ORDER NUMBER R 08-10 **November 6, 2008**

APPROVAL WITH MODIFICATIONS OF THE 2009 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 25, 2008, the Division of Insurance (division) received the 2009 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 4.8 percent decrease in voluntary loss costs and assigned risk rates from the current approved levels.

On July 28, 2008, the director issued Notice of Public Hearing H 08-02 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on September 15, 2008. 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 written testimony prior to the hearing on September 8, 2008. The division also asked for and received additional supporting information from NCCI. Testimony was received at the hearing. No additional written comments were received after the hearing.

DISCUSSION OF FILING METHODOLOGY

1. Consistent with the 2008 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 18.6 percent to 18.9 percent. NCCI bases the selection of LAE on experience obtained through a special data call. Consistent with the change in the 2008 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 four-year average for all the link ratios to the 19^{th} report because the fifth year ratios for the first few reports are different than the link ratios for the four more recent years.

4. For the tail loss development factors, NCCI used a six-year average rather than a five-year average as has been used in previous filings. 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 3.5 percent indemnity loss ratio trend and a plus one percent medical loss ratio trend. Frequency continues to decline and medical loss ratios have moderated recently after increasing significantly for several years.

6. Under AS 23.30.097, the current 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 present time there is no replacement fee schedule. Therefore, NCCI has estimated that the expiration of the current fee schedule will result in an increase to the workers' compensation system costs of 5.2 percent. Since the fee schedule will be in place for part of the year in which the proposed 2009 loss costs will be used, NCCI has prorated the increase to the overall system costs and included an increase in benefit costs of 4.9 percent into the filing.

7. Alaska Statute 23.30.121, which creates a presumption of workers' compensation coverage for fire fighters for certain occupational diseases, became effective on August 19, 2008. NCCI analyzed the impact of this presumption of coverage that shifts the burden of proof from the employee to the employer for respiratory disease, heart problems, and certain types of cancer. Using available research on the relationships between cancer rates and fire fighters, NCCI estimates that benefit costs for the fire fighter class code will increase 20 percent. Due to lack of available data, NCCI did not incorporate a specific loading for respiratory disease or heart problems.

8. Alaska Statute 23.30.190(d) requires that the latest version of the American Medical Association Guides must be used to determine permanent impairment rating. The sixth edition was adopted on March 31, 2008. The sixth edition contains a philosophical change in the way impairment ratings are determined, but NCCI did not include an explicit provision in the loss costs for this change due to the uncertainty over how the new rating methodologies will be interpreted and administered.

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

10. In this filing, NCCI continued to select a zero percent assigned risk market share consistent with the 2007 and 2008 filings 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.

11. The servicing carrier contracts are up for renewal in 2009 and the bid process was used to select servicing carriers for the next three years. At the time the filing was submitted to the division, the selection process had not been completed, so the 2008 servicing carrier allowance was included in the assigned risk rates, with the understanding that it would be revised, if necessary, when the selection process is completed.

12. Other items in the assigned risk portion of the filing that are consistent with the 2008 filing include

    - inclusion of an excess of loss reinsurance expense; and
    - an uncollectible premium provision.

13. The major contributors to the overall indicated loss cost level decrease are a continuing decline in frequency of accidents, continuing good experience seen in policy year 2005, and replacing policy year 2003 with a large loss ratio by policy year 2006 that is similar in experience to policy year 2004. In addition, while medical costs continue to increase, the rate of increase has slowed, which NCCI has recognized by selecting a one percent medical loss ratio trend compared to the two percent medical loss ratio trend in the 2008 filing.

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 and the medical fee schedule provision.

Trend comments: The increases shown in last year's filing based on accident year 2006 data materialized in the 2006 policy year data. Policy year 2005 was strongly impacted by the temporary medical fee schedule cap that took effect in December 2004, causing a short term but significant downward impact on paid medical expenses for policy years 2004 – 2006. Since no adjustment for this effect was included in the filing, the medical loss ratio trends are understated.

Medical fee schedule comments: The trend and loss development factors do not include a provision to adjust for the anticipated effect on medical costs of the medical fee schedule sunset. The medical fee schedule affects claims based on the date of medical treatment, not the date of loss, and will affect open claims from prior years. The sunset of the medical fee schedule is essentially a benefit change that should be expected to result in increasing medical loss ratios and average cost per claim, as well as loss development factors. These changes were not incorporated into the filing.

Frequency comments: The continued decrease in frequency is good news for Alaska. Safety, training, and experience have helped this trend continue.

