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Workers' Compensation Rates to Decrease in 2018

November 6, 2017 ANCHORAGE – Alaska businesses will see an average degrease of 5.4 percent for 2018 workers' compensation insurance assigned risk rates. Workers' compensation voluntary insurance loss costs will decrease by 7.9 percent.

"We are hopeful that the downward trend in workers' compensation rates that we've approved the past two years will continue," said Lori Wing-Heier, director of the Alaska Division of Insurance, "Lower workers' compensation costs reduce the burden on the small businesses that are helping to foster a stronger Alaska economy."

The 2018 rate reductions signify a positive continuing reduction in workers' compensation losses. This year's lower rates follow 2017 rates that represented a 5.1 percent reduction from the previous year. Director Lori Wing-Heier approved the filing from the National Council on Compensation Insurance on November 6, 2017.

The Division of Insurance is an agency housed within the Alaska Department of Commerce, Community and Economic Development (DCCED) tasked with protecting consumers in Alaska. For additional information about the division, visit https://www.commerce.alaska.gov/web/ins/. For information about DCCED and its other agencies, visit commerce.alaska.gov.

ATTACHED: Regulatory Order Number R17-09

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THE STATE of ALASKA

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REGULATORY ORDER NUMBER R 17-09

APPROVAL WITH MODIFICATION OF THE 2018 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 23, 2017, the Division of Insurance (division) received the 2018 Alaska Workers' Compensation Filing for Voluntary Loss Costs and Assigned Risk Rates from the National Council on Compensation Insurance, Inc. (NCCI)[1]. This filing proposed an overall 7.9% decrease in voluntary loss costs and an overall 4.2% decrease in assigned risk rates from the current approved levels.

On August 3, 2017 the director issued Notice of Public Hearing H 17-02 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on September 12, 2017. 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.

No 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, Alaska National Insurance Company provided oral and written testimony and supporting exhibits. The hearing record was held open for 10 days after the hearing; no written comments were received during that time.

DISCUSSION OF FILING METHODOLOGY

1. Consistent with what was approved in the 2017 filing[2], NCCI again:

    a. based the overall indication on three policy years (PY) of experience (PY2013, PY2014, and PY2015 in this filing);
    b. used a 50/50 weighting of "limited" and "unlimited" indications;
    c. for each indication, used an average of paid and paid-plus-case experience;

[1] The filing number assigned by the division is the SERFF tracking number, NCCI-131156296. 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.

[2] Within this Order, the year used to identify filings refers to the year the filing is effective. For example, the "2017 filing" refers to the filing that became effective January 1, 2017 and the filing subject to this Order is the 2018 filing.

        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 2017 filing include:
    a. Alaska-specific inputs were used to adjust the tail LDF (previously used countrywide inputs); and
    b. excess ratios that reflect non-terrorism exposure above $50 million were used (previously excess ratios did not include this exposure).

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 17.0% to 17.1%. This change is due to an increase, from 9.6% to 9.8%, in the defense and cost containment (DCC) portion of the LAE and a decrease in the adjusting and other (AO) provision from 7.4% to 7.3%. The impact of this change on loss costs is +0.1%.

5. NCCI proposed using annual trends of -3.5% and -1.5% 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 proposed loss ratio trends are 1.0% higher and 1.5% lower than those utilized in the 2017 filing, for indemnity and medical, respectively. The combined loss cost impact of this change is -5.1%.

6. The assigned risk portion of the filing includes the following items. The combined impact of these changes is +4.0% for assigned risk rates:
    a. servicing carrier allowance; the filing uses a value based on servicing carrier allowances applicable to the 2015 – 2017 contract period, since the 2018 – 2020 contract period servicing carrier contracts were not finalized at the time the filing was submitted. (no change[4]);
    b. assigned risk plan commission rate (no change);
    c. assigned risk plan administration expenses (decreasing 0.2%);
    d. excess of loss reinsurance expense (increasing 2.5%, including provision for a new layer of reinsurance);
    e. offset for expected reinsurance recoveries (new, 2.0%);
    f. profit and contingency provision (new, 2.0%); and
    g. uncollectible premium provision (decreasing 0.2%).

