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ORDER NUMBER R 12-05 **November 20, 2012**

APPROVAL WITH MODIFICATION OF THE 2013 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 22, 2012, the Division of Insurance (division) received the *2013 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 3.6 percent decrease in voluntary loss costs and an overall 4.2 percent decrease in assigned risk rates from the current approved levels.

On July 12, 2012 the director issued Notice of Public Hearing H 12-01 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on September 13, 2012. 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 testimony or questions were provided to the division prior to the hearing. Testimony was received at the hearing on behalf of Alaska National Insurance Company (ANIC) and Alaska Public Entity Insurance (APEI). ANIC provided several exhibits to support its testimony at the hearing. No other additional written comments were received after the hearing.

The division asked for and received additional supporting information from NCCI. On September 24, 2012, the division asked for additional supporting information as allowed under AS 21.39.043(e). On October 5, 2012, the division asked for information related to specific payroll and loss fluctuations in the Individual Classification Experience exhibits. NCCI's responses to these questions, which were received by the division on October 22, 2012, contain information related to specific insureds and therefore this correspondence is not subject to public inspection under AS 21.39.043(g). NCCI responded to the division's September interrogatories on October 12, 2012. On October 27, 2012, the division asked for an extension as provided for in AS 21.39.043(3). On October 31, 2012, the division asked for additional supporting information as allowed under AS 21.39.043(e). NCCI responded to these interrogatories on November 14, 2012.

DISCUSSION OF FILING METHODOLOGY

1. Consistent with the 2012 filing, NCCI again based the overall indication on three policy years of experience (2008, 2009, and 2010).

2. As required by Order R 11-05, NCCI used unlimited loss experience and did not use the large loss procedure that was implemented in 2005.

3. NCCI proposes to use a combination of paid-plus-case and paid loss development factors to promote stability. For 2012, NCCI relied only on paid-plus-case experience.

4. For the tail loss development factors, NCCI proposes to use paid-plus-case experience. In past filings NCCI included bulk and incurred-but-not-reported (IBNR) reserves in the calculation of the tail factors. NCCI no longer collects bulk and IBNR data from insurers, so the tail loss development factors are calculated using paid-plus-case data as are the loss development factors from 1st to 19th report.

5. NCCI is proposing to decrease the loss adjustment expense (LAE) provision from 18.5 percent to 18.1 percent. This change is due to a decrease, from 11.0 percent to 10.8 percent, in the defense and cost containment portion of the LAE and a decrease in the adjusting and other provision from 7.5 percent to 7.3 percent. NCCI bases the selection of LAE on experience obtained through a special data call. Consistent with the change first made in the 2010 filing, NCCI included only private carrier data, and excluded state fund data.

6. NCCI selected a minus 6.0 percent indemnity loss ratio trend and a 0.0 percent medical loss ratio trend. This results in no change in medical loss ratio trend from the 2012 filing. The indemnity loss ratio trend decreased 0.5 percent; it was minus 5.5 for 2012. NCCI states that the annual frequency trend continues to decline, although it has shown volatility over the trend period. Policy year 2010 is flat compared to policy year 2009 but accident year 2011 shows a decrease over accident year 2010. Since the indemnity loss ratio trends continue to decline due to frequency and severity declines, NCCI proposes to reduce the indemnity loss ratio trend to recognize this. Medical severity continues to increase at about 4.5 percent annually (in 2012 the severity trend was estimated at 3.5 percent), which is offset by the decline in frequency. The selected medical trend factor is at the high end of the various trend fits.

7. 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 2008 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 was not applicable after December 31, 2010. On October 7, 2011, the governor signed House Bill 13 which established a fee schedule to be effective on or after December 31, 2010. Therefore, the experience period used in this filing does not contain any data related to the impact of the new fee schedule. For the 2012 filing, NCCI estimated the impact of the new fee schedule to be an increase of 2.0 percent on overall system costs. NCCI did not update the analysis used in 2012 for the 2013 filing.

8. As in the 2012 filing, NCCI selected a lower experience rating off-balance target to reflect that smaller, non-rated risks have worse experience than statewide.

9. NCCI proposes to increase the USL&HW factor from 1.30 to 1.31 to recognize the difference between state and federal loss-based expenses.

