



State of Rhode Island and Providence Plantations
DEPARTMENT OF BUSINESS REGULATION
1511 Pontiac Avenue, Bldg. 69-2
Cranston, Rhode Island 02920

Insurance Division

June 19, 2013

Laura Backus Hall
State Relations Executive
National Council on Compensation Insurance, Inc. ("NCCI")
1493 Maple Hill Road
Plainfield, VT 05667

Re: NCCI 2012 Rhode Island Advisory Loss Cost Filing

Dear Ms. Hall:

On November 16, 2012, NCCI made a filing requesting an overall increase in advisory loss costs of +8% for industrial classes and -2.4% for "F" classes effective July 1, 2013. After careful review and analysis of the filing and all supplemental material provided, the Department finds that an overall increase of +7.4% for industrial classes and overall decrease of -3% for "F" classes is supported and is hereby approved. Further discussion of the process is included below.

This filing requests approval of "advisory loss costs" which, once approved, all insurers electing to write workers compensation insurance in Rhode Island must use as one component in setting the rates charged to employers. The Department's statutory directive is to determine whether the advisory loss costs are "excessive, inadequate or unfairly discriminatory." In coming to a conclusion on this issue the Department has initiated a process soliciting comment from the public and interested parties. The Department then reviewed all information obtained with the goal of achieving actuarially justified lost costs which are intended to produce a rate charged to employers that will adequately cover the costs incurred in providing benefits to injured employees while at the same time producing rates that are not excessive.

As discussed above the issue in the filing is approval of advisory loss costs that are not "excessive, inadequate or unfairly discriminatory." This is a function which requires both actuarial and public input. Prior to 2008 the Department utilized a formal legal proceeding which resulted in large expenses to employers without a coexistent benefit. Therefore, in 2008 the Department adopted a procedure to allow for input from the Attorney General and the public without the demands and costs of the prior legal proceedings. The goal of this procedure is to obtain public input while at the same time reducing costs, increasing timeliness and efficiency.

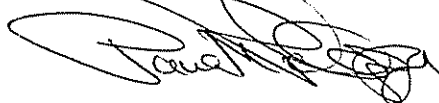
Review of this filing was instituted on January 17, 2013 with an email to the Attorney General and Beacon Mutual both of whom had previously indicated an interest in commenting on NCCI filings. In order to solicit comment from the public, the Department posted a notice on its website directing the public regarding how to submit comment. The Attorney General conducted discovery

concerning the filing, including data requests to NCCI, and provided the Department with written recommendations on March 15, 2013. NCCI responded to those recommendations on March 22, 2013. Beacon Mutual, who had received all communications in this matter, did not offer public comment. The Attorney General provided comments in response to NCCI's reply on March 28, 2013. NCCI provided final comments on April 2, 2013. On April 5, 2013 the Attorney General provided additional comments to NCCI's response to the Department's data request. No other comments were received.

The Department's role is to analyze the issues and arrive at advisory loss costs that will result in the lowest reasonable rates for Rhode Island employers while still maintaining a vibrant and competitive market for workers compensation insurance. Although the Department is always sympathetic to any argument that would reduce costs to employers, it must bear in mind that if advisory loss costs are not set appropriately employers will be adversely impacted through decreased competition and resultant increases in other portions of the rate. The Department appreciates and values the information provided by interested parties, especially that of the Attorney General, and has carefully considered each and every issue raised with an eye toward its statutory obligation. The conclusions reached by the Department are included in the actuarial report which is available to the public.

The Department hereby approves an overall increase in advisory loss costs of +7.4% for industrial classes and a decrease of -3% for "F" classes for use in Rhode Island beginning August 1, 2013, rather than the +8% for industrial and -2.4% for "F" classes requested by NCCI consistent with the discussion in this correspondence. NCCI is hereby directed to make a compliance filing consistent with this approval no later than July 1, 2013. NCCI shall issue a Circular advising member insurers to notify the Department no later than July 31, 2013 of its intention to adopt NCCI's advisory loss costs along with proposed loss cost multipliers. Any insurer electing to not adopt the 2013 Advisory Loss Costs, to delay adoption of the new loss costs, and/or to maintain its current loss cost multiplier must provide an explanation to the Department supporting its position, including statistical support. All notices and filings must be submitted electronically in SERFF.

Very Truly Yours,



Paula M. Palozzi
Chief Property & Casualty Insurance Rate Analyst

cc: Joseph Torti III, Superintendent of Insurance
Elizabeth Kelleher Dwyer, Esq.
Genevieve Martin, Assistant Attorney General
Brian Spero, Esq., Beacon Mutual Insurance Company

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

**NCCI PROPOSED WORKERS COMPENSATION
ADVISORY LOSS COSTS
EFFECTIVE 7/1/13**

Prepared for: State of Rhode Island and Providence Plantations
Department of Business Regulation
Cranston, RI

Date: June 18, 2013

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I. BACKGROUND

On 11/16/12, the National Council on Compensation Insurance, Inc. ("NCCI") filed for a revision to its Rhode Island workers compensation advisory loss costs to be effective 7/1/13. NCCI proposed an overall change in loss costs of +8.0% for the industrial classes and -2.4% for the Federal ("F") classifications. For the U.S. Longshore and Harbor Workers ("USL&HW") compensation percentage that adjusts for differences in benefits and loss-based expenses, NCCI proposed an increase from 61% to 62% (+0.6%).

The Department of Business Regulation ("the Department") has retained Milliman, Inc. ("Milliman") to perform an independent actuarial review of this filing.

