THE STATE
of ALASKA
GOVERNOR SEAN PARNELL

Department of Commerce, Community,
and Economic Development

DIVISION OF INSURANCE
Anchorage Office

550 W. 7th Avenue, Suite 1560
Anchorage, Alaska 99501-3567
Main: 907.269.7900
Fax: 907.269.7910
TDD: 907.465.5437

ORDER NUMBER R 13-04 **November 13, 2013**

APPROVAL WITH MODIFICATION OF THE 2014 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND:

On August 21, 2013, the Division of Insurance (division) received the 2014 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 3.9 percent decrease in voluntary loss costs and an overall 4.4 percent decrease in assigned risk rates from the current approved levels.

On July 15, 2013 the director issued Notice of Public Hearing H 13-03 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on September 10, 2013. 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 and Alaska Public Entity Insurance. Both parties provided several exhibits to support their testimony at the hearing. One additional written comment was received after the hearing from the Alaska Independent Insurance Agents and Brokers, Inc.

The division asked for and received additional supporting information from NCCI.

- On September 6, 2013, the division asked for additional supporting information as allowed under AS 21.39.043(e). NCCI responded to this objection letter on September 20, 2013.
- On September 10, 2013, 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 September 24, 2013, contain information related to specific insureds and therefore this correspondence is not subject to public inspection under Alaska Statute 21.39.043(g).
- On October 4, 2013, the division asked for additional information related to items that were discussed at the public hearing. NCCI responded to this objection letter on October 18, 2013.

DISCUSSION OF FILING METHODOLOGY

1. Consistent with the 2013 filing, NCCI again based the overall indication on three policy years of experience (2009, 2010 and 2011).

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. For the second year in a row, NCCI proposes to use a combination of paid-plus-case and paid loss development factors to promote stability. For the 2005 to 2012 filings, NCCI has relied on paid-plus-case experience.

4. As introduced in the 2013 filing, for the tail loss development factors, NCCI proposes to use paid-plus-case experience. In past filings (2012 and prior) 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 18.1 percent to 17.5 percent. This change is due to a decrease, from 10.8 percent to 10.3 percent, in the defense and cost containment portion of the LAE and a decrease in the adjusting and other provision from 7.3 percent to 7.2 percent. NCCI bases the selection of LAE on experience obtained through a special data call. Consistent with the change first made in the 2008 filing, NCCI included only private carrier data, and excluded state fund data.

6. In Order R 12-05 the director asked NCCI to address the issues that have been raised during the 2012 and 2013 hearings regarding volatility of the results due to the methodology used by NCCI to calculate the loss adjustment expense provision. NCCI responded to this item by saying that estimates can change from one evaluation to another and that ultimate adjusting and other expense (AOE) and loss dollars increased due to greater than expected development and carrier mix included in the data. In many states, claims have been staying open longer, increasing both benefit payments and AOE.

7. NCCI selected a minus 5.0 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 2013 filing. The indemnity loss ratio trend increased 1.0 percent; it was minus 6.0 for 2013.

8. NCCI states that the annual frequency trend continues to decline, although the decrease is slower in the last few years. For the three years included in the filing, the claim frequency is relatively flat. Policy year 2010 frequency is the same as policy year 2009 and policy year 2011 frequency is just slightly lower than policy year 2010. Accident year 2012 is just 0.1 points less than policy year 2011. In spite of the flat frequency trend over the most current three years, NCCI's selected loss ratio trends assume an implicit frequency trend of minus 4.0 percent annually.

9. Since the indemnity loss ratio trends continue to decline due to frequency and severity declines, although at a much slower rate since 2008, NCCI proposes to increase the indemnity loss ratio trend , from minus 6.0 percent to minus 5.0 percent, to recognize this. Medical severity continues to increase at about 4.0 percent annually, (in 2013 the severity trend was estimated at 4.5 percent) which is offset by the decline in frequency.

The selected medical trend factor is at the high end of the indicated trends based on differing trend periods.

10. Under Alaska Statute 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 contains just one calendar year of 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 2014 filing. Detailed data from a medical data call became available only after the 2014 filing was submitted to the division for review.

11. As in the 2013 filing, NCCI selected a lower experience rating off-balance target to reflect that smaller, non-rated risks have worse experience than statewide.

12. 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 servicing carrier bid process.

