THE STATE of ALASKA
GOVERNOR SEAN PARNELL

Department of Commerce, Community, and Economic Development

DIVISION OF INSURANCE

P.O. Box 110805
Juneau, Alaska 99811-0805
Main: 907.465.2515
Fax: 907.465.3422

ORDER NUMBER R 14-05 **November 6, 2014**

APPROVAL WITH MODIFICATION OF THE 2015 WORKERS' COMPENSATION LOSS COST FILING AND ASSIGNED RISK RATE FILING

BACKGROUND

On August 19, 2014, the Division of Insurance (division) received the 2015 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 0.8 percent decrease in voluntary loss costs and an overall 2.6 percent decrease in assigned risk rates from the current approved levels.

On June 27, 2014 the director issued Notice of Public Hearing H 14-03 notifying interested parties that, in accordance with AS 21.39.043, a hearing would be held on September 11, 2014. 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 written questions to the division prior to the hearing. Testimony was received at the hearing on behalf of Alaska National Insurance Company. Written comments were received after the hearing from Alaska National Insurance Company and a producer.

On September 17, 2014 the director issued a Supplemental Notice For Public Hearing H 14-03 to provide an opportunity for producers affected by the request to modify the filing by revising the assigned risk commission structure from a variable percentage based on premium size to a flat 5 percent to comment. The division received comments from 7 producers.

The division asked for and received additional supporting information from NCCI. as allowed under AS 21.39.043(e).

DISCUSSION OF FILING METHODOLOGY

1. Consistent with the 2014 filing, NCCI again based the overall indication on three policy years of experience (2010, 2011 and 2012).

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 paid-plus-case loss development factors as approved for the 2014 filing in Order R 13-04. The experience bases for the last ten years have been paid-plus-case experience for 2005 to 2012, a combination of paid-plus-case and paid loss development factors for 2013 and paid-plus-case only in 2014.

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 17.5 percent to 17.3 percent. This change is due to a decrease, from 10.3 percent to 10.0 percent, in the defense and cost containment portion of the LAE and an increase in the adjusting and other provision from 7.2 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 2008 filing, NCCI included only private carrier data, and excluded state fund data.

6. 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 loss ratio trends from the 2014 filing.

7. NCCI states that the annual frequency trend continues to decline, but shows volatility over the trend period. For the three years included in the filing, the claim frequency shows a slight downward trend, with policy year 2012 frequency 3.9 percent lower than that of policy year 2011. The implied annual frequency trend is minus 4.0 percent, no change from 2014.

8. Medical severity continues to increase at about 4.0 percent annually, (in 2013 the severity trend was estimated at 4.5 percent and 4.0 percent in 2014) which is offset by the decline in frequency. The selected medical trend factor is at the middle of the indicated trends based on differing trend periods. The selected indemnity severity of minus 1.0 percent is slightly higher than the high end (minus 1.2 percent) of the indicated trends.

9. 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 (HB 13) which established a fee schedule to be effective on or after December 31, 2010. Therefore, the experience period used in this filing contains only two full years of data, 2011 and 2012, related to the impact of the new fee schedule.

10. NCCI revised the procedure for determining the coal mine occupational disease load related to coal miner's black lung disease. Estimates of the number of expected claims and the average cost of a claim are needed in this procedure.

11. Since historical data to estimate the expected number of coal mine occupational disease claims is sparse, NCCI pools the data to create a more credible level of exposure. In previous filings NCCI included entitled claims and filed claims. In this filing, NCCI uses only claims that have currently resulted in an entitlement. Also, the frequency is now based on countrywide data whereas in previous filings countrywide data was divided into two groups, east and west of the Mississippi.

12. The average cost of a coal mine occupational disease claim is based on pooling data for most NCCI jurisdictions rather than on the data for an individual state since state data is sparse.

13. NCCI will no longer include a wage trend adjustment in the derivation of industry group differentials used in class ratemaking. Research conducted by NCCI showed that wage adjustments are close to unity and therefore have limited impact on the selected differentials.

14. Data for class ratemaking loss development is divided into two categories, likely-to-develop and not-likely-to-develop. NCCI evaluated historical data to determine if the current assignment is optimal and determined that one body part code should be moved to the likely-to-develop group. All claims associated with this body part code have been reassigned.