II. SUMMARY OF MILLIMAN FINDINGS

Table 1 summarizes the proposed changes of NCCI, Milliman, and the Department of the Attorney General ("AG").

Table 1 Rhode Island NCCI Loss Cost Filing Summary of Proposed Changes by Party Effective July 1, 2013			
	NCCI	Milliman	AG
Industrial Classes	+8.0%	+7.4%	-0.1%
"F" Classifications	-2.4%	-3.0%	-4.0%
USL&HW %	+0.6%	+0.6%	+0.6%

The following is a summary of the major findings of Milliman's independent actuarial review of this filing.

- **Industrial Classes:** With the exception of the LAE provision, we generally find NCCI's methodology to be within a range of reasonableness and its assumptions to be reasonably supported. Based on our review of the data and information presented in support of the LAE provision, we recommend lowering the selected LAE provision from +18.8% to +18.2%. This provision is composed of a DCCE provision of +10.9% (a decrease from NCCI's selection of +11.5%) and an AOE provision of +7.3% (no change to NCCI's selection). We estimate the overall revised indication for the industrial classes to be +7.4%. Please see Section VI for details.
- **"F" Classifications:** With the exception of the LAE provision, we generally find NCCI's methodology to be within a range of reasonableness and its assumptions to be reasonably supported. We recommend the same selected LAE provision as

noted above for the industrial classes. We estimate the overall revised indication for the "F" classifications to be -3.0%.

- **USL&HW:** NCCI's methodology is reasonable and its assumptions are reasonably supported at this time.

III. SCOPE AND INTENDED PURPOSE

The Department has retained Milliman to review NCCI's Rhode Island loss cost filing, effective 7/1/13, including the underlying assumptions, actuarial methodology, and reasonableness of the selections.

IV. DISCLOSURES AND LIMITATIONS

A. Disclosures

1. Terminology

Case Reserves and IBNR Reserves. Total loss reserves consist of case reserves (claims administrator's estimates of future payments on individual reported claims) and incurred but not reported ("IBNR") reserves. As used in this report, the terms "IBNR reserves" and "unreported losses" refer to the provision for unreported claims, changes in incurred values on open claims, and future payments on reopened claims.

Loss Adjustment Expenses ("LAE"). LAE are classified as allocated loss adjustment expenses ("ALAE") and unallocated loss adjustment expenses ("ULAE"). Generally, ALAE include claims settlement costs directly assigned to specific claims, such as legal fees, and ULAE includes other claims administration expenses. The National Association of Insurance Commissioners ("NAIC") categorizes LAE in the Annual Statement as Defense and Cost Containment Expenses ("DCCE") and Adjusting and Other Expenses ("AOE"). Generally, DCCE includes all defense and litigation-related expenses, whether internal or external to a company, while AOE includes all claims adjusting expenses, whether internal or external to a company.

2. Acknowledgment of Qualifications

John Herzfeld is a Principal of Milliman, a Fellow of the Casualty Actuarial Society, and a Member of the American Academy of Actuaries. John meets the qualification standards of the American Academy of Actuaries to provide the estimates in this report.

B. Limitation on Distribution

Milliman's work is prepared solely for the use and benefit of the Department in accordance with its statutory and regulatory requirements. Milliman recognizes that materials it delivers to the Department may become public records subject to disclosure to third parties, however, Milliman does not intend to benefit and assumes no duty or liability to any third parties who receive Milliman's work and may include disclaimer language on its work product so stating. To the extent that Milliman's work is not subject to disclosure under applicable public records laws, the Department agrees that it shall not disclose Milliman's work product to third parties without Milliman's prior written consent; provided, however, that the Department may distribute Milliman's work to (i) its professional service providers who are subject to a duty of confidentiality and who agree to not use Milliman's work product for any purpose other than to provide services to the Department, or (ii) any other applicable regulatory or governmental agency, as required.

Any reader of this report agrees not to use Milliman's name, trademarks or service marks, or to refer to Milliman directly or indirectly in any third party communication without Milliman's prior written consent for each such use or release, which consent shall be given in Milliman's sole discretion.

C. General Limitations

1. Reliance on Data

In performing this analysis, we relied on data and other information provided by NCCI. We have not audited or verified this data and information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete.

We performed a limited review of the data used directly in our analysis for reasonableness and consistency and have not found material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or relationships that are materially inconsistent. Such a review was beyond the scope of our assignment.

2. Uncertainty

Actuarial estimates are subject to uncertainty from various sources, including changes in claim reporting patterns, claim settlement patterns, judicial decisions, legislation, and economic conditions.

In estimating the amount of loss cost change required, it is necessary to project future losses and expenses. Actual future losses and expenses will not develop exactly as projected and may, in fact, vary significantly from NCCI's projections. Further, the projections make no provision for future emergence of new classes of losses or types of losses not sufficiently represented in NCCI's historical database or that are not yet quantifiable.

3. Variability of Results

NCCI's estimates are based on long term averages. Actual loss experience in any given year may differ from what is suggested by these averages.

V. SUMMARY OF NCCI FILING

A. Industrial Classes

Table 2 summarizes NCCI's proposed changes to its Rhode Island workers compensation advisory loss costs for the industrial classes to be effective 7/1/13.