    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 2013;
    b) a small increase in administrative expenses; and
    c) a small decrease in average commission percentage due to larger premium policyholders obtaining coverage through the assigned risk plan than in the past.

INTERESTED PARTY'S REQUESTED MODIFICATIONS AND COMMENTS

Alaska National Insurance Company (ANIC) provided testimony at the hearing and requested the following modifications to the filing:

- The overall indication should be 0.0%;
- The implicit frequency assumption should not be lower than minus 3 percent; and
- The adjusting and other expense methodology should be revised to use a method that drops off a year and adds a year.

ANIC questioned the whether using five-year average paid-plus-case loss development factors was appropriate this year since the factors for the oldest year tend to be the lowest.

ANIC noted that although the overall frequency trend is decreasing the three most recent years are relatively flat. ANIC stated that the implicit frequency trend decrease of 4.0 percent is too aggressive based on what the most recent data shows. They stated that this year should be viewed differently than last year since the 2012 accident year frequency is very similar to the 2011 policy year frequency whereas in the 2013 filing the 2011 accident year frequency suggested a downward trend for 2011 policy year experience. Using the accident year numbers as an indicator of what might be expected for the next policy year frequency point would suggest that the recent flatter frequency trend would be expected to continue.

ANIC questioned whether NCCI had adequately considered the implications of the new medical fee schedule. They recognized that the experience period includes a limited amount of data by which NCCI is able to evaluate the impact of the fee schedule but ANIC indicated that while all providers may not bill at the maximum allowable amount they are seeing higher bills, especially from hospitals. Also, the new treatment codes are not limited by the maximum allowable reimbursement amounts. ANIC claim data shows costs for the most common twenty CPT codes in their data costs are sharply.

Alaska Public Entity Insurance (APEI) provided testimony at the hearing and raised their concerns with the selected medical trend factor. Now that APEI has actual data under the new medical fee schedule to review they are seeing about 17 percent to 19 percent increase in medical costs per year. This is based on their review of APEI medical only claims as well as payments actually made. APEI believes that even accounting for wage trends and frequency decreases these will not offset the double digit medical cost increases that they are seeing. Even though many factors, such as the limited amount of actual data available to analyze, the addition of new CPT codes, and reserving uncertainty, make projecting an accurate trend difficult, the impacts of the increases that are being seen need to be incorporated in the loss costs. Although APEI did not provide a specific amount, they asked the director to modify the filing similar to the request by ANIC.

On September 11, 2013, after the hearing, the Alaska Independent Insurance Agents and Brokers, Inc. submitted written testimony in support of a flat 5 percent commission structure for the assigned risk rates rather than the current sliding scale. They requested that a flat 5 percent commission be approved in the 2014 filing. The rationale for this modification is that the sliding scale is cumbersome and inefficient as it creates extra work to reconcile interim and final premium payments. Since the average commission rate for the assigned risk plan is approximately 5 percent this would not have an impact on the overall assigned risk rates.

NCCI REBUTTAL

Medical Fee Schedule

NCCI continues to rely upon its analysis of the revised medical fee schedule performed for the enactment of HB 13 that was included in the 2012 filing to support the 2014 filing. NCCI states they reviewed historical paid and paid-plus-case link ratios, average paid per claim and average paid-plus-case reserves per claim, and paid and case loss-to-premium ratios to identify possible impacts of HB 13 on medical costs. This analysis did not reveal any evidence of extraordinary impacts related to HB 13.

Transaction-based data from NCCI's Medical Data Call became available after the 2014 filing was submitted to the Division. In response to an interrogatory from the Division, NCCI provided some additional insights into the effects of HB 13 for physician payments based on this data call. This analysis showed about an 8% increase in physician payments under the new fee schedule some of which is attributable to inflation. After adjusting for inflation NCCI estimates that the experience shown in their medical data call indicates that physician payments are 2 percent to 5 percent higher under the new fee schedule. This is in line with their 2012 analysis projecting costs associated with HB 13 of a 4.7 percent increase in physician costs. NCCI has not completed an analysis of other-than-physician medical costs at this time.

