ORDER NUMBER R 07-08 **November 5, 2007**

APPROVAL WITH MODIFICATIONS OF THE 2008 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND

On August 9, 2007, the Division of Insurance (division) received the 2008 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 10.9 percent decrease in voluntary loss costs and an overall 13.7 percent decrease in assigned risk rates from the current approved levels.

On August 9, 2007, the director issued Notice of Public Hearing H 07-02 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on August 29, 2007. 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.

Alaska National Insurance Company provided the division with two exhibits at the time of the hearing. No additional written comments were received after the hearing. The division also asked for and received additional supporting information from NCCI.

DISCUSSION OF FILING METHODOLOGY

1. Consistent with the 2007 filing, NCCI again

   - based the overall indication on three policy years of experience;
   - used limited losses in the loss development factor selection and incorporated an excess provision to adjust the losses to an unlimited basis; and
   - excluded maritime class experience from the overall indication but included it in the class ratemaking data.

2. NCCI is proposing to increase the loss adjustment expense (LAE) provision from 16.4 percent to 18.6 percent. NCCI bases the selection of LAE on experience obtained through a special data call. As a change from past practice, NCCI included only private carrier data, and excluded state fund data, from the LAE calculation for the 2008 filing.

3. NCCI proposes to continue using paid-plus-case data to calculate the loss development factors. Because the most recent three years of data show a decreasing trend in the link

ratios, NCCI selected the three-year average loss development factors for the first three ratios and continues to use the five-year average, as in the 2007 filing, for the remainder of the link ratios.

4. In this filing, NCCI continued to select a zero percent assigned risk market share consistent with the 2007 filing rather than the five percent market share the director asked NCCI to use in the 2006 filing as a transition value. NCCI's rationale for reverting to the zero percent assumption is that assuming an assigned risk market share other than zero percent artificially suppresses the voluntary loss costs and does not reflect the fluid nature of the assigned risk pool.

5. For the assigned risk portion of the filing, NCCI proposes to increase the maximum minimum premium from $750 to $800. No other changes to the minimum premium calculation are proposed.

6. Other items in the assigned risk portion of the filing that are consistent with the 2007 filing include

   - no change to the servicing carrier allowance;
   - inclusion of an excess of loss reinsurance expense; and
   - an uncollectible premium provision.

7. The major contributors to the overall indicated loss cost level decrease are a continuing decline in frequency of accidents and continuing improvement in experience seen in policy year 2005. In addition, while medical costs continue to increase, the rate of increase has slowed, which NCCI has recognized by selecting a two percent medical loss ratio trend compared to the three percent medical loss ratio trend in the 2007 filing.

8. NCCI included a provision for the change in medical fee schedule based on the U.S. Consumer Price Index to recognize the benefit changes in CSHB 228, effective August 1, 2007 through March 31, 2009.

INTERESTED PARTY'S REQUESTED MODIFICATIONS

There were no requests for modifications to the filing. However, some of the comments made at the hearing expressed concern over the selected loss development factors and trend. With two years of decreases greater than 10 percent (if the proposed 2008 filing is approved), preceded by several years of large increases, the market has been somewhat volatile. The accident year data, while admittedly immature, suggested that the decrease in loss ratios of the past several years may be turning around.

NCCI REBUTTAL

After a four-year period of relatively stable medical loss ratios, the medical loss ratios for policy years 2004 and 2005 improved significantly. In the 2008 filing, the exponential medical loss ratio trend indications were negative, ranging from minus 4.8 percent to minus 0.7 percent, while in the 2007 filing the trend indications were generally positive, ranging from minus 0.3 percent to plus 3.7 percent. Even when the 2005 accident year medical loss ratio is included, the five-point exponential accident year trend is negative, minus 0.9 percent, which is less than the selected trend. The selected medical trend factor still represents an expected increase in medical costs although the selection reflects a lower annual expected increase than in the 2007 filing.

For the indemnity trend, the policy year loss ratios have been declining for the last five years. The exponential indemnity loss ratio trend indications were negative, ranging from minus 13.8 percent to minus 8.9 percent, while in the 2007 filing the trend indications were slightly higher, ranging from minus 10.4 percent to minus 4.1 percent. Due to the improvement in loss ratio trends, the annual indemnity loss ratio trend was decreased from minus one percent in the 2007 filing to minus three percent in the 2008 filing.

For the loss development link ratio selection, the two oldest years are significantly different from the link ratios in the more recent three years. To recognize the decreasing trend in both medical and indemnity loss ratios, a three-year average was selected for the first three link ratios and a five-year average continued to be used for the remaining link ratios to balance stability and responsiveness to smooth the effect of reserve fluctuations. This same pattern, smaller link ratios for the more recent years, was also seen in the paid data.

FINDINGS

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

1. The exclusion of state fund data in the calculation of the loss adjustment expense provision is reasonable as Alaska does not have a state fund and the expense experience of the state funds may differ from that of private insurers. The proposed LAE amount of 18.6 percent has been adequately justified.

2. The use of three-year paid-plus-case averages for the first three link ratios has been justified. Both the indemnity and medical paid-plus-case link ratios have decreased fairly consistently over the last three years with the medical link ratios more volatile than the indemnity link ratios. Testimony at the hearing suggested that this decreasing trend in the medical link ratios may be due to adjusters adapting to the medical fee schedule freeze as they set reserves. The use of paid-plus-case data can be more volatile due to changes in reserves; however, the paid data also exhibits the same downward trends in link ratios for both the indemnity and medical data. The indemnity reserving would not be impacted by changes in the medical fee schedule and the paid data would not be impacted by reserve changes. NCCI has adequately supported its selection of loss development factors.

3. The NCCI selected indemnity trend factor of minus three percent and the selected medical trend factor of plus two percent have been justified. While the medical trend selection has continued to decrease from a high of plus 4.7 percent in the 2005 filing, the policy year medical loss ratios for 2000 through 2003 were fairly stable and the 2004, 2005 loss ratios began a decreasing trend. Medical loss ratios are continuing to grow, but the data indicates that the significant growth in medical loss ratios over the last 13 policy-years is moderating. When considering the loss ratio trends on an accident-year basis, which includes accident-year 2006 with a loss ratio more in line with the loss ratios of 2000 through 2003 than those of 2004 and 2005, the five-point exponential accident-year trend is slightly negative at minus 0.9 percent.

4. The premium on-level methodology includes a projected assigned risk market share percentage. NCCI has used statewide data in the Alaska loss cost filings for many years. Only in the last couple of years has the assigned risk market share assumption been zero percent. The division is accepting the zero percent assumption for this filing; however, we will continue to monitor this assumption in future filings.

5. NCCI has proposed a change to the maximum minimum premium and no change to the minimum minimum assigned risk premium. The minimum minimum premium amount of $150 has been in place since 1998 and was not increased in 2006 when the maximum minimum premium was increased. To better reflect the increasing cost of workers' compensation coverage over this time period, the assigned risk minimum minimum premium should be increased from $150 to $200.

6. The adjustment to increase the overall loss costs by 1.1 percent to recognize the effects of CSHB 228 is justified.

ORDER

For the reasons set forth above and in accordance with AS 21.39.043, the director orders the assigned risk minimum minimum premium to be increased from $150 to $200 and the maximum minimum premium to remain at $750.

With these changes, the voluntary loss costs will decrease overall by 10.9 percent and the assigned risk rates will decrease by 13.7 percent.

This order is effective November 5, 2007.

Linda S. Hall
Director