Table 2 Rhode Island NCCI Loss Cost Filing Proposed Changes - Industrial Classes Effective July 1, 2013	
<u>Component</u>	<u>Indication</u>
Change in Experience, Trend, and Benefits	+5.8%
Effect of Offset to Reflect Impact of Approved Item B-1425	+0.9%
Change in Loss Adjustment Expenses	+1.1%
Proposed Change in Loss Costs	+8.0%

NCCI proposed an overall change of +8.0% in loss costs of the industrial classes. This is derived from a change in experience, trend, and benefits of +5.8%, an offset to reflect the impact of approved Item B-1425 of +0.9, and a change in LAE of +1.1%.

B. "F" Classifications / USL&HW

Table 3 summarizes NCCI's proposed changes to its "F" classifications and the USL&HW percentage to be effective 7/1/13.

Table 3 Rhode Island NCCI Loss Cost Filing Proposed Changes - Other Effective July 1, 2013	
<u>Component</u>	<u>Indication</u>
"F" Classifications	-2.4%
USL&HW %	+0.6%

For the "F" classifications, NCCI proposed a loss cost change of -2.4%.

For USL&HW, NCCI proposed an increase in the percentage that adjusts for differences in benefits and loss-based expenses: from 61% to 62% (+0.6%).

C. Industry Group Loss Cost Level Changes

Table 4 below summarizes the distribution of the overall loss cost level change to each industry group as filed by NCCI. The overall change across all classes is designed to balance to the overall aggregate indication.

Table 4 Rhode Island NCCI Loss Cost Filing Proposed Changes - Industry Groups Effective July 1, 2013	
<u>Industry Group</u>	<u>Average Group Change</u>
Manufacturing	+8.2%
Contracting	+7.4%
Office and Clerical	+6.5%
Goods and Services	+9.0%
Miscellaneous	+7.6%
Overall	+8.0%

D. Item B-1425

Item B-1425 was recently approved in Rhode Island effective 1/1/13. In that filing, the increased limits percentages for employers' liability were reduced. This change will directly reduce the reported statewide financial call standard earned premium for years beginning on and after 1/1/13. However, in this year's filing, the experience period used to determine the proposed loss costs is from a time period prior to 2013 when the previous increased limits percentages were in place. In this year's filing, a premium adjustment factor was applied to the historical data in order to project the loss cost indication.

E. Experience Rating Plan Split Point

In experience rating, the split point separates losses into primary and excess components. For the past twenty years, the split point has been \$5,000. According to NCCI, experience indicates that the split point should be increased to \$15,000 as the experience rating plans becomes less responsive if the split point is not indexed for claim cost inflation. In this year's filing, NCCI has increased the split point to \$10,000 and no party has contested this issue.

VI. MILLIMAN ANALYSIS AND COMMENTS ON NCCI FILING

A. Loss Cost Level Indication

With respect to the treatment of individual large losses, NCCI used the same ratemaking methodology as used in recent filings of limiting individual large losses to a certain loss threshold (about \$3.3 million in this year's filing). The actual excess incurred loss amount greater than this amount is removed and replaced with an expected excess loss amount. This methodology is intended to stabilize the loss cost indications. According to NCCI, in the experience period used in this year's filing, there were no claims that exceeded the threshold.

Using this ratemaking methodology, NCCI calculated an indication of the estimated loss cost needed for the prospective year based on the loss experience of policy years 2008, 2009, and 2010 evaluated as of 12/31/11. The proposed indication was based on the following loss development methodology: 100% weight to developed paid losses using loss development factors ("LDFs") based on the average of the latest five years excluding the highest and lowest years for both indemnity and medical losses. This methodology is consistent with NCCI's methodology in recent Rhode Island filings.

We asked NCCI to calculate alternative loss cost level indications based on the same methodology as described above for the treatment of large losses, but using alternative scenarios. These alternative indications are listed below and compared in Table 5. Please note that these alternative indications reflect both the offset for the impact of approved Item B-1425 and the impact of the change in LAE.

- a. 100% weight to developed paid losses with LDFs based on the average of the latest five years
- b. 100% weight to developed paid losses with LDFs based on the average of the latest three years

- c. 100% weight to the developed paid plus case losses with LDFs based on the average of the latest five years
- d. 100% weight to the developed paid plus case losses with LDFs based on the average of the latest three years
- e. 100% weight to the developed paid plus case losses with LDFs based on the average of the latest five years excluding the highest and lowest years
- f. 50% weight to developed paid losses with LDFs based on the average of the latest three years and 50% weight to developed paid plus case losses with LDFs based on the average of the latest three years
- g. 50% weight to developed paid losses with LDFs based on the average of the latest three years and 50% weight to developed paid plus case losses with LDFs based on the average of the latest five years
- h. 50% weight to developed paid losses with LDFs based on the average of the latest three years and 50% weight to developed paid plus case losses with LDFs based on the average of the latest five years excluding the highest and lowest years
- i. 50% weight to developed paid losses with LDFs based on the average of the latest five years excluding the highest and lowest years and 50% weight to developed paid plus case losses with LDFs based on the average of the latest five years excluding the highest and lowest years
- j. 75% weight to developed paid losses with LDFs based on the average of the latest three years and 25% weight to developed paid plus case losses with LDFs based on the average of the latest five years excluding the highest and lowest years
- k. 25% weight to developed paid losses with LDFs based on the average of the latest three years and 75% weight to developed paid plus case losses with LDFs based on the average of the latest five years
- l. 25% weight to developed paid losses with LDFs based on the average of the latest three years and 75% weight to developed paid plus case losses with LDFs based on the average of the latest five years excluding the highest and lowest years

