THE STATE of ALASKA
MICHAEL J. DUNLEAVY
GOVERNOR

Department of Commerce, Community,
and Economic Development

DIVISION OF INSURANCE

P.O. Box 110805
Juneau, AK 99811-0805
Main: 907.465.2515
Fax: 907.465.3422

REGULATORY ORDER NUMBER R 19-04

APPROVAL WITH MODIFICATION OF THE 2020[1] WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 20, 2019, the Division of Insurance (division) received the 2020 Alaska Workers' Compensation Filing for Voluntary Loss Costs and Assigned Risk Rates from the National Council on Compensation Insurance, Inc. (NCCI)[2]. This filing proposed an overall 14.4% decrease in voluntary loss costs and an overall 11.3% decrease in assigned risk rates from the current approved levels.

On August 2, 2019 the director issued Notice of Public Hearing H 19-03 notifying interested parties that, in accordance with Alaska Statute (AS) 21.39.043, a hearing would be held on September 10, 2019. The purpose of the hearing was to allow interested parties to provide testimony or evidence as to whether the filing's prospective loss costs met the requirements of AS 21.39. Interested parties were also invited to include a recommendation for approval, disapproval, or modification of the filing.

Prior to the hearing, Alaska National Insurance Company (ANIC) requested additional supporting information from NCCI, as allowed by AS 21.39.043(c). No other requests for information or interrogatories were submitted to NCCI by member or subscriber companies prior to the hearing, and no written testimony was received by the division prior to the hearing. At the hearing, ANIC provided oral testimony and related supporting exhibits. The hearing record was held open for 10 days after the hearing. During that time, one set of written comments was received from ANIC in support of the testimony they provided during the hearing.

The division requested and received additional supporting information from NCCI as allowed under AS 21.39.043(e) as detailed below.

DISCUSSION OF FILING METHODOLOGY

1. Consistent with what was approved in the 2019 filing, NCCI again:
    a. based the overall indication on three policy years (PY) of experience (PY2015, PY2016, and PY2017 in this filing);

[1] Within this Order, the year used to identify filings refers to the year the filing is effective. For example, the "2020 filing" refers to the filing that will become effective January 1, 2020.
[2] The filing number assigned by the division is the SERFF tracking number, NCCI-132050053. The filing is open to public inspection per AS 21.39.043(g) and may be accessed via SERFF Filing Access at https://filingaccess.serff.com/sfa/home/AK.

b. used a 50/50 weighting of indications derived using limited and unlimited losses ("limited indication" and "unlimited indication", respectively);
c. for each indication, used an average of paid and paid-plus-case experience;
   i. paid loss development factors (LDF) are based on a 3-year average;
   ii. paid-plus-case LDFs are based on a 5-year average;
d. used paid-plus-case experience to derive the tail (19th report-to-ultimate) LDFs; and
e. used excess ratios (in the limited indication) that limit losses to $50 million, as losses over $50 million are funded via a separate catastrophe loss cost.

2. Changes in NCCI's methodology since the 2019 filing include:
   a. indemnity benefit changes due to changes in the State Average Weekly Wage (SAWW) are now captured through the indemnity trend selection rather than through explicit benefit changes;
   b. the defense and cost containment expense (DCCE) provision is now calculated in a more direct manner;
   c. the parameters and methodology underlying the large loss excess ratio were revised[3]; and
   d. the United States Longshore and Harbor Workers' (USL&HW) Coverage Percentage factor was updated.

3. The limited indication is based on NCCI's Large Loss Procedure (LLP)[4]. To accommodate the LLP, annual updates to the large loss limit threshold and excess ratio[5] were made, based on Alaska premium and loss data.

4. NCCI proposed to increase the loss adjustment expense (LAE) provision from 17.9% to 18.5%, as a percent of losses. This change is due to an increase, from 10.3% to 10.5%, in the DCCE portion of the LAE and an increase in the adjusting and other expense (AOE) provision from 7.6% to 8.0%. The impact of this change on loss costs is +0.5%.

