



Division of Insurance
Marcy Morrison
Commissioner of Insurance

Bill Ritter, Jr.
Governor

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Executive
Director

BEFORE THE DIVISION OF INSURANCE
STATE OF COLORADO

Order O-10-056

ORDER OF APPROVAL OF THE NATIONAL COUNCIL ON COMPENSATION
INSURANCE REQUEST FOR AN AVERAGE CHANGE IN WORKERS
COMPENSATION LOSS COSTS AND RATING VALUES.

On July 30, 2009, the National Council on Compensation Insurance (NCCI) submitted a workers compensation loss costs and rating values filing to the Colorado Division of Insurance (Division). This filing was submitted pursuant to §10-4-405, C.R.S., and is properly before the Commissioner of Insurance for review.

This loss costs and rating values filing was placed on public review on July 30, 2009. A public hearing was scheduled for the purpose of gathering additional information and receiving public comments on the proposed loss costs and rating values.

In accordance with §10-4-406(3.5), C.R.S., the Commissioner of Insurance sought the advice of an independent actuary in making her determination. Oliver Wyman Actuarial Consulting, Inc. (Oliver Wyman), an independent actuarial consulting firm, reviewed the filing to determine the reasonableness of the proposed loss costs and rating values.

The hearing took place on September 17, 2009. Presentations were made by NCCI and Oliver Wyman, and public testimony was received. The results of the presentations provided by Oliver Wyman and NCCI, along with public written and oral testimony, have been considered by the Commissioner in this order.

TESTIMONY

National Council on Compensation Insurance, Inc. (NCCI)

On September 17, 2009, the actuary for NCCI presented NCCI's request for an average decrease of 9.3% in workers' compensation loss costs and rating values.



The average changes to the five industry groups are as follows:

Manufacturing:	-10.3 %
Contracting:	-13.2 %
Office and Clerical:	-12.4 %
Goods and Services:	-4.9 %
Miscellaneous:	-6.9 %

The filing was based upon an indemnity loss trend that decreases 6.0% per year, and a medical loss trend that decreases 4.0% per year. The filing also establishes upper and lower bounds for the loss costs, resulting in a limit on the amount of increase or decrease for a given individual classification. This limit is average pure premium level change for the industry group to which the classification is assigned, plus or minus 25% (+/-25%).

The filing has a proposed effective date of January 1, 2010.

Oliver Wyman Actuarial Consulting, Inc. (Oliver Wyman) Recommendations

In his presentation, the actuary for Oliver Wyman recommended an average decrease of 10.4% to the loss costs and rating values.

The primary difference between NCCI's and Oliver Wyman's overall indications is the selection of the loss trend. The remaining recommendations deal with how the loss costs are distributed among the various classification codes.

New Class Ratemaking Methodology

In the NCCI's loss cost filing effective January 1, 2010, a new class ratemaking methodology was utilized to calculate the loss costs for the various classification codes. Concerning this new methodology, Oliver Wyman had the following alternative recommendations.

In its new class ratemaking methodology, the NCCI allocates all losses in excess of \$500,000 to a hazard group based on a theoretical claim distribution. The theoretical claim distribution was determined by an analysis of the underlying claim data. Oliver Wyman believed this was an appropriate methodology up to \$2 million, but did not believe this was an appropriate methodology for losses in excess of \$2 million because the excess factors calculated by the theoretical claim distribution did not follow the underlying workers compensation data for losses in excess of \$2 million. Oliver Wyman recommended losses in excess of \$500,000 and less than \$2 million to be distributed by hazard group using the excess calculated using the theoretical claim distribution, and that claims in excess of \$2 million to be socialized among all classification codes. Oliver Wyman recommended the \$500,000 and \$2 million thresholds to be reviewed annually for appropriateness.

D-Ratios

The new class ratemaking methodology was also used to determine the parameters used in the calculation of experience modification rating factors. Oliver Wyman reviewed the calculation of the D-ratio and the Expected Loss Rate (ELR) for each classification code. No issues were identified in the calculation of the ELRs. However, significant differences in the D-ratios effective January 1, 2009 and the proposed D-ratios effective January 1, 2010 were identified. These differences would result in significant changes to an employer's experience modification factor. To temper these differences, the NCCI proposed to limit the change to +/-0.03 of the current D-ratios. Oliver Wyman noted that even with this limit in place, the proposed D-ratios still had a significant amount of variation from the current D-ratios. As such, Oliver Wyman suggested the differences vary by +/-0.02 of the current D-ratios.