Table 5 Rhode Island NCCI Loss Cost Filing Industrial Classes Alternative Scenarios - Policy Year Basis	
Scenario	Indication
Original	+8.0%
100% Paid - 5 Yr Avg	+7.9%
100% Paid - 3 Yr Avg	+8.1%
100% Paid Plus Case - 5 Yr Avg	+6.9%
100% Paid Plus Case - 3 Yr Avg	+9.9%
100% Paid Plus Case - 5 Yr Avg excl. Hi/Lo	+6.8%
50% Paid - 3 Yr Avg / 50% Paid Plus Case - 3 Yr Avg	+9.0%
50% Paid - 3 Yr Avg / 50% Paid Plus Case - 5 Yr Avg	+7.5%
50% Paid - 3 Yr Avg / 50% Paid Plus Case - 5 Yr Avg excl. Hi/Lo	+7.5%
50% Paid - 5 Yr Avg excl. Hi/Lo / 50% Paid Plus Case - 5 Yr Avg excl. Hi/Lo	+7.4%
75% Paid - 3 Yr Avg / 25% Paid Plus Case - 5 Yr Avg excl. Hi/Lo	+7.8%
25% Paid - 3 Yr Avg / 75% Paid Plus Case - 5 Yr Avg	+7.2%
25% Paid - 3 Yr Avg / 75% Paid Plus Case - 5 Yr Avg excl. Hi/Lo	+7.1%

We also asked NCCI to provide an alternative indication based on loss experience and premium for accident years 2009, 2010, and 2011, using the same loss development methodology used in the original filing. Table 6 summarizes these alternative indications. Please note that these indications reflect both the offset for the impact of approved Item B-1425 and the impact of the change in LAE.

Table 6 Rhode Island NCCI Loss Cost Filing Industrial Classes Alternative Scenarios - Accident Year Basis	
<u>Accident Year</u>	<u>Indication</u>
2009	+12.7%
2010	+5.1%
2011	+9.7%
Total	+9.2%

In general, we believe that NCCI's selection based upon paid LDFs in the calculation of the loss cost indication is reasonable. Paid LDFs have been relied on for many years in Rhode Island and can be stable and reliable for workers compensation coverage, which typically makes periodic payments on claims.

B. Treatment of Large Losses

We believe that NCCI's ratemaking methodology with respect to the treatment of large losses is reasonable and appropriate for use in a small state like Rhode Island. It is a continuation of NCCI's program utilized in prior Rhode Island filings as well as similar to NCCI's program in other states. This methodology should help increase long-term stability in the loss cost level in Rhode Island. If one or more large losses occur in a policy year, it will not cause the loss cost level to increase as significantly in the years that follow. We also believe using a loss threshold of approximately \$3.3 million is reasonable at this time.

C. Tail Factors

A "tail factor" is the final LDF that is applied to losses to develop them to an ultimate basis, and is selected for each of medical and indemnity losses. NCCI selects its tail factors based on historical loss information. NCCI's selected paid medical tail factor of 1.049 corresponds to the latest eight-year average; this is lower than last year's eight-year average tail factor of 1.066. NCCI's selected paid indemnity tail factor of 1.019 corresponds to the latest eight-year average; this is also lower than last year's eight-year average tail factor of 1.033.

We asked NCCI to provide an alternative indication using last year's selected tail factors along with the other assumptions of the original filing. According to NCCI, the alternative indication in this scenario is +9.3%. Please note that these indications reflect both the offset for the impact of approved Item B-1425 and the impact of the change in LAE.

Based on the data and information that we received from NCCI, we believe that both the medical and indemnity tail factors are reasonably supported.

D. Trend

NCCI used trend factors to measure expected changes in benefit costs along with expected changes in wages. Trend was determined separately for indemnity and medical benefits. NCCI estimated that the indemnity portion of the total benefit costs would be 65% and the medical portion would be 35%.

In the current filing, NCCI proposes to increase the indemnity trend factor from -0.5% to 0.0% and to increase the medical trend factor of from 0.0% to +0.5%. NCCI's selections are based on a review of exponential and linear trends applied to Rhode Island historical loss ratios as well as economic data.

For comparison purposes, we asked NCCI to calculate alternative overall indications for each of the following alternative scenarios. (a) -0.5% for the indemnity trend factor and 0.0% for the medical trend factor (the currently approved trend factors in Rhode Island); (b) -1.0% for the indemnity trend factor and 0.0% for the medical trend factor; and (c) 0.0% for indemnity trend factor and 0.0% for the medical trend factor. The overall indications are +5.4% for scenario (a), +3.9% for scenario (b), and +7.1% for scenario (c). Please note that these indications reflect both the offset for the impact of approved Item B-1425 and the impact of the change in LAE.

NCCI also provided the currently approved indemnity and medical trend factors in other NCCI states, and the exponential and linear trend analyses that were reviewed for Rhode Island along with the goodness-of-fit statistics. In general, the selected indemnity and medical trend factors for Rhode Island are similar to those used in other states, and they appear reasonable based on a review of the exponential and linear trend analyses for Rhode Island and the corresponding goodness-of-fit statistics.

We note that the selection of trend factors is one of the least mathematical components of the loss cost indication. There is significant judgment involved in selecting the indemnity and medical trend factors. However, based on the historical indemnity and medical loss information provided in the filing as well as the supplemental information provided for other states, we believe that the trend factors utilized in NCCI's filing are reasonable at this time.

