



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

Insurance Division

May 29, 2012

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

Re: NCCI 2011 Rhode Island Advisory Loss Cost Filing

Dear Ms. Hall:

On November 18, 2011, NCCI made a filing requesting an overall increase in advisory loss costs of 6.4% effective June 1, 2012. After careful review and analysis of the filing and all supplemental material provided, the Department finds that an overall increase of 5.2% is supported and is hereby approved. Further discussion of the process is included below.

Implemented with NCCI's 2008 filing, the Rhode Island Department of Business Regulation ("the Department") adopted a procedure to allow for input from the Attorney General and the public. Consistent with the last NCCI filing, the Department collected comments from interested parties and the public. The goal of this procedure is to obtain public input while at the same time reducing costs, increasing timeliness and efficiency. On January 18, 2012, the Department issued an email to NCCI setting forth the review process and proposed timelines for soliciting public comment and discovery requests. Both the Attorney General and Beacon Mutual Insurance Company ("Beacon Mutual"), who each indicated interest in commenting in the past, were copied on the letter. The Department granted a request of the Attorney General to extend the proposed timelines to accommodate availability of the Attorney General's actuarial expert.

The Department posted a notice on its website soliciting public comment on the filing. The Attorney General conducted discovery concerning the filing, including a data request to NCCI, and provided the Department with written recommendations on March 26, 2012. NCCI responded to those recommendations on April 2, 2012. Beacon Mutual, who had received all communications in this matter, did not offer public comment. The Attorney General provided additional comments in response to NCCI's on April 9, 2012. NCCI provided final comments on April 9, 2012. No other comments were received.

The Attorney General raised five issues that are discussed in detail below. If all five issues were accepted, the Attorney General would recommend rejection of NCCI's proposed average loss cost increase of 6.4% and approval of loss costs with a proposed average increase of 1.7%. NCCI does not agree with these issues raised by the Attorney General and counters with its position that the methods and values utilized in the filing are reasonable and actuarially sound,

the methods have been previously approved by the DBR, and the proposed loss cost level is appropriate for Rhode Island.

The issues raised by the Attorney General and considered by the Department, and the findings determined with regard to this filing are as follows.

Selected Premium Development Factors

The Attorney General argues that NCCI’s selected premium development factors are inadequate. The Attorney General recommends that the Department require NCCI to use alternative premium development factors, reducing the proposed average increase in loss costs from 6.4% to an average increase of 6.0%.

NCCI’s methodology for selecting premium development factors is to use the average of the latest three premium development factors. The Attorney General proposes to use the average of the premium development factors for the latest five years excluding the highest and lowest points. The Attorney General argues that this methodology will provide a more stable result by excluding large outliers, and that this methodology will also make the premium development factors methodology consistent with the approved methodology for selecting loss development factors. NCCI disagrees, stating “maintaining a consistent methodology through varying economic conditions produces a more stable result in the long term,” and “different forces contribute to premium development and loss development, there is no specific actuarial reason that the averaging procedures for determining those two components should be the same.”

Ratemaking is a balance between consistency and responsiveness. The Department finds the responsiveness of NCCI’s methodology for premium development desirable and does not find the Attorney General’s arguments regarding the stability of a revised methodology compelling enough to overcome such a finding. In addition, we find no justification to prohibit a different methodology for premium versus loss development factor selection.

Selected Indemnity 19th-Ult. LDF Adjustment for the Impact of the 1992 Benefit Reform Legislation

The Attorney General argues that NCCI’s selected indemnity 19th to ultimate paid loss development factor is excessive. The Attorney General recommends instead that the Department require NCCI to adjust the Indemnity Unlimited Paid+Case to Incurred Including IBNR Ratio by 50%, reducing the proposed average increase in loss costs from 6.4% to an average increase of 6.2%. The Attorney General argues that while NCCI’s selected indemnity loss development factors include adjustments to recognize that paid losses, case reserves, and development beyond the 19th report would be expected to change as a result of the reform, NCCI does not make a similar adjustment for IBNR reserves. NCCI does not believe that IBNR reserves would be expected to change as a result of the reform.

The Department finds that NCCI's prior approved method for dealing with 1992 reform legislation is reasonable and is reasonably applied. The Attorney General raised the same issue concerning NCCI's 2008 rate filing. In its 2008 decision, the Department made the following statement: "We believe the AG's argument is flawed since it relies on extremely old loss development factors in its comparison to post reform factors. If the comparison is restricted to the last five years prior to the reform, NCCI's adjustment factor of .500 seems not only reasonable, but possibly too low." The Attorney General raised no new issues this year that would change the Department's decision from 2008.