15. The retrospective rating tax multiplier calculation is revised to include a variable factor by state that represents expense and profit, excluding taxes and assessments, rather than a constant factor of 0.2.

16. 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 decrease of 1.3 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 2014;

    b) a small decrease 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.

17. NCCI proposes increasing the maximum minimum premium from $800 to $850 for the assigned risk rating plan.

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 loss development methodology should be based on the blended methodology NCCI proposed in the 2014 filing, paid and paid-plus-case, rather than the methodology actually approved for 2014, paid-plus-case only.

ANIC provided comments in three areas, the loss development methodology, the frequency selection and wage trend. ANIC noted that because paid data is less volatile than paid-plus-case data they would like to see more reliance on just paid data, especially now that there are two full years of experience under the current medical fee schedule. The case data may be less reliable since insurers are still uncertain as to the actual effects of the medical fee schedule.

ANIC stated that a minus 4.0 percent frequency trend is too aggressive for the current experience. Older years in which decreases in frequency were greater than the recent experience are given too much weight since frequency in Alaska has been relatively flat since 2009.

ANIC questioned the appropriateness of the loss ratio trend factors if future wage growth is more or less than the historical rate of wage change. Is error introduced into the methodology if the selected trends do not consider the expected wage growth rather than historical wage growth? In particular, how does the wage trend assumption impact the medical loss ratio trend?

ANIC asked that NCCI test and evaluate the use of a loss ratio methodology for the trend selection. ANIC noted that both Massachusetts and California recently discussed trend selection methodology and the impact of wage trends.

ANIC also asked if NCCI had performed a review of defense and cost containment expenses (DCC) countrywide. Do differences in state requirements, such as the lack of medical cost containment in Alaska, have an impact on the differences seen in Alaska DCC and the countrywide amounts?

On September 16, 2014, after the hearing, a producer submitted written testimony requesting the filing be modified to include a flat 5 percent commission structure for the assigned risk rates rather than the current sliding scale. The commission structure ranges from 8.0 percent for the smallest premium size policies to 1.5 percent on the largest. 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

Loss Development
NCCI stated that the experience underlying the current filing (2014) is paid-plus-case due to concerns about the impacts of the medical fee schedule and that relying on paid-plus-case data would reflect carriers' latest estimates on claims. NCCI reviewed the indications and diagnostics and did not observe any clear reason to change the experience base from paid-plus-case for 2015.

Because paid-plus-case experience takes into consideration the claims adjusters' best estimates of claims under the HB13 medical fee schedule, there might be a slight edge for using paid-plus-case over using paid experience alone, especially in the context of consideration for stability in the experience base from one filing to the next.

Medical paid loss development factors were low in the previous evaluation, the first diagonal of data under HB 13. The medical paid loss development factors increased in the latest evaluation. Volatility of the loss development factors is also considered in the selection of the experience base.

The medical paid to paid-plus-case ratios for the latest diagonal appear to be higher than the 5-year averages, which might reflect higher than expected medical paid levels.

NCCI noted that the combination of higher medical paid loss development factors and higher medical paid to paid-plus-case ratios were the main reasons that the overall indications based on paid experience are generally higher than those for paid-plus-case in the latest evaluation and why paid indications in the past were lower than the paid-plus-case indications in the previous evaluation of the data.

Frequency
NCCI stated that they select loss ratio trends and that the estimated frequency trends are provided at the request of the division. Therefore, the estimated frequency does not have any direct bearing on the loss cost indications. The frequency in Alaska has historically fluctuated significantly with periods of moderate change being short-lived and not necessarily indicative of the frequencies following these periods. Therefore relying on short-term trends would not be as predictive for Alaska.

Wage Trend
NCCI responded that because they select loss ratio trends the trend selection will measure historical changes in losses compared to wages over time. Because medical loss ratios have fluctuated up and down over the past 5 and 8 policy years which had lower wage growth, there does not appear to be any clear relationship between the wage trend and loss ratio changes. Wage trend may be a factor in loss ratio changes, but it does not appear to be a driving force.

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 medical fee schedule. Using a longer time period over which to average these loss development factors helps control the volatility.