E. Loss Adjustment Expenses

NCCI's proposed LAE provision is determined in two steps:

1. Countrywide Provision

Using countrywide accident year data obtained from NCCI Call 19 for LAE, separate countrywide ratios for DCCE-to-loss and AOE-to-loss are developed to an ultimate basis based on selected development factors. NCCI selected separate DCCE, AOE, and loss development factors on both paid and incurred bases. NCCI selected a five year average for incurred DCCE, AOE, and loss development factors, which is consistent with its methodology used in last year's filing. According to NCCI, "longer-term averages are used because the incurred amounts include IBNR, which can be somewhat volatile." NCCI selected a two year average for paid DCCE, AOE, and loss development factors, which is different than its prior methodology of selecting a three year average. According to NCCI, the reason for the change in its selection of paid factors was due to an observed a historical decline in the estimated paid DCCE-to-loss ratios, which was generally attributable to a pattern of decreasing DCCE development factors and increasing loss development factors.

After estimating separate ultimate DCCE-to-loss and AOE-to-loss ratios on both paid and incurred bases for each accident year, NCCI applied 50% weight to each of the paid and incurred methods. Finally, NCCI selected a two year average of the results as its selected ultimate DCCE-to-loss and AOE-to-loss ratios. Based on a review of NCCI's analysis, we believe that its selected ultimate AOE-to-loss ratio of 7.3% is reasonable at this time. However, we believe that its selected ultimate DCCE-to-loss ratio of 12.5% is high for the following reasons:

- a. Selected Methods – NCCI applied 50% weight to the paid development method, which is generally reasonable for a coverage such as workers compensation, which typically makes periodic payments on claims. However, because the cumulative paid development factors (for both DCCE and loss) are very large for the more recent accident years, there is a higher degree of uncertainty in the estimated ultimate ratios produced by this method for these recent accident years. The resulting estimated ultimate losses are highly leveraged and may be

too high or too low. We recommend that in future filings NCCI consider applying more weight to the incurred development method for the more recent accident years, which uses cumulative incurred development factors that are not as large and uncertain, or consider using an alternative method such as the paid expected emergence method (also known as the Bornhuetter-Ferguson method), which blends an expected ultimate amount with actual payments.

- b. Selected Average – NCCI selected a two-year average of historical ultimate DCCE-to-loss ratios. Due to the tendency for the paid development method to be highly leveraged for more recent accident years and NCCI's selected weighting of 50% to this method, we recommend that NCCI select a longer term average. A longer term average will reflect the information that can be obtained from accident years that are more mature and that have been developed to an ultimate basis using more credible cumulative development factors.

Based on the above commentary, we recommend a selected ultimate DCCE-to-loss of 11.8% on a countrywide basis, which is lower than NCCI's selection of 12.5%. Our selection is based on a five-year average of historical ultimate DCCE-to-loss ratios without changing the 50%/50% weighting to the paid and incurred methods.

2. Rhode Island Provision

The countrywide DCCE ratio is converted to a state-specific DCCE ratio by comparing state-specific and countrywide calendar year paid DCCE-to-loss ratios and selecting a state relativity. The countrywide AOE ratio is added to the state-specific DCCE ratio to obtain the selected state-specific LAE allowance.

The selected Rhode Island DCCE relativity (0.920) is based on a latest three year average of Rhode Island-to-countrywide paid DCCE-to-loss ratios. We asked NCCI to provide the currently approved and prior approved LAE allowances in other states. We also asked NCCI to provide the Rhode Island DCCE relativities for each of the latest

few calendar years. We have summarized this information in Table 7. Please note that the data included in the following tables excludes state funds for the countrywide figures and excludes Beacon Mutual Insurance Company for Rhode Island. We note that Beacon Mutual has adjusted the LAE provision in their loss cost multiplier to account for this.

Table 7 Rhode Island NCCI Loss Cost Filing Industrial and "F" Classes Loss Adjustment Expense Provision			
Calendar Year	Paid DCCE Ratio		Rhode Island DCCE Relativity
	Rhode Island	Countrywide	
2006	9.7%	11.0%	0.880
2007	9.4%	11.2%	0.840
2008	10.6%	10.9%	0.972
2009	9.7%	10.9%	0.892
2010	10.2%	11.3%	0.905
2011	11.0%	11.5%	0.957

Selecting the number of years to use for the average DCCE relativity involves a trade-off between responsiveness to new data and stability relative to the longer-term average. Based on our review of both the filing data and the supplemental information, we believe that the selected Rhode Island DCCE relativity, which is based on a latest three-year average, is reasonable at this time.

Applying this Rhode Island DCCE relativity factor to our selected ultimate DCCE-to-loss ratio of 11.8% results in a ratio of 10.9%, which is lower than NCCI's selection of 11.5%.

F. Summary

NCCI's methodology in this year's filing is consistent with that used in last year's filing in terms of the following major areas of review:

- weighting of standard actuarial loss development methodologies
- selection of loss development factors
- treatment of large losses

We believe that NCCI's methodology with respect to these areas is reasonable at this time.

NCCI proposed to increase the indemnity trend factor from -0.5% to 0.0% and the medical trend factor from 0.0% to +0.5%. We believe that these selections are reasonably supported at this time.

Based on our review of the data and information presented in support of the LAE provision, we recommend lowering the selected LAE provision from +18.8% to +18.2%. This provision is composed of a DCCE provision of +10.9% (a decrease from NCCI's selection of +11.5%) and an AOE provision of +7.3% (no change to NCCI's selection). We estimate the overall revised indication for the industrial classes to be +7.4% and for the "F" classes to be -3.0%.

