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REGULATORY ORDER NUMBER R 18-04

APPROVAL WITH MODIFICATION OF THE 2019[1] WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 20, 2018, the Division of Insurance (division) received the 2019 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 14.8% decrease in voluntary loss costs and an overall 17.5% decrease in assigned risk rates from the current approved levels.

On July 30, 2018 the director issued Notice of Public Hearing H 18-02 notifying interested parties that, in accordance with Alaska Statute (AS) 21.39.043, a hearing would be held on September 12, 2018. 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; no written comments were received during that time.

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 2018 filing, NCCI again:
    a. based the overall indication on three policy years (PY) of experience (PY2014, PY2015, and PY2016 in this filing);
    b. used a 50/50 weighting of indications derived using limited and unlimited losses ("limited indication" and "unlimited indication", respectively);

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[1] Within this Order, the year used to identify filings refers to the year the filing is effective. For example, the "2019 filing" refers to the filing that will become effective January 1, 2019.

[2] The filing number assigned by the division is the SERFF tracking number, NCCI-131620618. 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.

c. for each indication, used an average of paid and paid-plus-case experience;
    i. paid loss development factors (LDF) are based on a three-year average;
    ii. paid-plus-case LDFs are based on a five-year average; and
d. used paid-plus-case experience to derive the tail (19th report-to-ultimate) LDFs.

2. Changes in NCCI's methodology since the 2018 filing include:
    a. excess ratios used in the limited indication assume losses are limited to $50 million in anticipation of introducing a separate catastrophe miscellaneous value to fund losses in excess of $50 million, to be effective early 2019.
    b. the parameters of the credibility formulas used to combine various alternative estimates of individual classification loss costs were updated.

3. The limited indication is based on NCCI's Large Loss Procedure (LLP)[3]. The large loss limit threshold utilized in the LLP was updated to reflect changes in Alaska's premium levels.

4. NCCI proposed to increase the loss adjustment expense (LAE) provision from 17.1% to 17.9%. This change is due to an increase, from 9.8% to 10.3%, in the defense and cost containment portion of the LAE and an increase in the adjusting and other provision from 7.3% to 7.6%. The impact of this change on loss costs is +0.7%.

5. NCCI proposed using annual trends of -3.5% and -2.5% 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. Compared to the loss ratio trends utilized in the 2018 filing, the proposed trends represent no change for indemnity and a 1.0% decrease for medical. The combined impact of this change on loss costs is -2.9%.

6. NCCI included adjustments to incorporate the expected impact of benefit changes as follows. The combined impact of these changes on loss costs is -0.7%:
    a. indemnity benefit costs are expected to decrease by 0.2% due to decreases in Alaska's average weekly wage;
    b. indemnity benefit costs are expected to increase by 1.3% due to increases in spendable wages due to the Tax Cuts and Jobs Act of 2017; and
    c. medical benefit costs are expected to decrease 1.4% due to automatic adoption, by reference, of annual updates to the Medicare fee schedules.

7. The assigned risk portion of the filing includes the following items. The combined impact of these changes on assigned risk rates is -2.6%:
    a. servicing carrier allowance; based on the 2018 – 2020 servicing carrier bid process. (no change[4]);
    b. assigned risk plan commission rate (no change);
    c. assigned risk plan administration expenses (+0.2%);
    d. excess of loss reinsurance expense (+0.8%);
    e. profit and contingency provision (-3.4%);
    f. offset for expected reinsurance recoveries (-0.2%); and
    g. uncollectible premium provision (no change).

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[3] NCCI's LLP is described in detail in the 2016 loss cost filing and in the NCCI paper "Catastrophes and Workers Compensation Ratemaking".

[4] Percentages represent the impact on premiums due to the proposed change in that component item, expressed as a % of premium.

8. NCCI proposed to change the minimum premium program (MPP) parameters used within the assigned risk rating plan, in an attempt to reduce an apparent inadequacy in the premiums charged to small risks subject to the MPP. The proposal would increase the Minimum Premium Multiplier from 150 to 175 and the Maximum Minimum Premium from $850 to $900.

9. Various values were revised within the "Footnotes" and "Advisory Miscellaneous Values" loss cost and rate pages based on previously approved standard formulas to reflect changes identified elsewhere within the filing, such as changes in the state average weekly wage, relative changes in state and federal benefits, and proposed loss cost level changes.