5. NCCI proposed using annual trends of -4.5% and -3.5% to adjust historical indemnity and medical loss ratios, respectively. Consistent with last year's filing, the loss ratios used to determine trends are based on experience data limited by the LLP and use an average of paid and paid-plus-case based severities. Losses are adjusted to a common wage level so these trends are in excess of wage inflation. These selections represent a 1.0% decrease compared to the loss ratio trends approved in the 2019 filing. The combined impact of this change on loss costs is -4.1%.

6. NCCI analyzed the expected impact of recent changes that directly affect benefit levels, but found that no adjustments were necessary:
   a. the combined effect on medical benefit costs of the automatic adoption, by reference, of annual updates to the Medicare relative value units and/or weights and the adoption of other changes to the Alaska medical fee schedule (MFS), both of which went into effect January, 1, 2019, was estimated to be negligible; and
   b. adjustments are no longer made for benefit level changes resulting solely from changes in the SAWW.

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[3] For details related to the methodology and updated parameters used to calculate the excess ratio see Item Filing R-1417, SERFF tracking # NCCI-131931563, and "NCCI's 2014 Excess Loss Factors", published in the Variance Journal, written by Corro and Tseng. https://www.variancejournal.org/articlespress/articles/ELFs-Corro-Tseng.pdf
[4] NCCI's LLP is described in detail in the 2016 loss cost filing and in the NCCI paper "Catastrophes and Workers Compensation Ratemaking".
[5] Unless the context suggests otherwise, references to "excess ratio", "excess experience", or "excess losses" refers to losses in excess of the large loss limit threshold, $3,950,228 in this filing.

7. The assigned risk portion of the filing includes the following items. The combined impact of these changes on assigned risk rates is +3.6%:
    a. servicing carrier allowance; based on the 2018 – 2020 servicing carrier bid process (no change[6]);
    b. assigned risk plan commission rate (no change);
    c. assigned risk plan administration expenses (+0.2%);
    d. excess of loss reinsurance expense (+2.6%);
    e. profit and contingency provision (no change);
    f. offset for expected reinsurance recoveries (+0.8%); and
    g. uncollectible premium provision (no change).

8. Various values within the "Footnotes" and "Advisory Miscellaneous Values" loss cost and rate pages and Experience Rating and Retrospective Rating plan manual pages were revised:
    a. based on previously approved formulas to reflect changes identified elsewhere within the filing, such as changes in the SAWW, relative changes in state and federal benefits, and proposed loss cost level changes; or
    b. to reflect changes approved in other filings.

REQUESTED MODIFICATIONS, COMMENTS, AND INTERROGATORIES

On August 30, 2019, the division asked NCCI for information related to observed fluctuations in payroll for specific individual classes, as shown in the "A Sheets" exhibits. NCCI responded to these questions on September 13, 2019. Since that response contains information related to particular insureds, it is not subject to public inspection under AS 21.39.043(g).

On August 28, ANIC requested from NCCI the indicated Assigned Risk Differential for Alaska. NCCI responded on September 5 with an exhibit showing the calculation of the requested value, which measures the relative performance of assigned risk market experience compared to the combined (assigned risk plus voluntary) market experience. The exhibits and correspondence between NCCI and ANIC are attached to the filing in SERFF and are available for public inspection.

At the hearing, after NCCI provided a brief presentation summarizing the components and impacts proposed in the filing, the division asked questions related to NCCI's methodology and analyses, including:

- how the individual years' experience ratios have changed from one evaluation to the next;
- whether the observation that experience ratios in older PYs are worse than in more recent PYs results from NCCI's method;
- how recent cumulative loss cost changes in Alaska compare to other states;
- whether medical cost increases or indemnity cost decreases have caused the shift in the share of benefit costs attributable to each benefit type.