VII. DISCUSSION OF ATTORNEY GENERAL RECOMMENDATIONS

In its review of the above filing, the AG disagrees with NCCI's proposed indication of +8.0% and provides an alternative indication of -0.1%. The AG's alternative indication is broken down into the following components:

A. Premium Adjustment Factor Due to Item B-1425

The AG disagrees with NCCI's premium adjustment factor (due to Item B-1425) that was applied to the historical data in order to project the loss cost indication. The AG believes that NCCI should use a factor of unity in its filing. The AG argues that employers will purchase more employers' liability coverage if the cost is cheaper. Also, they argue that employers may have a fixed budget for employers' liability coverage so employers will purchase more coverage if the cost is cheaper. The estimated impact of the AG's proposed change would decrease the indication from +8.0% to +7.0% for the industrial classes.

NCCI argues that Item B-1425 is an approved filing in the state of Rhode Island. Its impact was to reduce increased limits factors so the applicable offset is an increase in the loss costs. NCCI also argues that there is no evidence that employers' purchasing behavior will change if employers' liability costs decrease.

We agree with NCCI that the applicable offset for this approved filing is an increase in the loss costs. We disagree with the AG's argument that an insured would purchase more employers' liability coverage if the cost were lower. The cost of higher limits of employers' liability is low relative to the primary layer and employers buy the level of coverage that they need.

B. Loss Adjustment Expense Provision – Industrial Classes

The AG disagrees with NCCI's selected LAE provision of +18.8% and proposes a lower provision of 16.9%. The AG's provision is comprised of a DCCE provision of 10.0% and an AOE provision of 6.9%. The estimated impact of the AG's proposed change would decrease the indication from +8.0% to +6.3% for the industrial classes. The AG provides the following arguments:

1. NCCI develops loss, DCCE, and AOE data including IBNR but uses its own estimates of IBNR instead of that estimated by individual insurers. NCCI does not provide support for its IBNR estimates.
2. It is inappropriate for NCCI to determine a provision for the DCCE component of LAE as some insurers do not distinguish separate case and IBNR loads for DCCE.
3. For AOE, NCCI is using data that includes large deductible policies. It does not reduce AOE by the large deductible, only the large deductible provision so NCCI's estimate of AOE is overstated.
4. Comparing triangles of ratios of DCCE to loss on both incurred and paid bases shows that these ratios decrease significantly over time. Therefore, NCCI's estimate of the ultimate ratio of DCCE to loss is overstated.
5. NCCI uses an incurred method to estimate LAE, which produces a higher estimate. Paid data is more objective (i.e., it is a summary of payments made) while incurred including IBNR data is more subjective (i.e., it is a reflection of NCCI adding IBNR to the IBNR already determined by insurers). From 24 months on, using a paid method is less excessive than an incurred method.
6. The availability of AOE data is less than that for DCCE. Similar to its argument for DCCE, the AG argues that using an incurred method to estimate the AOE load results in an excessive provision. The AG recommends using the paid method.

NCCI counter argues that the application of LDFs is a standard actuarial procedure and that NCCI provided support for its tail factors. NCCI also notes that Rhode Island statute states that loss costs must include LAE so it is absolutely necessary for NCCI to determine a provision for DCCE. NCCI correctly accounts for large deductible policies in estimating its AOE provision. Loss development methods using both paid and

incurred data are valid actuarial techniques and each provides viable estimates of the LAE provision. NCCI states that it modified its development selections to be more responsive to the downward trend in the LAE provision.

Please see Section VI for Milliman's recommendation on the LAE provision.

Regarding NCCI's statement that it modified its development selections in this year's filing, we reviewed NCCI's selections and note that their modifications did not have a significant impact on the overall LAE indication.

Regarding the AG's arguments, we disagree with all six arguments for the following reasons:

1. NCCI no longer collects data that includes IBNR. Although individual companies estimate their own IBNR reserves, different assumptions and methodologies are used to develop these reserve estimates. NCCI's approach of estimating IBNR reserves for all companies combined using consistent assumptions and methodologies is a reasonable approach. NCCI did provide support for its IBNR estimates in the interrogatories.
2. NCCI should estimate a provision for the DCCE component of the LAE provision. It would be illogical and incomplete for NCCI to eliminate its component of the LAE provision.
3. NCCI makes an adjustment for the large deductibles policies in the AOE provision that is reasonable.
4. Although it is true that NCCI's estimated DCCE-to-loss ratios have decreased over time, this does not imply that the current selected DCCE-to-loss ratio is automatically overstated. A more thorough review of the analysis is necessary. Please see Section VI for Milliman's recommendation for the DCCE component of the LAE provision.
5. The AG's conclusion is that, since the incurred method produces an LAE estimate that is higher than that produced by the paid method, the incurred method overstates the results and should not be used. However, one could also conclude that the paid method understates the results and should not be used using the same criteria. The AG's logic is not convincing. We performed an independent review of the LAE analysis and our recommendation is summarized in Section VI.

6. The AG's conclusion about NCCI's methodology with respect to AOE is the same as that presented in #5. Again, the AG's logic is not convincing. We performed an independent review of the LAE analysis and our recommendation is summarized in Section VI.