Additional supporting information: Due to the short time period between when the filing is received by the division and the hearing date (20 to 25 days), interested parties have requested that additional supporting documentation that is routinely requested by the division be included as part of the original filing, so that any interested party who would like to provide testimony at the hearing has adequate time to review the additional supporting documentation.

NCCI REBUTTAL

While medical loss ratios have been declining or stabilizing since 2001, the policy year 2006 medical loss ratio, the latest policy year, has increased over policy year 2005. However, the accident year 2007 medical loss ratio is lower than the policy year 2006 medical loss ratio. The exponential medical loss ratio trend indications range from minus 3.4 percent to minus 1.9 percent. The selected medical trend factor of one percent is higher than the indicated trend factors and was reduced by one percentage point from the 2008 filing to move the trend selection in the direction of the trend indications.[1] The consistent decline in claim frequency has been a driving force on the loss ratio trend indications. One of the reasons that NCCI selected a medical loss ratio trend that is higher than the indicated trends is to reflect benefit changes related to the medical fee schedule sunset.

NCCI recognizes changes in benefit level between the experience period losses and the current benefit level using the "Medical Loss On-level Factor" adjustment. The impact of the medical fee schedule sunset was incorporated into the loss ratio calculations using the "Factor to Reflect Proposed Changes in Medical Benefits" to bring the current benefit level to the level expected to be in effect upon sunset of the medical fee schedule. Since the medical loss ratio trend is higher than the indications and the historical benefit levels have been adjusted to the proposed benefit level to be in effect after March 31, 2009, the rate filing adequately recognizes the medical fee schedule sunset.

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 four-year paid-plus-case averages has been justified. In general, the oldest year of experience produced link ratios that were higher than the four most recent years. Both the indemnity and medical paid-plus-case link ratios show a decreasing trend with the medical link ratios more volatile than the indemnity link ratios. Testimony at the hearing suggested that the experience period may not be representative of future development due to the medical fee schedule freeze that was in place during part of this time. 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. In addition, the downward trend began before the medical fee schedule freeze took effect, so that alone does not account for change in loss development patterns. NCCI has adequately supported its selection of loss development factors.

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 3.5 percent and the selected medical trend factor of plus one 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 2002 through 2006 were fairly stable with a significant drop in 2005. The strong decreasing trend in medical loss ratios beginning in 2000 appears to be flattening out. The overall direction of the medical loss ratios over the last 19 years continues to be an increase, but at a slower rate than before 2002.

5. The recognition of the benefit level change resulting from the lack of a medical fee schedule after March 31, 2009, by incorporating a specific provision in the loss costs, is appropriate to comply with the requirement that rates not be inadequate.

[1] In the 2008 filing, the selected two percent medical trend was also higher than the exponential medical loss ratio trend indications, which ranged from minus 4.8 percent to minus 0.7 percent.

6. Adjusting the firefighter class code for the increase in benefits resulting from the statutory change related to presumption of coverage for certain occupation diseases is appropriate to comply with the requirement that rates not be inadequate or unfairly discriminatory.

7. The change contained in the sixth edition of the American Medical Association Guides does not lend itself to an objective calculation of the impact on system costs. Allowing any changes to be reflected as those changes manifest themselves in future experience is acceptable.

8. The increase in maximum minimum premium to $800 for assigned risk policies is acceptable.

9. 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.

10. After the 2009 through 2011 servicing carriers were selected and the new servicing carrier allowance was known, the division asked NCCI to provide an amended overall assigned risk rate indication. The revised indication is a decrease of minus 5.2 percent resulting from the decrease in servicing carrier allowance from 30.56 percent to 30.29 percent.

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 4.8 percent and assigned risk rate change of minus 5.2 percent.

The director also orders that, in the future, the additional supporting documentation be included as part of the original filing rather than being submitted after a request from the division so that all interested parties have time to thoroughly review the supporting documentation. This supporting documentation should consist of

1. alternative loss development factor calculations, including the actual dollar triangles from which the loss development factors are calculated by all of the following: accident year and policy year, limited and unlimited, paid and paid-plus-case factors;
2. support and calculations for the trend alternatives and the selected trends by policy year and accident year;
3. exhibits showing the overall indications using various alternate loss development assumptions; and
4. support for the accident year developed DCCE and AOE ratios used in selecting the LAE provision.

This order is effective November 6, 2008.

Linda S. Hall

Linda S. Hall
Director