10. Values were also revised within the Experience Rating and Retrospective Rating plan manual pages based on previously approved standard formulas. In Order R16-04 the division requested that NCCI file these revisions separately, since they are not subject to AS 21.39.043. For various practical reasons these revisions were allowed to be filed within this 2019 filing; NCCI clearly communicated within the filing that these pages are not subject to AS 21.39.043.

REQUESTED MODIFICATIONS, COMMENTS, AND INTERROGATORIES

On August 21, 2018, 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 August 30, 2018. Since that response contains information related to particular insureds, it is not subject to public inspection under AS 21.39.043(g).

On August 23, ANIC requested from NCCI exhibits showing the frequency and severity of claims above $1 million and $3 million, both in Alaska and countrywide, similar to the exhibits provided in the 2018 filing as Section F of the Supplemental Data part of the filing. Those 2018 exhibits were created specifically to respond to the division's Order R16-04, item C, and required NCCI undertake a special research project; the exhibits and their underlying analyses are not a standard part of NCCI loss cost filings. Accordingly, NCCI was unable to produce the requested exhibits until after the hearing on September 12. The exhibits and correspondence between NCCI and ANIC is attached to the filing in SERFF and is 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:

- whether and how their analysis considered the current and expected state of Alaska's economy;
- how the observed spread between limited and unlimited indications compares to the spread in other states;
- whether any events occurred after the filings preparation date that may have a material impact on costs, and specifically whether the sunset of the second injury fund in Alaska due to the passage of House Bill 79 would have any short-term impacts;
- what is the makeup the carriers' data that is excluded or not available and why is that data excluded or not available;
- how different is Alaska's tail factor compared to other states; and
- whether NCCI has observed or expects to observe movement from the voluntary to assigned risk markets as loss costs continue to go down.

NCCI responded during the hearing to each of the questions; any questions that remained unresolved were included within an interrogatory letter sent to NCCI on September 28, 2018.

ANIC then provided oral testimony and related supporting exhibits at the hearing, posed questions to NCCI, and made implicit requests for modifications. A copy of ANIC's hearing exhibits is attached to the filing in SERFF and is available for public inspection.

The testimony focused on three areas of concern:

1. the overall adequacy of prospective loss costs, using the assigned risk pool results as a barometer;
2. whether NCCI's methodology adequately reflects prospective exposure due to large losses; and
3. the appropriateness of the trend selections and trending methodology considering available alternatives. In particular, ANIC suggested NCCI modify the filing such that changes in wages are addressed separately from the loss ratio trend analysis.

NCCI did not respond to ANIC's oral testimony during the hearing. Instead ANIC's concerns were incorporated into the September 28 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 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). No written testimony or proposed modifications to the filing were received by the division within that timeframe.

As noted above, questions and concerns raised during the hearing were incorporated by the division into an interrogatory letter sent to NCCI on September 28, 2018. The letter requested additional supporting information related to both the hearing testimony and other issues identified by the division (including issues related to the assigned risk rate portion of the filing which is not subject to the hearing, per AS 21.39.043(m)), and required a rebuttal to the evidence provided by ANIC in support of their proposed modification, in accordance with AS 21.39.043(e) and (f). NCCI responded with the requested information and rebuttal on October 12, 2018.

NCCI RESPONSE AND REBUTTAL

Regarding the issue of whether NCCI's methods adequately reflect exposure to large losses, NCCI pointed out that the filing's proposal reflects the full impact of large claims to the extent of the weight given to the unlimited indication (50% weighting), and provided evidence to show why they believe the excess provision included in the limited indication also yields reasonable and appropriate results.

NCCI did not explicitly deny ANIC's suggestion that the decrease in the dollars available to pay "excess" claims[5], implied by combining the lower excess ratio with the lower proposed loss cost levels, must imply an expectation by NCCI that exposure to large losses is going down, but noted that a reduction in the dollars available to pay excess claims is not unreasonable considering the loss cost decreases observed over the last several years. They also explained that the excess ratio used in the limited indication is an expected value, and while it incorporates more data and analysis than

[5] "excess" claims refers to claim amounts that are above the LLPs large loss limit threshold.

simply updating for recent and immature Alaska experience, it may still fluctuate slightly from one filing to the next.

Regarding the appropriateness of the trend selections and trend methodology, NCCI provided documentation to address ANIC's questions about which types or sizes of claims are the ones leaving from the sample as frequency declines. NCCI explained that they do not adjust for differences in frequency trends by loss size or injury type when performing their analysis of severity trends. Any impacts due to these types of differences is implicitly reflected via their method of analyzing and selecting loss ratio trends.

