STATE OF ALASKA

DEPARTMENT OF COMMERCE COMMUNITY AND ECONOMIC DEVELOPMENT

DIVISION OF INSURANCE

Frank H. Murkowski, Governor

ORDER NUMBER R 05-02 **November 17, 2005**

APPROVAL WITH MODIFICATIONS OF 2006 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 26, 2005, the Division of Insurance (division) received the 2006 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 7.9 percent increase in voluntary loss costs and a 3.6 percent overall increase in assigned risk rates from the current approved levels.

On August 26, 2005, the director issued Notice of Public Hearing H 05-03 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on September 16, 2005. 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.

Before the hearing, both the division and Alaska National Insurance Company (ANIC) sent interrogatories to NCCI requesting additional supporting information. After the hearing but no later than September 26, 2005, ANIC provided additional written testimony to the division which included recommendations to modify the filing. The division also asked for and received additional supporting information from NCCI.

DISCUSSION OF FILING METHODOLOGY

The primary change in methodology in the 2006 prospective loss cost filing is the use of a five-year average of paid + case reserve loss development factors. In the 2005 filing, NCCI selected a five-year average excluding the highest and the lowest loss development factors. For the assigned risk rates, the primary methodology changes are the inclusion of an uncollectible premium provision in the expense component and an increase in the minimum premium calculation.

1. According to NCCI, the five-year average loss development method was selected, instead of the five-year average excluding the highest and the lowest factors, to respond to shifts in the most recent development factors and to maintain stability. If the highest and lowest loss development factors were excluded, this would have removed some of the

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more recent factors that are indicating a change in pattern, downward for indemnity and upward for medical. This change in methodology, using a five-year average rather than the five-year average excluding the highest and the lowest factors, results in minimal impact to the overall indication, 7.9 percent vs. 7.8 percent, since the changes in the indemnity and medical factors offset each other.

2. NCCI proposed to increase the expense component of the assigned risk rates to include a provision for uncollectible premium. The purpose of including an uncollectible premium provision is to ensure that the assigned risk rates are sufficient to offset any premium that is ultimately determined to be uncollectible. By comparing historical Alaska gross-billed premium to the historical Alaska collected premium, NCCI estimated the impact of the uncollectible premium on the assigned risk rates to be 2.4 percent.

3. NCCI proposed to increase the minimum premium multiplier from $75 to $150, based on analysis of experience for the small risks in the assigned risk market. This analysis indicated that the smallest risks generally had poorer experience than that of the larger risks in the assigned risk market. In addition to changing the minimum premium multiplier, NCCI proposed to increase the maximum minimum premium from $500 to $750. These changes are accompanied by an offset provision so that their effect is revenue neutral.

   To determine the appropriate amount by which the minimum premium calculations should be revised, NCCI assumed that the minimum premium methodology should be sufficient to provide for the estimated loss potential for one full-time employee covered for one year under a particular class. The indicated minimum premium multiplier, $374, is based on the estimated January 1, 2006 Alaska average weekly wage. NCCI proposed a multiplier of $150, or 40 percent of the indicated multiplier.

4. The rest of the methodology used in the filing is consistent with that used last year. NCCI again

   - used limited losses in the loss development factor selection and incorporated an excess provision to adjust the losses to an unlimited basis;
   - excluded maritime class experience from the overall indication but included it in the class ratemaking data; and
   - included the assigned risk excess of loss reinsurance expense.

5. NCCI proposed that the loss costs be increased by 3.4 percent to account for the impact of changes in the Alaska Medical Fee Schedule that became effective on December 1, 2004.

6. At the time this filing was delivered to the division, a servicing carrier bid process was underway to select servicing carriers for the assigned risk market for 2006 – 2008. NCCI noted that the servicing carrier allowance of 32.2 percent initially incorporated into the assigned risk expenses would be revised when the results of the bid process became available. The bid process resulted in a new servicing carrier allowance of 30.56 percent, which will be included in the filing.

7. During the division's review of the filing it was noted that the payroll reported in Class Code 4279 appeared to be incorrect. NCCI determined that this amount had been incorrectly reported in this class code and the carrier has corrected the data subsequent to the filing being completed.

8. The division's review also uncovered a change in assumptions used in the premium on-level procedure. This change uses a projected assigned risk market share percentage of zero percent rather than a projected assigned risk market share factor that is actually likely to occur.

INTERESTED PARTY'S REQUESTED MODIFICATIONS

ANIC requested that NCCI incorporate two modifications into the 2006 loss cost filing. The requested modifications were 1) increase the medical loss ratio trend to no less than 1.050 and 2) leave the LAE provision at its current approved level of 16 percent.

1. ANIC stated that it seems illogical to use a trend lower than that approved in the 2005 loss cost filing when the medical loss ratio trend seems to be increasing. ANIC was also concerned that the implied frequency trend of -5 percent in the selected medical and indemnity loss ratio trends is too aggressive.

2. ANIC stated that they believe the method used by NCCI to develop the ALAE provision does not respond to the Alaska experience. They also stated that, since the ULAE factor filed by NCCI is based solely on countrywide data, it also does not reflect Alaska conditions. ANIC would like NCCI to file loss costs without any provision for ULAE for 2007 and recommended that NCCI leave the total LAE provision at its currently approved level of 16 percent.

