STATE OF ALASKA
DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT
Division of Insurance

Sean Parnell, Governor
Emil Notti, Commissioner
Linda S. Hall, Director

ORDER NUMBER R 09-04 **November 6, 2009**

APPROVAL OF THE 2010 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 25, 2009, the Division of Insurance (division) received the 2010 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 10.3 percent decrease in voluntary loss costs and an overall 9.9 percent decrease in assigned risk rates from the current approved levels.

On July 21, 2009, the director issued Notice of Public Hearing H 09-01 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on September 15, 2009. 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.

No written comments were received either before or after the hearing. The division asked for and received additional supporting information from NCCI.

DISCUSSION OF FILING METHODOLOGY

1. Consistent with the 2009 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 18.9 percent to 19.3 percent. NCCI bases the selection of LAE on experience obtained through a special data call. Consistent with the change in the 2009 filing, NCCI included only private carrier data, and excluded state fund data.

3. NCCI proposes to continue using paid-plus-case data to calculate the loss development factors. NCCI selected a five-year average for all the link ratios. This differs from the 2009 filing in which NCCI selected a four-year average because the fifth year ratios for the first few reports were different than the link ratios for the four more recent years. The unusual data is no longer in the experience period and all years could be used.

4. For the tail loss development factors, NCCI used a six-year average, which was also used in the 2009 filing, rather than a five-year average as had been used in filings before 2009. The addition of one more year is to smooth the impact of one unusually large indemnity tail factor and two unusually large medical tail factors.

5. NCCI selected a minus 4.0 percent indemnity loss ratio trend and a plus 0.5 percent medical loss ratio trend. This is a change in assumption from the 2009 filing, which used a minus 3.5 percent indemnity loss ratio trend and a plus 1.0 percent medical loss ratio trend. Frequency began to flatten after several years of fairly steady declines and medical loss ratios have fluctuated over the last four years, 2004 – 2007, after increasing significantly from about 1997 to 2001, followed by a couple of years of decreases. NCCI states that the change in medical trend from plus 1.0 percent to plus 0.5 percent "reflects the recent flattening of the frequency decline, and the moderation of medical severity, as well as economic pressures."

6. Under AS 23.30.097, the fee schedule for medical treatment or service based upon the December 1, 2004 fee schedule and adjusted for changes from 2004 to 2006 in the medical care component of the Consumer Price Index for all urban consumers compiled by the United States Department of Labor, Bureau of Labor Statistics, will no longer be applicable after March 31, 2009. At the time of the 2009 filing there was no replacement fee schedule. Therefore, NCCI included an increase in benefit costs of 4.9 percent into the 2009 filing. Effective March 31, 2009, a fee schedule was reinstated and NCCI filed a law-only filing to recognize the updated fee schedule. The law-only filing took effect on May 1, 2009. Therefore, the 2010 filing does not need to be adjusted for the updated physician fee schedule.

7. The assigned risk portion of the filing includes

   - an excess of loss reinsurance expense;
   - an uncollectible premium provision; and
   - the assigned risk plan administration expenses.

   The 1.2 percent increase in assigned risk expenses is due, in part, to the decreasing premium in the assigned risk market as well as an increase in the excess of loss reinsurance provision.

8. In the 2010 filing, NCCI introduced a new class ratemaking methodology changing the way that losses are developed, how losses are limited, and how the losses above the limit are spread to other classes. The new methodology changes the way losses are grouped for purposes for loss development. For 2009 and prior years, class losses were grouped by injury type and categorized as either serious, non-serious, or medical. Beginning with the 2010 filing, class losses will be grouped into two categories, "likely-to-develop" and "not-likely to develop." Not-likely-to-develop claims consist of medical only claims and claims that are fatal at first report. Likely-to-develop claims consist of claims that are fatal at second and subsequent reports but not at first report and permanent total claims. Permanent partial and temporary total claims are classified as likely-to-develop or not-likely-to-develop based on whether the claim is open at the first report and the body part that is injured.

9. The new class ratemaking methodology limits all claims to $500,000. For 2009 and prior years, the limitation varied by state. For the 2009 filing, the Alaska losses were capped at $876,000. NCCI is making this change because their research has shown that the higher loss limitations can result in large fluctuations in class loss costs from year to year.

10. The excess losses that remain after the large loss cap is applied are then spread back to the remaining losses. The new class ratemaking methodology uses excess ratios from the retrospective rating plan factors for each hazard group. For 2009 and before, the excess losses were distributed back by industry group rather than hazard group. The new method allows the excess losses to be based on expected losses rather than actual loss experience and should result in more stable loss costs for each class.

11. Because of the changes to the class ratemaking methodology, the full credibility standards were revised so that the new credibility standards maintained approximately the same credibility that would have been assigned under the previous methodology. The results were tested for six states.

12. The coal mine occupational disease model was updated in the 2010 filing. States are grouped into Western and Eastern regions to reflect differences in mining operations and claim frequency that exists on either side of the Mississippi River. Other changes to the coal mine model were 1) updated Federal claim frequency and approval rate assumptions and 2) updated average Alaska mining salaries.