ANIC then provided oral testimony and related supporting exhibits at the hearing and made requests for modifications. The testimony focused on four areas of concern:

1. the overall adequacy of prospective loss costs, using the assigned risk pool results as a barometer;
2. the appropriateness of the medical loss ratio trend selection;
3. the adequacy of the DCCE-to-loss ("DCCE ratio") selection; and
4. whether NCCI's methodology adequately reflects prospective exposure due to large losses.

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[6] Percentages represent the impact on premiums due to the proposed change in that component item, expressed as a % of premium. The servicing carrier allowance change is net of changes to the LAE provision included in the loss costs.

NCCI responded to the division's questions and briefly addressed some points raised by ANIC in their testimony. ANIC's concerns were also incorporated into the September 23 interrogatory letter, except that no interrogatory explicitly required NCCI to address ANICs testimony suggesting that the loss costs being collected within the assigned risk pool specifically are inadequate. Assigned risk pool premiums are capped, relative to voluntary market premiums, by AS 21.39.155(c). Since current rating rules already apply the maximum allowed surcharge when calculating assigned risk pool premiums, any evidence suggesting that assigned risk pool loss costs are inadequate must also be accompanied by evidence demonstrating that the inadequacy is not due to the statutory limitation imposed by AS 21.39.155(c).

No other interested parties provided testimony or posed questions to NCCI during the hearing.

The hearing record remained open for 10 days after the hearing date, in accordance with AS 21.39.043(d)(7). On September 16, ANIC provided written testimony in support of their oral testimony. No other written testimony or proposed modifications to the filing were received by the division within that timeframe.

A copy of ANIC's hearing exhibits and written testimony is attached to the filing in SERFF and is available for public inspection.

As noted above, questions and concerns raised during the hearing were incorporated by the division into an interrogatory letter sent to NCCI on September 23, 2019. The letter requested additional supporting information related to both the hearing testimony and other issues identified by the division, and required a rebuttal to the evidence provided by ANIC in support of their proposed modifications, in accordance with AS 21.39.043(e) and (f). NCCI responded with the requested information and rebuttal on October 8, 2019.

NCCI RESPONSE AND REBUTTAL

Regarding the medical loss ratio trend selection, ANIC specifically argued that the PY2013 medical loss ratio data point should be adjusted as it is the result of circumstances unique to that PY, and its inclusion improperly affects the exponential trend fits used by NCCI to guide their trend selection. NCCI argued that the testimony provided by ANIC fell short of providing evidence sufficient to demonstrate the PY2013 medical loss ratio was distorted by events unique to that PY such that it requires adjustment or special handling. NCCI explained that they did consider adjusting it, but decided not to. Instead, NCCI believes they have given due consideration to that data point by selecting a trend that is higher than the most recent trend fits (those fits that are most affected by the PY2013 data point).

Regarding the adequacy of the DCCE ratio selection, ANIC specifically argued that DCCE severities have been increasing historically relative to losses and thus it is more likely than not that the DCCE ratio will be greater than NCCI's selected 10.5%. NCCI responded that their method of selecting a DCCE ratio based on a 3-year average appropriately balances stability and responsiveness to the latest available Alaska-only data, and that low DCCE ratio development factors in the latest valuation may cause current DCCE ratio estimates to decrease and may signal that future DCCE ratios will not continue the apparent increasing trend.

Regarding the issue of whether NCCI's methods adequately reflect exposure to large losses, NCCI argued that the most recent excess experience in Alaska, while higher than the excess experience in the years used to develop the excess ratio and higher than the proposed excess ratio itself, has limitations for projecting expected excess ratios for ratemaking purposes—for example, it is sparse, volatile, and immature. NCCI instead identified a few reasons why the excess ratios determined via their procedure are appropriate, despite the recent experience. NCCI also pointed out that the proposed excess ratio is reasonable in relation with longer-term historical excess experience.

NCCI pointed out that the filing's proposal to 50/50 weight the limited and unlimited indications is designed to balance concerns related to the fact that indications based solely on unlimited data will be overstated in periods of significant excess loss activity and understated in periods of low or no excess loss activity.