Loss Development Factors

NCCI addressed their selection of loss development factors by noting that paid-plus-case loss development factors in Alaska have fluctuated considerably. Using a shorter time frame than five years would likely result in loss cost indications that would be potentially over-reactive. Using a shorter term average would not necessarily be more predictive since shorter time averages might reflect short term changes in carrier case reserving practices. Therefore, NCCI selected a five-year average to balance stability and responsiveness.

NCCI also noted that the paid and paid-plus-case loss cost indications were very similar this year in that the various paid averaging techniques resulted in indications of about minus 5 percent and the paid-plus-case averaging techniques resulted in indications of about minus 3 percent or approximately a two percentage point range of loss cost indications between the paid and paid-plus case methodologies. Historically in Alaska this range has been higher.

NCCI notes that the latest medical link ratio represents the change from the cumulative medical losses that have emerged through December 31, 2011 to the cumulative medical losses that have emerged through December 31, 2012 for each policy year. The medical losses that emerged during this period represent medical services rendered after the enactment of HB 13. These paid link ratios for the first three time periods are in line with or slightly lower than the historical averages. For the medical paid-plus-case link ratios, the first time period ratio is slightly higher than the historical average but the next two link ratios are in line with the historical averages. Based on this analysis NCCI was not able to observe any extraordinary changes that may be clearly attributable to HB 13.

Trend

NCCI stated that they select and use loss ratio trends in the calculation of the loss cost change to better reflect the interaction between the frequency and severity components. A change in frequency, such as a greater or lesser incidence of smaller claims, can also affect severity. Also, combining separate severity and frequency trends to produce a loss ratio trend is mathematically true if the trend periods are the same for the severity and frequency selections.

Alaska's frequency has been volatile over time including periods of both flat and steeply declining frequency. Before selecting a trend based on a short term frequency trend, one would want some type of qualitative information that the conditions underlying a few years would continue into the future.

FINDINGS

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

1. The use of 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 particularly with the uncertainty surrounding the true impacts of the new medical fee schedule. . Using a longer time period over which to average these loss development factors helps control the volatility. The use of paid-plus-case data does take into consideration the adjuster's expected impact of the new medical fee schedule and may result in more accurate estimate of individual losses than paid data alone since there is limited experience under the new medical fee schedule.

2. The paid loss development factors are not as volatile as are the paid-plus-case loss development factors. Since the paid experience for the most recent period includes medical costs actually paid under the new medical fee schedule, it is reasonable to incorporate a paid loss development method in the calculation. But paid loss development can also understate the ultimate loss amount since it is generally the larger claims that take longer to settle. With only one calendar year of paid claims under the new medical fee schedule there is more uncertainty over how well the paid data is a true reflection of ultimate costs under the new medical fee schedule.

3. The use of a five-year average for the paid-plus-case loss development factor selection is acceptable. Due to the volatility of these factors, discarding a year simply because it happens to be the lowest one in the experience period could over time produce excessive rates. The five-year period used in this filing also contains one year that has unusually high loss development factors. So that the experience of a single year does not unduly affect the loss cost indication it is appropriate to either incorporate all five years or to exclude both the highest and lowest factors from the average.

4. The use of paid-plus-case data to calculate the tail factor 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. The difference in the data underlying the tail selection in the 2013 filing and this filing is just the inclusion of one additional year of experience. Both the indemnity and medical tail factors are volatile, but the medical tail factors show about a 1 percent annual decreasing trend and the indemnity factors are relatively flat. Increasing the number of years used to calculate the tail factor incorporates the most recently available data and is acceptable.

5. The proposed LAE of 17.5 percent is acceptable. However, NCCI's response to the 2013 Order did not adequately address the issues that have been raised related to the selection of LAE since only general possible explanations for changes in the LAE were provided. The Alaska defense and cost containment expense relativity has shown a decreasing trend over the past seven years. This relativity appears to be one of the drivers in the decreasing LAE provision included in the filing. NCCI should evaluate and address exactly what is happening in Alaska related to LAE amounts, whether it be loss development, carrier mix or some other factor.

6. The NCCI selected indemnity trend factor of minus 5.0 percent and the selected medical trend factor of 0.0 percent are acceptable. Based on the upward trend in medical severity, the changes in the medical fee schedule and the comments provided by those testifying at the hearing regarding the impact of HB 13 that they are seeing, the selected medical trend factor is counterintuitive. The division has carefully considered whether an adjustment to the medical trend factor is appropriate. As mentioned in Order R 12-05,

the lack of adequate data to evaluate the impact of the new medical fee schedule on the loss costs creates a dilemma for all parties.