In response to ANIC's suggestion to identify trend components, where possible, and make explicit adjustment for observed or expected discontinuities in those components, NCCI pointed out that their method of using loss ratio trends automatically reflects complex interaction effects, including the impacts of wage growth and other component forces without need to adjust for points or periods of apparent discontinuity. NCCI further explained that the procedure proposed by ANIC complicates the trend selection and application with no clear improvement in predictive accuracy. The added complexity and error comes, in part, from the requisite assumptions about dependency and interaction that are necessary in order to accurately remove historical impacts of certain component forces, or adjust for any observed or expected discontinuities.

FINDINGS

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

1. The use of an average of paid and paid-plus-case experience is acceptable. Using paid-plus-case experience in combination with paid experience takes advantage of the information contained in adjusters' best estimates of ultimate claim amounts without fully disregarding the more objective paid data. Having two estimates should lessen the volatility observed in either method individually, particularly when based on different timeframes.
    a. Paid LDFs are more objective and generally less volatile than paid-plus-case LDFs. The three-year time period over which to average these LDFs strikes a reasonable balance between stability and responsiveness.
    b. Paid-plus-case LDFs can be relatively more volatile over time due to differing reserve philosophies and due to insurers adjusting the adequacy of their case reserves. Accordingly, using a longer time period over which to average paid-plus-case LDFs helps control the volatility and lessens the influence of short term anomalous reserving changes. The five-year time period over which to average paid-plus-case LDFs strikes a reasonable balance between stability and responsiveness.

    NCCI's applicable supporting documentation and discussion adequately support the claim that both paid and paid-plus-case experience have merit in this filing. In particular, NCCI provided exhibits of loss development diagnostics which show no reason to change the averaging techniques or methodologies that have been used in recent prior filings.

2. Using the medical LDFs, calculated as described in Discussion #1.c above, without additional adjustment is acceptable. In this filing, medical age-to-age link ratios are lower using shorter averaging periods for almost all reports, with the greatest differences being in the first few link ratios. The division asked NCCI to consider whether the medical LDFs required adjustment to account for this observation. NCCI responded that the cause of the recent lower link ratios is not entirely clear, but provided context for the observed decreases in relation to other states' recent observations, historical time periods' observations in

Alaska, and across the full spectrum of maturities. Based on this information and considering alternative indications that utilize different candidate sets of LDFs and the diagnostics referred to in Finding #1 above, it is acceptable to use the medical LDFs without explicit adjustment.

3. NCCI's loss ratio trend selections are acceptable. The selected trends are on the high end (least negative) of all exponential trend fits using the most recent 3 to 15 years of data. The indemnity selection is very close to shorter-term fits and less negative than longer-term fits; the medical selection is very close to the longest-term fits and much less negative than shorter-term fits. Accordingly, the medical loss ratio trend selections make conservative predictions about the amount of change expected in medical loss ratios considering the observed changes over the most recent few years. Considering the indication remains highly negative, this implicit conservativism is not unreasonable or contrary to AS 21.39.030.

   Measuring trends at the loss ratio level of aggregation (separately for indemnity and medical) avoids having to make the many, varied assumptions necessary to model the complex interaction effects of the various component drivers of changes in loss ratios over time—some of which may not be readily identifiable or well understood—and the attendant increase in estimation error. As NCCI showed in their Response, any relationship between (a change in) the observed value of a single component driver and (a change in) the observed value of loss ratios is complex. In particular, NCCI provided evidence that historically the simplifying assumption of independence between wage growth and medical loss ratios has not been observed. Finally, the apparent intended effect of ANIC's requested modification is an increase in the overall loss cost indication. However, as noted above, the selected loss ratio trends already result in an overall indication that is on the high end (least negative) of reasonable estimates.

4. The use of a 50/50 weighting of limited and unlimited indications is acceptable and produces a reasonable indication of expected future losses, where the limited indication is based on NCCI's LLP. This is consistent with the treatment used in the two most recent years' filings. The 50/50 weighting incorporates the desirable characteristics of each method in a balanced way. In this year's filing, the difference between the limited and unlimited indications has further converged; the unlimited indication is now 1.0% more negative.

   NCCI again updated the parameters of their LLP using Alaska-specific inputs to reflect that Alaska tail factors and excess ratios are sufficiently different than countrywide.