10. The assigned risk portion of the filing includes

    - an excess of loss reinsurance expense;
    - an uncollectible premium provision;

- the assigned risk plan administration expenses; and
- the servicing carrier allowance based on the 2012 – 2014 RFP.

NCCI proposes a small decrease of 0.5 percent in assigned risk expenses. This change is due to

a) the excess of loss reinsurance provision is a smaller percentage of the premium than in 2012; and
b) a small increase in administrative expenses.

11. NCCI proposes increasing the maximum minimum premium from $800 to $900. NCCI plans to gradually increase this over several years to NCCI's target for most states of $1,500.

INTERESTED PARTY'S REQUESTED MODIFICATIONS AND COMMENTS

ANIC provided testimony at the hearing and raised four general concerns with the filing:

- the adjusting and other expense provision volatility from year-to-year;
- indemnity loss development factors that are too low;
- selection of loss ratio trend assumes an aggressive underlying frequency trend;
- lack of recognition of the impact of the new medical fee schedule.

The following rationale for these concerns was provided.

ANIC commented that reasonableness should be added to the stability and responsiveness criteria for evaluating a change. ANIC commented on year-to-year volatility in the adjusting and other expense (AOE) provision and that the methodology for making the selections may be causing some of the fluctuation rather than actual changes in cost. For example, when comparing the developed adjusting and other expense provisions between the 2012 filing and the proposed 2013 filing, the 2013 filing shows that the older accident years are still changing. For example, accident year 2002 estimated AOE for the 2013 filing is 2.4 percent higher than for the 2012 filing on a paid basis and 2.7 percent higher on an incurred basis. ANIC questioned whether this type of change in the older years was reasonable. ANIC also noted that for accident year 2011, NCCI estimates a lower ultimate paid AOE than is estimated for accident year 2010. ANIC questioned whether this was a reasonable conclusion.

ANIC questioned the selection of the indemnity loss development factors. ANIC commented that the most recent paid-plus-case loss development factors differ from the older factors; the more recent years tend to be higher than the older years. Therefore, using a straight average results in loss development factors that are too low.

ANIC noted that, although the overall frequency trend is decreasing, there have been two years of increasing trend since 1996 and two periods in which the frequency trend was flat, including the most recent three years, policy years 2009 and 2010 and accident year 2011. ANIC questioned whether the implicit frequency trend decrease of 4.5 percent could be sustained, particularly in light of the most recent data. ANIC also provided information from NCCI's Annual Issues Symposium in which NCCI indicated that frequency is flat. If frequency is in fact flat, ANIC estimated the overall indication to be an increase of 16 percent.

ANIC also discussed whether NCCI had adequately considered the implications of the new medical fee schedule. They recognized that the experience period does not include any real data by which NCCI is able to evaluate the impact of the fee schedule, but ANIC suggested that

NCCI's conclusions from the 2012 analysis turned out to be wrong. ANIC commented that most providers are already billing in 2012 at or above the fee schedule, that many of the CPT code charges increased significantly, there are very few PPO arrangements in Alaska, and the medical community is small and the providers tend to know what other providers are charging. All of these issues will tend to have an upward pull on medical costs for the workers' compensation system.

Because the medical fee schedule that became effective on December 31, 2010 is based on a completely different methodology from the previous fee schedules, the new fee schedule is based on the 90th percentile of billed charges while the 2005 to 2010 fee schedules were tied to the consumer price index, use of data from 2005 to 2010 to project medical costs does not make sense.

APEI provided testimony at the hearing and raised the following concerns with the filing:

- the medical trend factor does not reflect the new medical fee schedule;
- alternate indications are not really realistic, and alternate indications that include alternate trend assumptions would be more useful than some of the alternatives currently provided.

APEI questioned whether NCCI had updated last year's analysis of the impact of the new medical fee schedule. APEI said they compared their historical medical costs to costs for those same services under the new medical fee schedule and found that medical costs could increase by about 47 percent if providers charged the maximum allowable under the new fee schedule. Under the prior medical fee schedule, methodology payments to providers were controlled based on the consumer price index. Under the new fee schedule, methodology payments are based on what providers are billing and this methodology tends to drive up medical costs over time. Therefore, the medical trend shown in the NCCI data is flatter than it would be under the new methodology.