Even though each insurer has its own response to estimating claim costs under the current medical fee schedule, the use of paid-plus-case data does take into consideration the adjuster's expected impact of the 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 two periods includes medical costs actually paid under the new medical fee schedule, it may be reasonable to incorporate a paid loss development method in the calculation. But the newest year of data has paid loss development factors that are higher than the prior year of data, which has some of the lowest paid loss development factors of the last 5 years. It is unclear which of the two years would be more representative of loss development under HB13. If the methodology were revised to include an average of paid and paid-plus-case loss development, the indicated change would range from minus 0.2 percent to 0.5 percent depending on how many years of paid loss experience is used.

3. In Order R 13-04, NCCI was asked to use only paid-plus-case loss development for the 2014 loss costs because of concerns that the low paid loss development factors of the first year of experience under HB13 would understate the ultimate loss amount. After reviewing the explanations and data provided by NCCI and ANIC, the use of an average of paid and paid-plus-case data would comply with AS 21.39.030(a)(1). However, adequate evidence has not been provided to demonstrate that the use of paid-plus-case experience only does not comply with AS 21.39.030(a)(1). AS 21.39.040(d) states that the information furnished in support of a filing may include the filer's interpretation of the statistical data it relies on. The use of paid-plus-case loss development only, as filed by NCCI, is acceptable.

4. The proposed LAE of 17.3 percent is acceptable. In Order R 13-04 NCCI was asked to evaluate and address exactly what is happening in Alaska related to LAE amounts, whether it be loss development, carrier mix or some other factor. NCCI's discussion did not address these issues, but simply pointed out that the Alaska ratios have declined over time. In response to an objection, NCCI responded that one possible explanation may be that the very high average benefit cost per case in Alaska compared to countrywide may result in lower ratios of DCC-to-loss in Alaska.

5. In the 2016 filing NCCI is requested to address the questions raised by ANIC related to any differences in what types of expenses are included in DCC in Alaska compared to countrywide, such as the lack of medical cost containment in Alaska, and evaluate whether there is a significant difference that impacts the DCC-to-loss ratios used in selecting the DCC percentage.

6. 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.

7. The changes to the procedure for estimating the coal mine occupational disease load are acceptable.

8. The change in maximum minimum premium for the assigned risk rating plan is acceptable.

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.

10. In response to the Supplemental Notice sent to producers to provide them with an opportunity to comment on the recommended modification to change to a flat commission percentage, 2 of the 7 comments did not support the change. One comment in opposition stated that it will materially affect the public in that many agencies are likely to refuse to write modest assigned risk policies altogether (as many already do) or at least give more agencies an incentive to require a broker agreement under AS 21.27.560.

11. The request to modify the assigned risk commission structure has been made on two previous occasions and it has not been approved due to concerns raised by producers who would be adversely affected by the change. Based on the comments received from producers on this proposed modification, while the use of a flat commission percentage would simplify accounting procedures it does not justify the negative impacts that will be experienced by some producers and possibly to consumers. The sliding scale commission structure will remain in place.

12. A servicing carrier RFP was published in May 2014 to select servicing carriers for the Alaska assigned risk market for 2015 – 2017. When NCCI submitted the filing to the division, the servicing carrier selection process was not complete. Therefore, NCCI included the 2011 servicing carrier allowance in the expenses for 2014 until the actual servicing carrier allowance is known.

ORDER

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

A. The 0.8 percent overall decrease in voluntary loss costs is approved.

B. The expense provisions of the assigned risk rate will be updated to include the actual 2016 servicing carrier allowance of 28.84. This will result in a 3.4 percent overall decrease in the assigned risk rates.

C. NCCI should address the questions raised by ANIC related to any differences in what types of expenses are included in DCC in Alaska compared to countrywide, such as the lack of medical cost containment in Alaska, and evaluate whether there is a significant difference that impacts the DCC-to-loss ratios used in selecting the DCC percentage.

D. NCCI should address the questions raised by ANIC related to wage trend, its impact on the selected trend, and evaluate whether use of a loss ratio trend is the most appropriate methodology for trend selection.

This order is effective November 6, 2014.

Lori Wing-Heier
Director