C. Large Loss Methodology

The AG disagrees with NCCI's large loss methodology. The AG provides the following arguments:

1. The excess charge is calculated in an inappropriate manner that results in an excessive charge.
2. NCCI's credit for limiting the amount of paid loss in excess of the large loss limit for the latest three policy years has produced no value to Rhode Island.
3. NCCI's credit for limiting the amount of paid loss in excess of the large loss limit in the calculation of LDFs is almost valueless to Rhode Island policyholders.
4. NCCI's countrywide data reaffirms that the premium received by insurers as a result of the large loss limitation procedure is grossly excessive.
5. Any potential value of the large loss limitation procedure in Rhode Island is diminished by using the procedure of excluding highest and lowest values when calculating LDFs.
6. The premium received by insurers as a result of the large loss limitation procedure is redundant to the catastrophe premium charge and the terrorism premium charge.
7. The premium received by insurers as a result of the large loss limitation procedure is not held in a separate account and instead is given away as dividends to stockholders.
8. The large loss limitation procedure may be in violation of Rhode Island statutes which repealed the use of profit and contingency factors in workers compensation ratemaking in 1998.
9. NCCI did not provide any support for its factor to adjust its 19th to ultimate LDF from an unlimited basis to a limited one.

The AG believes that NCCI should remove its large loss limitation procedure from its methodology to determine loss costs in Rhode Island. The estimated impact of the AG's proposed change would decrease the indication from +8.0% to +4.5% for the industrial classes.

NCCI counter argues that many of the AG's arguments have been fully vetted in prior Rhode Island filings. The statewide excess ratio has been calculated based on the data and analysis underlying the excess loss factors that were filed and approved in item R-4104. It is consistent with the approach used for determining the excess loss factors that have been filed and approved in past Rhode Island loss cost filings. The AG's approach is a different methodology and is inconsistent with other approved filings in Rhode Island. NCCI's methodology for calculating the limited tail factor has not changed from that approved in prior Rhode Island loss cost filings. NCCI's methodology uses Reinsurance Association of America ("RAA") data. The AG cites a number of concerns with this data but does not provide an alternative. NCCI believes that RAA data provides the best source for making this adjustment from an unlimited basis to a limited one.

We agree with NCCI that the substantial majority of the AG's arguments have been fully vetted in prior filings. We believe that NCCI's large loss methodology is reasonable at this time. We note that NCCI uses a large loss methodology in all states where it files loss cost filings. We offer the following commentary in response to the AG's arguments.

For the following reasons, we disagree with the AG's argument that NCCI's estimated excess ratio is excessive and that the AG's alternative calculation is reasonable.

- The AG's alternative calculation includes only a short period of loss history (policy years 2001 through 2008) and none of these data points reflect data evaluated as of 12/31/11 (the evaluation date used in the filing).

- The AG's calculation reflects only two of five categories of losses (permanent total and permanent partial but not fatal, temporary total, or medical only). The AG is incorrectly excluding three categories of losses.
- The AG's calculation is based on actual historical loss experience in the state of Rhode Island. Since Rhode Island is a small state, its actual historical loss experience is not always fully credible and should be supplemented with actual countrywide loss data or simulated loss experience, especially concerning large losses which occur infrequently. Just because Rhode Island has not experienced certain types of losses or very many large losses does not mean that they will never occur. Countrywide loss data and simulated loss experience provide valuable information when projecting future loss costs. In our opinion, the AG's analysis is unreasonable.

The AG believes that the large loss methodology is not valuable to policyholders because there have been no paid losses in excess of the large loss threshold in the experience period used in the filing. Since Rhode Island is a small state, we do not expect there to be large losses that pierce the large loss threshold every year. NCCI's large loss methodology is designed to mitigate the impact of large losses when they occur by capping losses at a certain level and applying a small load to represent potential large losses. NCCI's large loss methodology will smooth loss cost indications over time by eliminating the fluctuation of large losses.

The Department approved NCCI's large loss methodology in 2004 (DBR No. 04-I-0174). In 2010, NCCI stated that "the application of a large loss methodology is an actuarially accepted methodology" and is different from the selection of LDFs. LDFs are influenced by many elements, including claim reporting patterns and case reserve adequacy. Large losses can increase or decrease LDFs depending on their timing. Even if LDFs could be smoothed of the large loss influence, the large losses could still enter into the rate calculation so a large loss procedure is still necessary.

As discussed last year, the catastrophe premium charge and the terrorism premium charge are intended to cover different loss exposures than the premium received by insurers as a result of the large loss limitation procedure. The difference between the two provisions is based on frequency. Although large losses generally occur infrequently, catastrophes and terrorism should occur far less frequently than large losses. Consequently, NCCI calculates a separate load for each of them.

We believe that the AG's comment about insurer's keeping the premium received as a result of the large loss limitation procedure in a separate account does not conform with Statutory Accounting, to which insurers must comply.

Finally, we disagree with the AG's argument that NCCI's tail factor adjustment is unsupported and therefore unreasonable. NCCI's methodology of using countrywide data to estimate this adjustment is reasonable. NCCI noted the limitations of its financial data calls and using RAA data is a reasonable industry source to utilize in this situation. Additionally, we note that the AG has provided alternative calculations in all other areas where it disagrees with NCCI but the AG does not provide an alternative solution in this case.

Therefore, we believe that NCCI's large loss methodology is reasonable at this time.

D. Adjusting Losses for Prior Policy Years

The AG argues that NCCI has proposed unsupported increases in growth factors already established in prior filings and that the purpose of changing the methodology is to obtain unsupported increased loss costs. The AG also states that the growth factors derived under NCCI's methodology are not consistent with Rhode Island growth patterns, which are negative in recent years. The AG believes that NCCI should use a factor of unity in its filing. The estimated impact of the AG's proposed change would decrease the indication from +8.0% to +7.8% for the industrial classes.