APEI noted that the 2011 accident year medical cost per case, which is lower than policy year 2010, is an unexpected result and wondered if NCCI had done any analysis to evaluate what was causing costs to appear to go down.

APEI stated that the alternate assumptions shown in the filing are not really realistic. For example, a two-year average of loss development factors has not been used in Alaska and, therefore, is not a realistic comparison to include as an alternate assumption. APEI asked that the director include in the order a requirement for NCCI to include alternate trend assumptions as well as alternate loss development factor assumptions.

NCCI REBUTTAL

Medical Fee Schedule

NCCI indicated that they relied upon the analysis performed for the 2012 filing to support the 2013 filing. They did note that NCCI surveyed stakeholders to gather input on the impact of the new medical fee schedule but did not receive any associated statistical data. Observations about large increases in at least some medical service codes were identified. NCCI did review historical ratios of paid amounts compared to charged amounts in Alaska and found that medical paid amounts have been substantially less than both the provider charged amounts and the maximum allowable reimbursement. Based on this, NCCI stated that the new medical fee schedule "may not necessarily have as dramatic an impact on the medical paid amounts as it may have on provider charged amounts and the maximum allowable reimbursements."

NCCI noted that the experience data has been adjusted for the changes in medical feel schedule that were effective in 2003, 2004, 2007, and 2009, as well as NCCI's estimated impact for the December 31, 2010 fee schedule from the 2012 filing, via benefit on-level factors. Therefore, NCCI stated that the indicated medical loss ratio trends reflect cost changes unrelated to medical fee schedule changes. NCCI recognized that, because the new fee schedule differs from the prior fee schedules, there may be an increased risk that costs will be higher or increase faster than trend indications.

Although the maximum allowable reimbursements under the new medical fee schedule have increased substantially, the impact of these changes on provider charged amounts and, most importantly, the associated paid amount is as yet unknown. Sufficient credible data by which to evaluate this impact is unavailable at this time. However, NCCI did select a medical loss ratio trend at the high end of the range of trend indications to reflect the unknown risk.

In response to APEI's question related to accident year 2011, NCCI stated that, although accident year 2011 average medical cost per case is lower than policy year 2010, it is still higher than policy year 2009. Policy year 2010 appears to be a historical high. The combination of generally declining frequency and generally increasing medical severity has produced variable loss ratio results. NCCI's estimate of the average annual trend in medical cost per case is 4.5 percent, which means NCCI expects average medical costs to increase over the trend period.

NCCI did not really address the impact that the difference in methodology between a fee schedule based on the consumer price index and a fee schedule based on actual charges (at the 90th percentile) could have on costs. NCCI's analysis for the new fee schedule was included in the 2012 filing and benefits in the 2013 filing were adjusted via on-level factors. NCCI stated they did discuss the impact of the new medical fee schedule by noting that the "estimated medical loss ratio trend is closer to the long term average and reflects the potential risk of medical cost inflation in Alaska (especially in light of the recently enacted medical fee schedule)." Data on which additional analysis can be done is not available at this time.

Loss Development Factors

NCCI addressed their selection of loss development factors (LDF) by noting that paid-plus-case loss development factors in Alaska have historically been volatile. High loss development factors have dropped in subsequent evaluations. Therefore, NCCI selected a five-year average to help smooth out these annual fluctuations.

NCCI also noted that the paid loss development factors were very similar to the paid-plus-case loss development. To reflect responsiveness, NCCI included a two-year average of paid loss development factors. Therefore, the averaging of paid and paid-plus-case loss development factors balances stability and responsiveness.

FINDINGS

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

1. The use of paid and paid-plus-case loss development is acceptable. Paid-plus-case loss development factors can be volatile over time due to differing reserve philosophies and as insurers adjust the adequacy of their case reserves.

2. Item D in Order R 11-05 specifically asked NCCI to include a five-year xhilo loss development factor average using both paid and paid-plus-case data. This alternate assumption was not included in the filing.

3. The change in methodology for calculating the tail loss development factors is acceptable. The use of paid-plus-case data matches the data used for the non-tail loss development factors as well as removing another layer of potential volatility since IBNR reserves are not included. Excluding IBNR also allows policy-year data to be used rather than accident-year data, allowing the tail experience to be consistent with non-tail data.

