. NCCI also addressed the reasoning behind their method of projecting the Alaska DCC expense ratio, which relies on a relationship between Alaska and countrywide DCC expense ratios which has seen continuing divergence in recent years. NCCI's explanation, and thus the proposed DCC expense ratio projection method, is acceptable.

3. Order R14-05 ordered NCCI to address the impact of wage trend on the selected trend and evaluate whether use of a loss ratio trend is the most appropriate methodology for trend selection. NCCI provided applicable discussion within the Explanatory section of the filing and during the hearing. The selection of loss ratio trends without explicit estimation or recognition of implicit wage trend is acceptable.

4. NCCI's trend selection procedure, as described in their October 2, 2015 rebuttal, is acceptable. The -5.0% indemnity loss ratio trend and 0.0% medical loss ratio trend have been adequately supported as required by AS 21.39.040.

5. The Large Loss Procedure is acceptable and results in loss costs that comply with AS 21.39.030(a) and 3 AAC 29.250(c). NCCI has adequately explained and demonstrated the benefits of using limited losses with appurtenant adjustments. Previous approval Orders expressed concerns related to the fact that the LLP added subjective adjustments within the indications even though no losses were being removed from the experience and concerns with the appropriateness of those adjustments for Alaska. These concerns are no longer entirely relevant since the experience now includes multiple large claims which are subject to limitation under the LLP and due to updates made to NCCI's excess factor methodology combined with changes in Alaska's excess ratios. In order to stabilize loss cost indications in the presence of these large claims, a method of addressing the impact that large claims have on loss cost indications is necessary and appropriate.

6. Previous approval Orders have expressed concerns that a change from a sliding scale commission structure for assigned risk policies to a flat commission rate would

significantly reduce commission amounts paid to producers who are willing to assist smaller policyholders. However, the division has received continued support for a change in commission structure, including resolutions passed by the Alaska Workers' Compensation Review and Advisory Committee and by the Alaska Independent Insurance Agents and Brokers, Inc., in July 2015, indicating that the costs and work required by the current commission scale are significant and movement to a flat commission rate would provide desired relief.

The division requested NCCI include a proposal to change the commission structure to a flat rate in this 2016 filing in recognition that the benefits of a flat commission rate may outweigh any potential negative market impact. The proposed change was structured to be approximately rate neutral; under the sliding scale, the average commission rate varies based on the underlying premium distribution, but has generally been close to the proposed 5.0%. No testimony or requests for modification were received related to the proposed change in commission structure. Accordingly, the proposed flat 5.0% commission rate for assigned risk policies is acceptable.

7. Order R11-05 ordered NCCI to calculate the administrative expenses for the assigned risk rates based on the most recent five years of data based on concerns that including additional older year of data may not comply with AS 21.39.030 and 3 AAC 30.030(d)(3). Based on review of the patterns of these expenses over the longer historical time period, the use of a 10-year weighted average to calculate the assigned risk market administrative expense provision is acceptable.

Note that the above findings are specific to the subject filing and are not meant to apply generally to past or future filings or to provide guidance for future filings unless specifically noted.

ORDER

For the reasons set forth above and in accordance with AS 21.39.043, the director orders:

A. The 2.6% overall decrease in voluntary loss costs is approved.

B. The 2.7% overall decrease in assigned risk rates is approved.

C. NCCI should continue to provide alternate indications in the 2017 filing, including indications based on combinations of 3-year, and 5-year averages and 5-year xhilo average for paid loss development and the same set of averages for paid-plus-case loss development. NCCI may include any other alternative indications that it feels are necessary to support the filing.

D. The alternative indications in the 2017 filing should continue to also include alternate trend assumptions. These alternatives should include the trend assumptions approved in this 2016 filing, and other reasonable alternative trends such that at least one alternative is presented that is higher than the trend assumptions selected for the 2017 filing, and at least one alternative is presented that is lower.

This order is effective October 28th, 2015.

Lori Wing-Heier
Director