NCCI counter argues that with the elimination of IBNR from NCCI's financial data calls, the tail factor methodology required modification and the growth factors are just one component of the calculation. Because of the change in methodology, the factors in this year's filing are not directly comparable to those in last year's filing. In addition to reflecting paid plus case losses without IBNR, the factors are now computed on a policy year basis rather than accident year. Additionally, a greater number of years (and therefore, a greater volume of data) is now being used to calculate the growth factors. The indemnity and medical tail factors proposed in this filing are lower than the tail factors used in last year's filing. This new methodology has been filed and approved in other states.

We disagree with the AG's argument that NCCI's growth factors are unsupported and biased high. Given that NCCI's new financial data calls do not reflect IBNR, it is reasonable to include a growth factor to reflect estimated IBNR. IBNR is the provision for unreported claims, changes in incurred values on open claims, and future payments on reopened claims. For workers compensation, it is critical to include a provision for IBNR as new claims can be reported, case reserves can be deficient, and closed claims can reopen and incur additional losses. For these reasons, IBNR should be a positive number in this case and it is unreasonable to assume no growth. We also believe that NCCI's revised methodology is reasonable as it is based on accident year data (which is comparable to the rest of the filing) and it utilizes a greater volume of data in its calculation.

E. Premium Adjustment Factors

The AG argues that NCCI consistently selects an average expected mod that is less than the actual average mod when actual data becomes available. As a result, the understatement of the average expected mod causes loss costs to artificially be too high in direct proportion to the amount of error. The AG assumes that this

overstatement will continue. The AG recommends that NCCI's selected premium adjustment factors be increased to account for the average understatement in the average expected mod over the last six years. The AG selected alternative premium adjustment factors. The estimated impact of the AG's proposed change would decrease the indication from +8.0% to +6.2% for the industrial classes.

NCCI counter argues that the AG does not express any disagreement with the application of an off-balance adjustment factor, but objects to the factors that are applied based on a comparison of the selected target off-balance in prior filings and the actual mod for the corresponding rating year. The off-balance shown in the AG's exhibit reflects the overall average mod, including both intra- and interstate rated risks. As a result of including interstate mods, the comparison will be influenced by changes in experience rating factors in other states. The overall actual mod in a given year may be expected to differ from the overall target mod for a number of reasons, including the use of a new year of experience in the mod calculations, the mix of intra- and inter-state risks, and the distribution of experience rated versus non-rated risks. The AG's suggested modification to the premium adjustment factors is analogous to selecting a different target mod. The target mod implied by the AG's recommendation is 1.009, which is higher than NCCI's selected overall target mod of 0.993. Based on the distribution of intra-state, inter-state, and non-rated risks, and assuming no change to NCCI's selected target interstate mode, this implies a target intrastate mod of 1.015. NCCI believes it would be undesirable and unusual to target an intrastate mod greater than unity.

We agree with NCCI that the AG's selected premium adjustment factors are unreasonable. We agree that targeting an intrastate mod of 1.015 is unusual as a factor just under 1.000 is more typical and is similar to that seen in other states. We believe that NCCI provides a reasonable explanation for the reason that the average expected mod has been consistently lower than the average actual mod as data becomes available. Therefore, we recommend no change to NCCI's selection.

F. Loss Adjustment Expense Provision – “F” Classes

The AG recommends that the indicated change for the “F” classes be revised to reflect the alternative LAE provision presented as argument B. The estimated impact of the AG’s proposed changes would decrease the indication from -2.4% to -4.0% for the “F” classes.

NCCI’s counter arguments presented against argument B (i.e., LAE provision for the industrial classes) apply here. Please see Section VI for Milliman’s recommendation on the LAE provision.

VIII. GLOSSARY OF INSURANCE TERMS

Adjusting and Other Expenses ("AOE"): the portion of loss adjustment expenses that covers all claims adjusting expenses, whether internal or external to an insurance company

Case Reserves: claims administrator's estimates of future payments on claims that have been reported to the insurance company for a particular period at a specific point in time.

Defense and Cost Containment Expenses ("DCCE"): the portion of loss adjustment expenses that covers all defense and litigation-related expenses, whether internal or external to an insurance company

Incurred But Not Reported ("IBNR") Reserves: the provision for unreported claims, changes in incurred values on open claims, and future payments on reopened claims.

Loss Adjustment Expenses ("LAE"): the sum of allocated loss adjustment expenses ("ALAE") and unallocated loss adjustment expenses ("ULAE"), generally, ALAE includes claims settlement costs directly assigned to specific claims, such as legal fees, and ULAE includes other claims administration expenses.

Loss Cost: ultimate losses divided by payroll (in \$100 increments) and usually (but not always) includes LAE.

Loss Development Factors ("LDFs"): factors used to develop paid or "paid plus case" losses from their values at specific evaluation ages to their ultimate values; LDFs are estimated by reviewing historical experience.

Paid Losses: losses for a particular period that have been paid on all known claims.

"Paid Plus Case" Losses: the sum of all paid losses and case reserves for a particular period at a specific point in time; also called incurred losses or case incurred losses.

Premium On-Leveling: the process of estimating what historical premium levels would be, had the insurance been written today.

Tail Factor: a final LDF that is applied to losses to develop them to an ultimate basis, and is selected for each of medical and indemnity losses.

Trend Factors: factors used to adjust the losses and exposures for any underlying trends that are expected to produce changes over time (e.g., an indemnity trend factor accounts for expected growth in indemnity benefits as compared to wages, a medical trend factor accounts for expected growth in medical costs).

Ultimate Losses: the sum of paid losses, case reserves, and IBNR reserves for a particular period at a specific point in time; until all claims are closed, any calculation of ultimate losses is an estimate.