Coal Mine Classifications

Oliver Wyman also had alternative recommendations for the factors used to calculate the disease advisory loss costs for the coal mine classifications (codes 1005, 1015, 1016 and 1019). These recommendations included a different claim frequency, entitlement rate, mortality table, cost of living adjustment, load for state claim factor and the discounting of future benefits.

F Classifications

Due to the fact that there is little or no premium for F classifications in Colorado, Oliver Wyman recommended that the national pure premium be adopted as the basis for their loss costs.

Swing Limits

Finally, Oliver Wyman recommended that the maximum upper and lower bounds for the loss costs be reduced from +/-25% to +/-15%.

Public Testimony

The Workers' Compensation Coalition provided written comments that the entire loss cost filing should be treated as a public document (nothing held as confidential), and provided support for Oliver Wyman's treatment of losses in excess of \$2 million, the +/-0.02 cap on D-ratios and the +/-15% swing limit.

FINDINGS, CONCLUSIONS AND ORDERS

Trend

The largest difference between the NCCI's and Oliver Wyman's estimates is due to the trend selections. The selection of trend requires a large amount of judgment. NCCI selected indemnity and medical trend factors based on experience data over the period from 1996 through 2007. Oliver Wyman's indemnity and medical trend factors were based on an exponential trend model analysis from 2000 through 2007.

NCCI Indemnity Trend:	-6.0%
Oliver Wyman Indemnity Trend:	-5.7%
NCCI Medical Trend:	-4.0%
Oliver Wyman Medical Trend:	-4.7%

Both calculations were performed using generally accepted actuarial methodologies, and complied with the appropriate Actuarial Standards of Practice. Oliver Wyman's analysis demonstrated to the Division that the NCCI's selected trend factors were appropriate. As such, the NCCI's indemnity and medical trend factors are **APPROVED AS FILED**.

Large Loss Methodology

Although the Division recognizes that the new class ratemaking methodology is a significant improvement from the prior methodology, a number of concerns were discussed in Oliver Wyman's report and during the September 17th hearing. The issues causing the most concern were the treatment of large losses and the calculation of the D-ratios.

The NCCI's class ratemaking methodology allocates losses from claims in excess of \$500,000 to hazard groups based on the theoretical distribution of claims. The theoretical distribution is estimated from an analysis of the underlying workers compensation claims data.

Oliver Wyman recommended that the NCCI's class ratemaking methodology be modified such that losses in excess of \$500,000 but less than \$2 million are allocated to hazard groups based on the theoretical distribution of claims, and that losses in excess of \$2 million are socialized among all classification codes.

There are approximately 11,000 lost time workers compensation claims annually in Colorado; approximately seven of which exceed \$2 million. When the actual claim data is reviewed, it appears that inconsistencies arise between the theoretical claim distribution and actual losses from claims in excess of \$2 million.

Fewer inconsistencies were noted in claims greater than \$500,000 and less than \$2 million.

The Division is concerned about the limited amount of loss data for claims in excess of \$2 million, and the differences in estimated losses calculated using the theoretical distribution and losses from the actual claims. Because of these concerns, the Commissioner **ORDERS** the NCCI's class ratemaking methodology to be modified so that losses in excess of \$500,000 but less than \$2 million are allocated to hazard groups based on the theoretical claim distribution, and that claims in excess of \$2 million are socialized among all classification codes.

The Commissioner also **ORDERS** that the \$500,000 and \$2 million threshold be reviewed periodically to ensure that they remain appropriate.

The Commissioner **ORDERS** the NCCI to perform an analysis of losses in excess of \$500,000. This analysis should combine financial call data and statistical plan data to evaluate the appropriateness of the proposed class ratemaking methodology for claims in excess of \$500,000.