Selected 19th-Ult. Loss Development Factors

The Attorney General argues that NCCI's selected 19th to ultimate indemnity and medical loss development factors are excessive. The Attorney General recommends that the Department require NCCI to use alternative loss development factors, reducing the proposed average increase in loss costs from 6.4% to an average increase of 5.8%.

The Attorney General proposes that an adjustment be made to the indicated 19th to ultimate loss development factors in consideration of the AG's consultant's opinion that the ratio of paid+case/incurred including IBNR is unreasonable. The Attorney General recommends that NCCI utilize the judgmental selections of the AG's consultant. NCCI disagrees with making such adjustments as it creates an inconsistency between the IBNR reflected in the incurred tail and that included in the paid+case/incurred ratio.

The Department finds that NCCI's prior approved method for selecting the 19th to ultimate loss development factors is reasonable and is reasonably applied. In NCCI's 2006 rate filing hearing, the Attorney General also requested that the Department defer to the AG's consultant's opinion on the tail factor selections rather than rely on the direct calculations of NCCI. In its 2006 decision, the Department was not persuaded by the Attorney General's argument that its consultant's judgmental selections were more reasonable than NCCI's methodology based on actual data. The Attorney General raised no new issues this year that would change the Department's decision from 2006.

Selected Factor to Adjust Limited Losses to an Unlimited Basis

The Attorney General argues that NCCI's selected factor to adjust limited losses to an unlimited basis is excessive, resulting in excessive loss costs. The Attorney General recommends that the Department instruct NCCI to immediately discontinue use of this factor in Rhode Island. This change by itself lowers the proposed average increase in loss costs by 2.1% from an average increase of 6.4% to an average increase of 4.3%.

In prior filings, the Attorney General has disagreed with the inclusion of the "Large Loss Limitation" process utilized by NCCI. NCCI introduced this process to remove undesirable fluctuation in average loss costs due to a single very large claim. Since 2005, NCCI's loss cost filings have incorporated a large loss methodology, whereby actual losses in excess of a

specified dollar threshold are removed from the experience, and replaced by a provision representing expected losses in excess of the threshold, i.e., the statewide excess ratio. The large loss methodology has not changed from previous filings approved by the DBR. The following issues have been raised by the Attorney General:

1. The Attorney General asserts that NCCI's methodology is flawed because NCCI relies on Financial Call data that is not consistent with the Workers Compensation Statistical Plan ("WCSP") data. NCCI recognizes that there are inconsistencies in the data sources. These inconsistencies include: a) large deductible policies are included in the WCSP data but are not included in the financial data calls; b) carriers that are in run-off or who have otherwise gone out of business are not required to submit financial data calls; and c) there can be differences due to the timing of the evaluation of the financial data calls versus the WCSP reports. However, NCCI needs to use individual loss data in its large loss limitation procedure and this level of loss detail is only available in the WCSP. Although this item presents a new argument from the Attorney General, the Department agrees with NCCI's methodology.
2. The Attorney General noted that NCCI's proposed provision for large losses was larger than the amount of large losses eliminated from the actual developed ultimate losses. The Attorney General presented the same argument in the prior filing for 2011 rates. NCCI previously stated: "The level of actual paid excess losses in the most recent policy years would be expected to be very low relative to the magnitude of the excess loss provision, which reflects a provision for losses at their full ultimate value." The large loss provision is based on an average, therefore actual developed losses for some years will be larger than the average and others will be less. In most years there will be no large losses, so the average provision placed in the rates will be greater than actual experience. However, in the few years where there is a large loss, the average provision will be less, potentially far less. The Attorney General raised no new argument this year that would change the Department's decision from 2011.
3. The Attorney General raised the issue of the volatility of Rhode Island's large loss experience due to the state's size. The Attorney General raised this same issue of the volatile nature of Rhode Island's large loss experience in the prior filing for 2011 rates. NCCI previously replied "NCCI's calculations recognize that not all states have sufficient volume to be fully credible. When calculating the excess ratios, state specific data is augmented with countrywide data in the calculations of the average severities and in the excess loss curves." The Attorney General raised no new argument this year that would change the Department's decision from 2011.
4. The Attorney General argued that the large loss limitation is unnecessary, stating that if this procedure were removed, any large loss would be excluded from the selected loss development factors because the excluding high/low methodology would exclude that LDF. 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 loss development factors. Loss development factors are influenced by many elements,

including claim reporting patterns and case reserve adequacy. Large losses can increase or decrease loss development factors depending on their timing. Even if loss development factors could be smoothed of the large loss influence, the large losses would still enter into the loss database so a large loss procedure is still necessary. The Attorney General raised no new argument this year that would change the Department's decision from prior years.