4. The proposed LAE of 18.1 percent has been adequately supported. The use of a two-year average for calculating the adjusting and other expense portion of the LAE is acceptable. NCCI should address the issues that have been raised during the last two hearings related to the volatility of the results due to the methodology used by NCCI to calculate the LAE provision.

5. The NCCI selected indemnity trend factor of minus 6.0 percent and the selected medical trend factor of 0.0 percent are acceptable. The decreasing trend in medical loss ratios beginning in 2006 is reversed for policy year 2010 but the 2011 accident year indication is a slight decrease from policy year 2009. The medical severity continues to be a fairly steady upward trend with early indications for accident year 2011 showing a decline. The indemnity loss ratio trend shows a steady pattern of decreases since 2006.

6. Much of the testimony at the hearing focused on whether NCCI had adequately considered the impact of the new fee schedule in the 2013 filing. Over the past year, as the impact of the new medical fee schedule began to be seen, concern has been expressed to the division and to NCCI over the large increases in the allowable costs for some of the service categories. Although comments provided at the hearing suggested that costs may increase over 40 percent if providers bill at the maximum allowable amounts, experience is not yet available to evaluate actual provider billing practices under the new fee schedule. All parties recognized that the lack of experience made projecting costs difficult.

   NCCI selected a medical loss ratio trend at the high end of the range to reflect the uncertainty surrounding the impact of the new medical fee schedule. NCCI also stated that historically the amounts paid for medical services have been less than the provider charged amounts and the maximum allowable reimbursements, and this was true under both the consumer price index fee schedule (2005 – 2009) and the usual and customary fee schedule (2000 – 2004). Whether this will continue to be the case going forward is unknown. The division does not have any experience data under the new fee schedule to estimate its impact on medical costs. As experience under the new fee schedule emerges in the data collected by NCCI and will be incorporated in the 2014 loss cost filing, the division recognizes that this may result in rate increases as experience matures.

7. The revision to the calculation of the experience rating off-balance factors is acceptable.

8. The proposed USL&HW percentage of 31 percent to be applied to non-F classifications is acceptable.

9. The inclusion of a provision for the excess of loss reinsurance, the calculation of the assigned risk administrative expenses, the servicing carrier allowance, and the uncollectible premium for the assigned risk rates is acceptable.

10. NCCI states that the purpose of the minimum premium program is to motivate policies subject to the minimum premium program to obtain coverage in the voluntary market. These smaller policies are not subject to experience rating and thus the parameters of the minimum premium program must be adjusted over time. Based on data provided by NCCI at the 2012 Alaska State Advisory Forum, 72 percent of the policies in the residual market have premium less than $2,500. This percentage is consistent with prior years. In response to the division's interrogatory, NCCI estimated that about 480 policyholders will see an increase in minimum premium from $800 to $900. Based on NCCI's Residual Market Quarterly Results as of Second Quarter 2012, the Alaska residual market operates at about break-even. Increasing the maximum minimum premium for a small number of policyholders is not likely to make these small risks better able to find voluntary coverage nor is it likely to significantly affect the overall residual market operating gain or loss.

ORDER

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

A. The 3.6 percent overall decrease in voluntary loss costs is approved.

B. The 4.2 percent overall decrease in assigned risk rates is approved.

C. In the 2014 filing NCCI will again use unlimited losses.

D. The alternative indications NCCI provides in the 2014 filing should include unlimited losses with a three-year average, a five-year average, and a five-year xhilo average using both paid and paid-plus-case loss development. NCCI may include any other alternative indications that it feels are needed to support the filing.

E. The alternative indications in the 2014 filing should also include alternate trend assumptions. One of these alternatives should be the trend assumptions approved in the 2013 filing. NCCI may select one additional set of reasonable alternative trend assumptions in addition to the trend NCCI selects to file for 2014.

F. In the 2014 filing, NCCI should address the concerns that have been expressed at the last two hearings related to the selection of the adjusting and other expense provision.

G. The maximum minimum premium of $900 is disapproved. The maximum minimum premium will remain at $800.

This order is effective November 20, 2012.

Bret S. Kolb

Bret S. Kolb
Director