7. NCCI included adjustments to incorporate the expected impact of benefit changes as follows. The combined loss cost impact of these changes is +0.3%:
    a. indemnity benefit costs are expected to increase by 0.2% due to increases in Alaska's average weekly wage; and
    b. medical benefit costs are expected to increase +0.3% due to automatic adoption, by reference, of annual updates to the Medicare fee schedules.

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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 are changes versus the corresponding component values approved in the 2016 filing and are expressed as a % of premium.

8. Various values were revised within the Footnote 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.

9. In addition to the method changes identified in paragraph 2 above, NCCI complied with Order R16-04 by:
   a. providing exhibits and discussion to respond to Order items B and C; and
   b. separately filed revisions identified in Order item D.

INTERESTED PARTY'S REQUESTED MODIFICATIONS AND COMMENTS

Alaska National Insurance Company (ANIC) provided oral testimony at the hearing and written testimony immediately following the hearing which followed their oral testimony. ANIC's testimony included exhibits and related discussion, posed questions, and requested a modification. A copy of the written testimony is attached to the filing in SERFF and is available for public inspection.

The testimony focused on three areas of concern:

1. loss ratio trend selections and the change in these selections since last year's filing (with a focus on the medical component selection), including implicit change in LDFs;
2. the interaction of wage growth and trend selections, and how recent observations in wage growth have been incorporated in the trend selections;
3. whether NCCI's methodology adequately reflects exposure due to large losses

ANIC requested the filing be modified to increase the number of years used to calculate paid LDFs from three to five.

NCCI provided an immediate response to ANIC's oral testimony during the hearing. Nevertheless, the questions posed by ANIC within their testimony were incorporated into an interrogatory letter sent to NCCI on September 26, 2017.

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 26, 2017. 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 11, 2017.

NCCI REBUTTAL

Regarding the loss ratio trend selections, NCCI identified the drivers of the trend indications as improving experience and loss development. Considering all exponential fits ranging from 5 to 15 years and including the most recent available PY, 2015, their medical loss ratio trend selection is equal to the least negative of all of the fits.

Regarding the proposed modification to change the number of years used in calculating LDFs, NCCI acknowledged the observed decline over the most recent evaluations. During the hearing NCCI responded by noting that the tail LDF (unlimited, paid-plus-case, 19th report-to-ultimate) was lowered (1.120 to 1.100) and is still higher than seven out of ten of the indicated tail factors, demonstrating their conservative approach to lowering their LDF selections. NCCI also noted that, for the states they file loss costs in, it is common to use three years or fewer for indications based on paid losses and five years or shorter for indications based on paid-plus-case losses. NCCI's written response echoed their belief that the three-year average for paid loss development patterns provides a reasonable balance between stability and responsiveness.

Regarding the incorporation of recent wage growth observations in the trend selections, NCCI provided an exhibit showing the historical relationship between changes in wages and medical loss ratios and concluded that there was no clear relationship. NCCI also pointed out that using loss ratio trends automatically reflects interaction effects, including wage growth and other component forces that may be correlated with wage growth. Therefore, the trend fits already reveal the sensitivity of loss ratio trends to changes in wages.

Regarding large loss exposure, NCCI explained reasons for using a large loss procedure and referred to an applicable Actuarial Standard of Practice that supports the use of large loss procedures in general. NCCI's LLP uses a longer-term and more mature history of Alaska claims to reduce volatility and to avoid overstatement of indications when there are a few large claims in the recent experience period. NCCI also enumerated a few of the changes they made for the 2018 filing in response to concerns expressed in previous filings related to their LLP, all of which serve to increase the indication.

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 less volatile and more objective than paid-plus-case LDFs. The three-year time period over which to average these LDFs strikes a reasonable balance between stability and responsiveness. In this filing, medical link ratios are lower using a three-year average than using a five-year average for almost all reports, and the greatest difference is in the 1st to 2nd link ratio. NCCI validates the accuracy of the data and link ratios and has concluded the reported link ratios are accurate, including the most recent, lower, 1st to 2nd medical link ratio. Corresponding differences in indemnity link ratios do not exhibit a clear pattern. The alternative indications provided by NCCI demonstrate the sensitivity of

altering the averaging period; changing to a five-year averaging period for paid LDFs would result in an impact of +1.2%. Based on the considerations described in this subparagraph and considering that a timeframe of three-years or less is consistent with other NCCI states (including other small volume states) and historical Alaska filings, there is insufficient cause to increase the timeframe over which paid LDFs are averaged.

b. Paid-plus-case LDFs can be relatively more volatile over time due to differing reserve philosophies and 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.