5. The Attorney General contends that there is redundancy between the excess charge utilized in the large loss methodology and the provision for catastrophes and terrorism. NCCI stated that these provisions are intended to cover different loss exposures. 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 so NCCI calculates a separate load for each of them. Although this item presents a new argument from the Attorney General, the Department agrees with NCCI's methodology.

Although the Attorney General presented two new arguments this year, the Department finds that NCCI's methodology for dealing with large losses is reasonable, and is reasonably applied.

Selected Allowance for Loss Adjustment Expense (LAE)

The Attorney General disagrees with NCCI's selection of an 18.7% allowance for LAE. The Attorney General recommends instead that the Department require NCCI to use an allowance for LAE of 17.5%. This change by itself lowers the proposed average increase in loss costs by 1.2% from an average increase of 6.4% to an average increase of 5.2%.

The allowance for LAE in loss costs is measured as a percent of expected losses. LAE has two components: Defense and Cost Containment Expense (DCCE) and Adjusting and Other Expense (AOE). NCCI is proposing an AOE component of 7.5% of expected losses, and a DCCE component of 11.2% of expected losses, resulting in a decrease of the allowance for LAE from 18.85% to 18.7%.

The Attorney General argues that NCCI's data shows a pattern of overstating the ratio of DCCE to losses at its first valuation, and that these estimates are lowered after having been used in the Rhode Island loss costs filings. NCCI disagrees and contends that use of a three-year average provides appropriate stability and a reasonable result.

In its prior decision, the Department wrote, "The Attorney General has not convincingly demonstrated that the downward movement in LAE ratios for 2006-2008 that occurred this year will definitely occur again next year for what will be the latest three years at that time (namely 2007-2009). On the other hand, the Department is concerned that the latest three years, which are the principal basis for calculating the LAE ratio did exhibit the downward movement year on year."

In its prior decision, the Department directed NCCI to provide additional analysis of the historical development of the DCCE and AOE ratios, including retrospective analysis of calculated ratios and whether or not there are biases in the methodology in its next filing. NCCI did not provide this additional analysis in the current filing.

The following table displays the change in the LAE ratios for all available periods between NCCI's prior and current filings.

	(1)	(2)	(3)	(4)
Year	Accident Year Developed LAE Ratio from NCCI's 2010 Filing	Accident Year Developed LAE Ratio from NCCI's 2011 Filing	Change (2) - (1)	% Change (3) / (1)
2006	19.0%	18.6%	(0.4%)	(2.1%)
2007	19.5%	19.1%	(0.4%)	(2.1%)
2008	19.5%	19.0%	(0.5%)	(2.6%)
2009	21.3%	19.6%	(1.7%)	(8.0%)

In recognition of the apparent trend at this single point in time, we again request that NCCI provide a more detailed examination of this phenomenon in its next rate filing. In light of NCCI's failure to provide the requested additional analysis, the Department accepts the methodology proposed by the Attorney General and directs NCCI to use this methodology for determining the proposed LAE provision of 17.5%.

Indicated Loss Cost Change for F- Classifications

As a result of NCCI's selection of an 18.7% allowance for LAE, the Attorney General disagrees with NCCI's proposed allowance for LAE in "F" classifications as being excessive. NCCI uses the same allowance for LAE in determining "F" classifications loss costs as it does for determining loss costs for all other classifications. The Attorney General requests that the Department require NCCI to utilize a 17.5% allowance for LAE when calculating "F" classification loss costs. NCCI does not advocate a different LAE allowance for F-Classifications.

With a 17.5% allowance for LAE, the average change in "F" classifications loss costs changes from a 7.7% decrease to an 8.6% decrease.

Conclusion

The Department hereby approves an overall increase in advisory loss costs of 5.2% for use in Rhode Island beginning June 1, 2012, consistent with the discussion in this correspondence. NCCI is hereby directed to make a compliance filing consistent with this approval no later than June 1, 2012, or to request a revised effective date. NCCI shall issue a Circular advising member insurers to notify the Department no later than June 30, 2012 of its intention to adopt NCCI's

advisory loss costs along with proposed loss cost multipliers. Any insurer electing to not adopt the 2012 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. Pallozzi

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