13. On January 1, 2007, revisions to the aviation industry classifications became effective. One of the changes moved all helicopter flying crew operations to Code 7425. When the filing was approved, the division requested that NCCI monitor the transition rates to ensure that they would not be excessive or unfairly discriminatory since the experience of Code 7425 and Code 7422, where most of the risks were expected to come from, were fairly different. NCCI proposes no change to the loss costs for Code 7425 for 2010 since the early indications suggest that a substantial decrease may result when the actual experience for the class is used for the first time for the 2011 loss costs.

14. In the past, NCCI applied the same swing limits to the F-classes as to the industrial classes. NCCI proposes to change the swing limits from +/-25 percent to +/-15 percent for the F-classes due to relatively low exposure and the potential for large swings in loss costs for these classes.

INTERESTED PARTY'S REQUESTED MODIFICATIONS AND COMMENTS

There were no requests for modifications to the filing. However, some of the comments made at the hearing expressed concern over the selected trend factors, the large loss procedure and the use of 2005 data, which appears to be a better than average year.

Trend comments: Medical frequency is going down but severity is still going up. It does not seem to make sense to select smaller trend amounts when severity is increasing.

Large loss procedure: All of the indications using uncapped losses are less than the indications using capped losses, suggesting that the losses being removed are less than the losses that are spread back. The detrending procedure was questioned as to whether a wage index is the appropriate choice for detrending and whether the large loss threshold should change with premium, which is a moving amount, particularly with the large decreases in loss costs that have occurred in the last couple of years.

2005: Policy year 2005 appears to be an anomaly and is, therefore, providing excessive downward pressure on the loss costs and may contribute to an overstatement of the indications. Since policy year 2008 does not appear to be as good as 2005, the loss cost change for 2011 may be a larger increase than otherwise expected, if equal weight is given to an unusual year in the experience period for the 2010 loss costs.

NCCI REBUTTAL

The purpose of the large loss procedure is to stabilize loss cost indications. When the large loss procedure was introduced in 2005, NCCI reviewed alternatives, wage indexes and medical Consumer Price Indexes, for detrending the large loss threshold. The differences between using a wage index and medical index were minimal, so the wage index was chosen since it is already used in other parts of the filing and, since it reflects indemnity inflation, it is expected to be a reasonable proxy for medical inflation.

NCCI's definition of premium excludes insurer pricing tools and expenses so that it is essentially payroll multiplied by loss costs. When the large loss procedure was introduced, the large loss threshold was selected so that a claim that hit the threshold would impact the overall aggregate indication by one percent or more. Therefore, the threshold is calculated as one percent of the experience period ultimate on-leveled loss costs.

NCCI uses an experience period of three policy years to balance stability and responsiveness. Averaging the three years using unequal weights would be inconsistent. In addition, the loss ratio for calendar-accident year 2008 is more comparable to the loss ratio of policy year 2005 than the other two years of the experience period.

FINDINGS

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

1. The increase in LAE has been adequately supported based upon steadily increasing LAE ratios as shown in Exhibit II of the filing.

2. The use of a five-year paid-plus-case average is acceptable.

3. The use of a six-year average rather than five to calculate the loss development tail factors is acceptable.

4. The NCCI selected indemnity trend factor of minus 4.0 percent and the selected medical trend factor of plus 0.5 percent are acceptable. While the medical trend selection has continued to decrease from a high of plus 4.7 percent in the 2005 filing, the strong decreasing trend in medical loss ratios beginning in 2000 appears to be flattening out with policy year medical loss ratios for 2004 through 2007 being fairly stable with a drop in 2005. In spite of the leveling off of the medical loss ratios, the medical severity continues to be a fairly steady upward trend. In the 2011 filing, NCCI should include additional supporting information demonstrating how the medical severity trend is considered in the selection of the medical loss ratio trend.

5. The new class ratemaking methodology is acceptable. The division recommends that, when NCCI makes future changes to its ratemaking methodology, NCCI be able to show the impact of the changes specifically for Alaska. While a representative sample of states may be sufficient for NCCI to determine that new methodology works as expected, NCCI should have also anticipated and recognized that individual states would want to know how the changes impact each individual state.

6. The Alternative Indications Exhibits provided in each filing since 2005 consistently show that the indications based on limited losses result in larger decreases and smaller increases than the comparable indications based on unlimited losses. In the 2011 filing, NCCI should address this pattern and provide some rationale as to the reason for it.

7. The revisions to the coal mine model are acceptable.

8. The freeze on the loss costs for Code 7425 is acceptable.

9. The revised swing limits for the F-classes are acceptable.

ORDER

For the reasons set forth above and in accordance with AS 21.39.043, the director approves the voluntary loss cost change of minus 10.3 percent and assigned risk rate change of minus 9.9 percent.

This order is effective November 6, 2009.

Linda S. Hall
Director