2. NCCI's loss ratio trend selections are acceptable and have been supported as required by AS 21.39.040. 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 medical trend selection equals the highest fit. The change in trend selections versus the prior year's filing is explained by similar decreases in shorter-term trend indications since the last filing. The selections are reasonable in the context of various alternative indications, including those based on excluding the most recent PY2015 data point or based on using the LDFs from the 2017 filing or using five-year averaged paid LDFs.

   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 and the attendant increase in estimation error. As NCCI showed in their Rebuttal, if there is a relationship between wage growth and changes in medical loss ratios, the relationship is complex. Accordingly, even if a modeling exercise could separate out the historical wage growth component of loss ratio trends and future wage growth could be modeled with an acceptable degree of accuracy, it is not clear that the results would be helpful for estimating the necessary loss trends for the filing's effective period.

3. The use of a 50/50 weighting of limited and unlimited indications is acceptable and produces a reasonable indication of expected future losses. Within the findings in Order R16-04, the division acknowledged the soundness of the LLP, but expressed reservations including concern with the mismatch between the data underlying the experience period and that used in calculating excess ratios. Accordingly, the director's order required a 50/50 weighting of the limited and unlimited indications in an attempt to incorporate the desirable characteristics of each method in a balanced way.

   NCCI has made various method changes (see paragraph 2 under "Discussion of Filing Methodology" above) which, together with other factors such as the reduction in the large loss limit threshold, have lessened other concerns present in the 2017 filing. For example, compared to last year's filing, the limited and unlimited indications have converged, and the limited indication now exhibits lesser spread between the paid and paid-plus-case component indications than does the unlimited indication.

   In response to paragraph C of Order R16-04, and to the concern that Alaska is observing or has observed a fundamental shift in the frequency and severity of the largest claims, due to, for example, medical technological improvements, NCCI provided exhibits showing that countrywide, the frequency and severity of the largest claims appears

relatively flat. Similar exhibits based solely on Alaska claims data show an increase in the frequency of large claims in Alaska in the last few years, which is consistent with documentation provided in the 2017 filing. However, the analyses that rely solely on Alaska data are not fully credible or conclusive due to the small Alaska dataset and the characteristic volatility of these large claims. Considering the presumed drivers of the increase in large claims are not Alaska specific, the countrywide exhibits add to the body of evidence making it difficult to conclude that the recent Alaska large loss experience is more predictive of future expected costs than the alternative which is based on longer term averages.

Nevertheless, it remains prudent and reasonable to give equal weight to both the limited and unlimited indications.

4. The proposed 2.0% profit provision in the assigned risk rates is acceptable. In Order R04-10, the division noted, "the assigned risk pool does not exist in order to make a profit or receive a return on its investment." While that position remains true, it is not inconsistent with the proposed profit provision. Notably, even a 0.0% profit provision implicitly assumes an offsetting relationship between investment income on claims reserves (which are required to be considered in the pool's ratemaking per regulation 3 AAC 30.030(d)(4)) and underwriting results. NCCI's proposal makes the relationship explicit and appropriately allows the provision to vary with investment market results.

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:

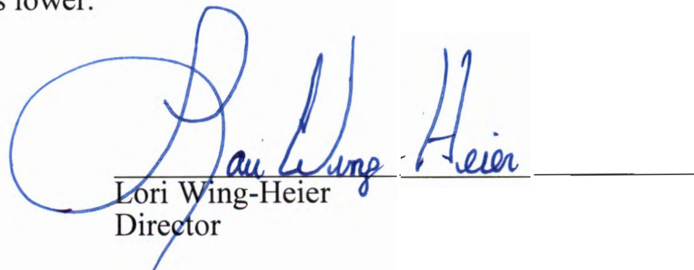
A. The -7.9% overall decrease in voluntary loss costs is approved.

B. The expense provisions of the assigned risk rate will be updated to include the actual 2018 servicing carrier allowance of 28.4%. This will result in a 5.4% overall decrease in the assigned risk rates.

C. NCCI should continue to provide alternate indications in the 2019 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 2018 filing, at least one alternative that is higher than the trend assumption selected for the 2019 filing and at least one alternative that is lower.

This order is effective November 6, 2017.



Lori Wing-Heier
Director