NCCI REBUTTAL

NCCI elected not to include the ANIC proposed recommendations for the following reasons.

1. NCCI uses loss ratio trends in their filings and does not select independent frequency and severity trends. NCCI believes that frequency and severity trends are not independent and this dynamic relationship can exacerbate the error that can result from selecting each component separately. NCCI stated that the use of loss ratio trends automatically incorporates changes in the dynamic components by recognizing changes in total cost compared to premium.

   Another reason NCCI uses loss ratio trends is that the individual frequency and severity components can be volatile, whereas the loss ratio trends are more stable, thus making it more difficult to select the correct trends for frequency and severity.

2. NCCI stated that the ALAE methodology used in the 2006 loss cost filing is their standard methodology. It begins with a countrywide ALAE ratio and then adjusts it to reflect individual state differences. The data call used to determine the ALAE ratio is not available on a state-by-state basis.

   NCCI also noted that insurers currently have the option of deviating from the filed ULAE provision to the extent that the individual insurer's expenses differ from those used in the filing. The methodology used for determining the LAE provision has been used in the Alaska filings for several years.

FINDINGS

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

1. The five-year paid + case loss development method is acceptable. The use of the five-year average, rather than the five-year average excluding the highest and lowest factors, reflects the increasing medical costs and slight lowering of indemnity costs while maintaining stability. For the 2007 filing, NCCI should review the data to see if once again using paid data, or at least some combination of paid and paid + case, is appropriate.

2. The provision for uncollectible premium in the assigned risk rates is acceptable.

3. The increase in minimum premium multiplier and maximum minimum premium is acceptable. The minimum premiums have remained constant for several years during a period in which loss costs have increased significantly. An increase in the minimum premium is appropriate to reflect the increasing cost of providing workers' compensation benefits to all employers.

   NCCI also proposed to offset the increase in minimum premiums so that the impact of this change to the assigned risk market is revenue neutral. The last time changes to the minimum premium were made was in the 1998 rate filing. In this filing, the minimum minimum and maximum minimum premium were lowered to allow smaller risks to benefit from the continuing improvement in loss experience that had been reflected in lower loss costs. At that time no offset to the rates was made for the decrease in premium that resulted from the changes in minimum premiums. Therefore, with the proposed increase in minimum premium, there should also be no offset to the rates due to the increased minimum premium.

4. The medical loss ratio trend of 4.5 percent selected by NCCI is acceptable. While it is lower than that approved in last year's filing, it is a reasonable selection based upon the possible range of trend factors. While the policy year eight-point medical loss ratio trend increased over that included in the 2005 filing, the more recent five-point medical loss ratio trends, for both policy year and accident year, are lower than those calculated last year.

   While there are pros and cons for using loss ratio trends, one of the advantages is that a comparison of loss ratios over time includes the collective effects of multiple factors that may have an impact on frequency and severity. A disadvantage of using loss ratio trends is that the underlying reasons for changes in the trends are more difficult to interpret. Because of the multiple interacting factors that can impact workers' compensation claims, the use of loss ratio trends rather than individually selecting frequency and severity components is acceptable.

5. The payroll incorrectly reported in Class Code 4279 should be removed and the loss cost for this class revised to reflect the correct payroll amount of $0 for the April 2002 through March 2003 policy period.

6. The new servicing carrier allowance of 30.56 percent, resulting from the bid process selection, should replace the 32.2 percent provision included in the assigned risk expense component. No other changes to the expense calculation should be made.

7. The premium on-level methodology includes a projected assigned risk market share percentage. In this filing, as in the previous two filings, NCCI has selected zero percent for the projected assigned risk market share. The reason NCCI gives for selecting a zero percent assigned risk market share is that this assumption calculates loss costs that are appropriate for the whole market, not just the voluntary market, and that it is a means to reduce the size of the assigned risk market. NCCI did not indicate in any of the previous filings that they were changing the assumption about the projected assigned risk market share in the premium on-level procedure. (Prior to the change to a zero percent assumption, the projected assigned risk market share percentage included in the Alaska filing was approximately 15 percent.) A zero percent projected assigned risk market share is not a realistic assumption and increasing the voluntary loss costs as a means for depopulating the assigned risk pool is inappropriate.

   The projected assigned risk market share should be increased to 5 percent. This percentage is a transition value and will need to be re-evaluated to determine the appropriate level to be included in future filings.

In the future, NCCI should include in the filing a discussion and rationale for all changes in assumptions or methodologies used in their filings. These changes should not be discoverable by the division only when the division asks the appropriate questions that uncover the changes in assumptions.

8. NCCI's current method of calculating the loss adjustment expense load is acceptable. If an insurer believes the filed loss adjustment expenses are either excessive or inadequate, the insurer may file a deviation in its loss cost multiplier filing with appropriate support for the deviation.

9. The proposed increase due to the revised medical fee schedule is acceptable.

ORDER

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

1. the new servicing carrier allowance of 30.56 percent should replace the existing 32.2 percent provision in the assigned risk expenses;
2. the offset for the change in minimum premium should be removed from the assigned risk rates; and
3. the projected assigned risk market share percentage should be increased to 5 percent.

With these revisions to the filing, the voluntary loss costs will increase by 7 percent and the assigned risk rates will increase by 0.5 percent.

This order is effective November 17, 2005.

Linda S. Hall

Linda S. Hall
Director