Alaska Statute 21.39.040(c) states that information in support of a filing may include (1) the experience or judgment of the insurer or rating organization making the filing; (2) the insurer's interpretation of the statistical data it relies upon; (3) the experience of other insurers or rating organizations; (4) other relevant factors. The supporting information described in (3) is not relevant to this filing since no other state, rating organization or insurers' whose data is not already included in this filing, are subject to the costs under Alaska's medical fee schedule. The filing does include a discussion of the rating organization's judgment and statistical data it relied on to make the medical trend selection.

The remaining item to consider is whether there are other relevant factors to suggest that the selected medical loss ratio trend would result in loss costs that are inadequate and thereby violate AS 21.39.030(a)(1). Those relevant factors are a) that medical costs in 2014 will be different than the medical costs underlying most of the experience used to support this filing and b) that testimony provided at the hearing indicated that some increase in medical costs is being paid by insurers. While these items may create an upward tension on loss costs, the division has not received adequate data to help in selecting the appropriate amount by which to suggest changes to the medical loss ratio trend. Without adequate supporting information as required by AS 21.39.040, the division is not able to select a medical loss ratio trend that would produce loss costs that are more in compliance with AS 21.39.030(a)(1) than the NCCI selected 0.0 percent trend.

7. The selection of loss ratio trends rather than separately selecting frequency and severity trends, is acceptable. A minus 5 percent indemnity loss ratio trend and a zero percent medical loss ratio trend have been supported as required by AS 21.39.040.

8. In Order R 12-05, the director ordered NCCI to include alternative trend assumptions when providing alternate indications. The director required NCCI to include the trend selections in the 2013 filing and one additional reasonable alternative trend assumption of NCCI's choice. NCCI selected an indemnity loss ratio trend of minus 5 percent and a medical loss ratio trend of minus 0.5 percent. In light of the uncertainty surrounding the impact of the new medical fee schedule, the alternate medical loss ratio trend was not a reasonable assumption.

9. The division recognizes the extra work involved in reconciling assigned risk commission amounts under a sliding scale instead of a flat commission rate. However, a flat commission will significantly reduce commission amounts paid to producers who are willing to assist smaller policyholders. This change will affect producers who assist policyholders with a premium level of less than $10,000, or approximately 62% of the assigned risk market policies.

   It is also worth noting that while most states use a sliding scale commission, Alaska's scale differs from these other states by applying a higher commission percentage to larger premium policies, i.e. in Alaska NCCI's Graduated Interval Table applies a commission rate ranging between 8 percent and 5.3 percent on policies up to$10,000 in premium while on a countrywide basis this scale applies only on policies up to $5,700. This helps to address the fact that the Alaska assigned risk pool consists of a large proportion of small policies.

In a resolution dated October 14, 2010, the Alaska Independent Insurance Agents and Brokers, Inc.(AIIAB) supported the use of a flat commission rate. The resolution was not provided to the division in time for consideration as testimony and evidence in 2010 under the hearing for the 2011 filing. Because it has been three years since the resolution was made and there is no evidence that notice was provided to producers outside of the Board of Directors of the AIIAB of the proposed commission modification, it does not seem appropriate to implement this change at this time.

ORDER

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

A. The filing methodology should be based only on the five year average of paid-plus-case loss development factors. With this change the director approves a voluntary loss cost change of minus 2.6 percent and an assigned risk rate change of minus 3.1 percent.

B. To obtain the revised overall changes, each proposed 2014 class loss cost will increase by a uniform percentage.

C. The alternative indications NCCI provides in the 2015 filing should include unlimited losses with a 3 year average, a five year average and a 5year 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.

D. The alternative indications in the 2015 filing should also include alternate trend assumptions. These alternatives should include the trend assumptions approved in the 2014 filing, NCCI may select at least one additional set of reasonable alternative trend assumptions in addition to the trend NCCI selects to file for 2014. These reasonable alternatives should include trends both higher and lower than the selected trends.

E. NCCI should evaluate and address exactly what is happening in Alaska related to LAE amounts, whether it be loss development, carrier mix or some other factor.

This order is effective November 13, 2013.

Bret S. Kolb

Bret S. Kolb
Director