FINDINGS[7]

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

1. NCCI's medical loss ratio trend selection is too negative. NCCI's October 8 response explained that a medical loss ratio trend greater than their selected -3.5% would be unresponsive to the *change* in trend fits between those in the 2019 filing and those in this 2020 filing. However, a change from a -2.5% selection in 2019 to -3.0% does reflect that the least negative trend fits have changed from -2.3% to -2.9%. Considering the impact to the overall loss cost level change indication due to other components, i.e. experience and development, a selection that falls within a range of reasonable estimates but that also avoids additional disruption in loss cost levels is prudent and not contrary to AS 21.39.030. NCCI's selected indemnity loss ratio trend matches the least negative of all exponential trend fits using the most recent 3 to 15 years of data. The medical loss ratio trend selection can be increased to -3.0% and still fall within the range of trend fits over that same data range. This is true regardless of whether the PY2013 data point is adjusted or omitted.

2. The use of a 50/50 weighting of limited and unlimited indications is acceptable.

   Implicit in the LLP is an excess ratio which continues to decrease year over year, even as the excess loss threshold increases, contrary to expectations. The changes in the excess ratio were driven by two separate updates: (1) an annual update to reflect changes in Alaska's premium levels and loss experience, and (2) an update to the underlying excess ratio curves, which was last done in 2014. The former uses relatively immature data from PYs spanning 2011 to 2016; the latter uses more mature data, spanning PYs 2005 to 2010, and also makes use of "countrywide[8]" data.

   ANIC showed in their testimony that the Alaska-specific excess experience within the range of PYs used to update the excess ratio curves exhibits relatively low large loss activity versus PYs outside of that range. As NCCI uses the variability of a state's claim data relative to the variability observed in the countrywide data to adjust the countrywide-developed excess ratio curves, if a state's claim data from the PY2005 – PY2010 period happens to exhibit relatively little large loss activity, it will show relatively less variation than if a different period were used, and the resulting state-specific excess ratio curves will produce relatively lower excess ratios. This appears to be the case in Alaska.

   This concern is not related to the theoretical aspects of NCCI's method for calculating excess ratios, but whether the specifics of the present case require judgmental manual

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[7] The Findings do not represent a comprehensive list of the information reviewed and considered by the director, nor does the list imply relative importance or materiality.

[8] Combined data for 37 NCCI states: AK, AL, AR, AZ, CO, CT, DC, FL, GA, HI, IA, ID, IL, IN, KS, KY, LA, MD, ME, MO, MS, MT, NC, NE, NH, NM, NV, OK, OR, RI, SC, SD, TN, UT, VA, VT, WV

intervention. Considering the discussion within NCCI's October 8 response related to why such judgmental adjustment to the excess ratio is not necessary, the impact on the indication if reasonable alternatives were implemented, and the desire to maintain a consistent approach from year-to-year, maintaining the 50/50 weighting of limited and unlimited indications—which is consistent with the treatment used in the three most recent annual filings—is acceptable for this 2020 filing. This weighting incorporates the desirable characteristics of each method in a balanced way.

3. The use of excess ratios that are based on the assumption that losses above $50 million are funded through a separate catastrophe loss cost is acceptable. This ensures loss costs calculated in this filing do not double count for catastrophe losses. The catastrophe loss cost was separately approved in NCCI-131730211, with a common January 1, 2020 effective date.

4. The change in the method used to calculate the DCCE provision is acceptable. In particular, using Alaska-specific ratios of paid DCCE-to-paid losses by PY and developing to ultimate based on DCCE ratio development patters makes the calculation consistent with the basis for the losses and premium underlying the filing's loss cost level change analysis.