D-Ratios

In order to minimize the potential negative effects the new class ratemaking methodology may have on the experience modification factors of Colorado employers, the Commissioner **ORDERS** that the D-ratios be capped at +/-0.02 of the currently approved D-ratios. This cap will reduce large swings in experience modification factors due to the implementation of the new class ratemaking methodology, and will permit a gradual shift in D-ratios from their current levels to their actuarially determined levels.

Coal Mine Classifications

The NCCI and Oliver Wyman differed in several factors used to calculate the disease advisory loss costs for coal mine classifications. The most significant factors are discussed below.

Claim Frequency

The NCCI credibility weighted the western states' claim frequency with the eastern states. This is an actuarially appropriate methodology if there are enough similarities between the two groups. Oliver Wyman only considered the western states' frequency because of the large differences in claim frequency between western and eastern states.

	Surface Mines Frequency	Underground Mines Frequency
Eastern	1.80%	2.50%
Western	0.11%	0.35%
National	1.22%	2.31%

Because of the differences in claim frequency, the two groups may not be considered homogenous groups, and credibility weighting the frequencies may not be appropriate.

Entitlement Rate

The entitlement rate is the portion of filed claims that are expected to result in a claim entitled to black lung benefits under the Federal Act, and therefore not resulting in payments by Colorado workers compensation insurers. The NCCI judgmentally selected an entitlement rate of 10%. Oliver Wyman selected an entitlement rate of 6.1% based on data from the last five years.

Since it is based on actual historical data, an entitlement rate of 6.1% would seem to be more appropriate.

Mortality Table

One component of the expected claim cost is composed of supplemental benefits which are payable to the spouse while the miner is alive. The NCCI calculated these supplemental benefits using a mortality table based on males from the general population. Oliver Wyman derived a joint life table in its calculation.

Because the supplemental benefits are paid as long as the miner and spouse are both alive, the use of a joint life table is more appropriate.

Load for State Claim

The load for state claim factor is a load for claims that are expected to result in occupation disease benefits.

The NCCI included a provision for occupational disease claims which roughly translated to a 25% load. Oliver Wyman judgmentally selected a 10% load. Neither party was able to justify their selected load with claim data.

Occupation disease claims are expected to result from these classification codes. Until the 25% load can be justified, the Division believes it to be more appropriate to use the smaller of the two loads for state claims.

Disease Advisory Loss Costs for Coal Mine Classifications

Due to the difference in factors used to calculate the loss costs for the coal mine classifications, Oliver Wyman recommended disease advisory loss costs that were substantially lower than those proposed by the NCCI. The most significant of these factors are discussed above. It is the determination of the Division that the factors selected by Oliver Wyman are most appropriate. The Commissioner therefore **ORDERS** that the disease advisory loss costs for coal mine classifications be those shown in the Oliver Wyman report dated September, 2009, which are as follows:

Classification Code	Rate
1005	0.09
1015	0.28
1016	0.28
1019	0.09

F Classifications

Due to the limited credibility of the data for these classifications in Colorado, the Division believes that the NCCI methodology for calculating these loss costs is appropriate. As such, the NCCI's loss costs for F classifications are **APPROVED AS FILED**.

Swing Limits

The NCCI loss cost filing introduces a significant methodology change that can have drastic changes in the various classification code loss costs. In order to mitigate some of these potentially wide swings in loss costs, the Commissioner **ORDERS** the upper and lower bounds for the loss costs in any given classification to be plus or minus 20% of the average pure premium level change for the industry group to which the classification is assigned.

Loss Cost Change

After consideration of all evidence presented, the Commissioner **ORDERS** the proposed filing be amended to reflect an average reduction to the loss costs and rating values of 9.7%.

In reaching this decision, careful consideration was given to the arguments presented by both NCCI and Oliver Wyman. The 9.7% decrease was calculated by using Oliver Wyman's pure premium on-level factors, in conjunction with the remaining rating factors used by the NCCI, including but not limited to loss development factors and trend.

This results in a total decrease in the overall loss costs of 9.7%. The impact of each component can be summarized as follows:

Change due to Experience / Trend / Benefits:	-10.0 %
Change in Loss Adjustment Expenses:	<u>0.3 %</u>
Change in Loss Cost:	-9.7%

The filing is approved as amended, effective January 1, 2010.

Marcy Morrison
Commissioner of Insurance

10/26/09
Signed This Date