   Implicit in the LLP is an excess ratio which appears to be moving contrary to expectations. Considering the concurrent proposals to decrease both the large loss limit threshold and overall loss costs, and the possibility that the observed decreases in claim frequency are due to relatively more smaller claims leaving the sample, combined with the expectation that exposure to the largest claims is not expected to diminish prospectively, the decrease in the excess ratio is surprising. NCCI demonstrated the theoretical appropriateness of its calculation via exhibits and reference to past filings and research, and also explained that this is an expected value and is thus subject to some fluctuation. Considering the relative insensitivity of the overall indication to changes in the excess ratio for changes on the order of the observed reduction—for example, the observed change from 0.053 last year to 0.046 this year has a -0.3% impact on the overall indication—the lower excess ratio observed in this filing does not make the LLP's results unreasonable. And again, as noted in Finding #3 above, the loss ratio trend selections are conservative so that, to the extent that the mix of claims may be shifting toward a greater proportion being higher severity claims[6], the trend selections, which have a highly leveraged impact on the overall indication, should more than cover the understatement due to any downward bias caused by the excess ratio's calculation not explicitly accounting for such change in mix. Similarly, the conservative trend selections should cover any understatement due to random fluctuation in recent claims experience causing the excess ratio to be slightly lower than its true future value.

At the request of ANIC, NCCI once again provided exhibits showing that in Alaska as well as countrywide, the frequency and severity of the largest claims appears relatively flat. The exhibits provide no new evidence suggesting that adjustments to methods or assumptions are necessary to accommodate expectations of increased frequency or severity of the largest claims beyond what NCCI's methods and assumptions already anticipate and account for.

Due to the desirable characteristics of each of the limited and unlimited indications, it remains prudent and reasonable to give equal weight to both.

5. 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. The catastrophe loss cost was not able to be included in this filing due to the need to revise other Basic Manual rules, which are subject to different review procedures, but will be included within the loss cost filing in future years. The impact is immaterial.

6. The revised credibility parameters used for classification ratemaking are acceptable. The classification ratemaking procedure combines three estimates to arrive at the proposed class loss cost, where the Alaska experience-based pure premium estimate is one of those three. The updated parameters give less weight to this Alaska experience-based estimate, which increases stability, especially for smaller volume classes. The use of the other two estimates for the complement of the class indication ensure that the class loss costs remain accurate estimates of future loss. In addition to the credibility parameters, NCCI imposes "swing limits" on rate changes by class. The new parameters replace the somewhat arbitrary current method of limiting rate changes by class via imposition of "swing limits" with a more theoretical and measured approach to limiting fluctuation.

7. The proposed changes to the MPP parameters for the assigned risk rating plan have not been adequately supported at this time. For example, the relative pure premiums of minimum premium risks compared to all statewide risks provided as support appear to be volatile and are not significantly different than 1.00 such that choosing a different historical experience period may result in different conclusions. Further, the support provides the comparison for a single alternative set of MPP parameters, but it has not been shown that, for example, lowering one or both of the two subject MPP parameters instead of raising them both would not likewise exhibit more equitable pure premium relativities over a relevant historical timeframe[7]. Finally, it is not clear that increasing the minimum premiums employers must pay is appropriate considering the extended period of improvement in overall loss experience and corresponding rate decreases.

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[6] Based on documentation provided in NCCI's Response, claim types that are generally more severe (Fatal and Permanent Total (PT)) have been increasing slightly over the long historical timeframe where the generally less severe claim types have been decreasing.

[7] The support and NCCI's conclusion, that MPP parameters should be raised, appears to assume that the relative pure premiums will always be worse when the parameters are lower, but that has not been shown to be true. Indeed, within the applicable supporting exhibit, there are policy periods where the pure premium relativities are worse when the MPP parameters are increased.

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 14.8% overall decrease in voluntary loss costs is approved.

B. The 17.5% overall decrease in the assigned risk rates is approved.

C. The proposed increases to the Minimum Premium Multiplier and the Maximum Minimum Premium are not approved.

D. NCCI should continue to provide alternate indications in the 2020 filing. The alternative indications should include combinations of the following:

   1. Losses: unlimited and limited;
   2. Loss development averages: 2-year, 3-year, and 5-year paid; 3-year, 5-year, and 5-year xhilo paid-plus-case;
   3. Trend assumptions: the assumptions approved in this 2019 filing, at least one alternative that is higher than the trend assumption selected for the 2020 filing and at least one alternative that is lower.

E. 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 2018 filing in Section F 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.

F. 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 6th, 2018.

Lori Wing-Heier

Lori Wing-Heier
Director