5. The selected DCCE and AOE provisions appear inadequate. The combined LAE provision is calculated as a ratio to losses. Accordingly, a constant percentage implicitly implies that LAE costs will track with loss costs. However, LAE costs do not appear to have exhibited the same decreasing trend as losses, as evidenced by increasing DCCE- and AOE-ratios. Selecting ratios based on relatively short historical timeframes is not sufficient to adjust for prospective expectations; trends in LAE should be reflected similar to how trends in losses are reflected. Or rather, when historical trends in LAE dollars do not align with historical trends in loss dollars, loss trends should not be imputed on LAE.

6. The change to reflect SAWW-related changes via trend versus explicit benefit changes is acceptable.

7. The updated USL&HW Coverage Percentage factor is acceptable. The updated factor is the result of a full study of the relative average costs of claims subject to the USL&HW Act versus those subject to Alaska's Workers' Compensation Act. The previous full study was performed in 2003 and the factor has been updated annually since that time to account for relative changes in the value of federal benefits versus Alaska benefits. The change, from 1.27 to 1.25, applicable to industrial class loss costs for the portion of payroll that the USL&HW Act exposure, represents a negligible overall impact.

8. On October 3, 2019, the Workers' Compensation Board adopted changes to Alaska-specific conversion factors, used in the Alaska MFS, which will go into effect January 1, 2020. Due to the timing and small magnitude of conversion factor changes historically, the impacts have been accounted for in the following year's loss cost filing[9]. However, this year's changes are expected to have a greater impact on costs. On October 24, 2019, NCCI provided the division a cost impact analysis associated with the Board-adopted conversion factor changes, estimating the impact at -3.7% on overall costs. The cost analysis follows the same method as has been used in recent filings and has been found to be an acceptable method.

   The Alaska MFS is also affected by updates to Medicare's relative value units and/or weights. Those values, which also go into effect January 1, 2020, will not be known until early 2020. Historically, the impact of these updates has been small relative to the impact of

[9] For example, see item 6.a under DISCUSSION OF FILING METHODOLOGY above.

the changes in conversion factors. This creates a range of possible values around NCCI's estimate for the expected combined impact.

To reflect that certain conversion factors will be materially reduced beginning January 1, 2020, but considering the uncertainty of the combined impact, adjusting loss costs and rates beginning January 1, 2020 is appropriate, but the adjustment should be tempered to half of NCCI's estimate.

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 following modifications should be made to the 2020 loss costs and assigned risk rates:
   1. The medical loss ratio trend should be revised from -3.5% to -3.0%.
   2. The combined LAE provision should be revised from 18.5% to 20.0% of losses (11.5% DCCE and 8.5% AOE).
   3. A -1.9% adjustment should be incorporated into the loss costs and assigned risk rates to account for the impact of the MFS changes adopted by the Alaska Workers' Compensation Board which go into effect January 1, 2020. The cost impact analysis documentation should be added to SERFF to make it available for public inspection.

   Based on the information provided within the filing, these modifications should result in approximately a -13.8% change in voluntary loss costs, and approximately a -10.7% change in assigned risk rates.

B. NCCI should continue to provide alternate indications in the 2021 filing. The alternative indications should include combinations of the following:
   1. Experience Period: 3-year and 5-year;
   2. Losses: unlimited and limited;
   3. Loss development averages: 2-year, 3-year, and 5-year paid; 3-year, 5-year, and 5-year xhilo paid-plus-case; and
   4. Trend assumptions: the assumptions approved in this 2020 filing, at least one alternative that is higher than the trend assumption selected for the 2021 filing and at least one alternative that is lower.

C. NCCI should include supporting information related to whether, and to what extent, the frequency and severity of the largest claims are changing. This can be done by providing pages similar to those included in the 2020 filing in Section E of the Supplemental Data, showing the frequency and severity of claims above $1 million, both in Alaska and countrywide. NCCI should also provide an update on any research that is being performed related to this issue.

D. All carriers issuing workers' compensation insurance in Alaska shall use and apply, in strict accord, the loss costs, rating plans, rules, and classifications approved for NCCI, except to the extent a carrier has a deviation approved.

This order is effective November 05, 2019.

Lori Wing-Heier

Lori Wing-Heier
Director