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

Insurance Division

April 20, 2011

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 19, 2010, NCCI made a filing requesting an overall increase in advisory loss costs of 3.9% effective June 1, 2011. After careful review and analysis of the filing and all supplemental material provided, the Department finds that an overall increase of 3.6% 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 December 9, 2010, the Department issued a letter 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 1, 2011. NCCI responded to those recommendations on March 8, 2011. Beacon Mutual received all communications in this matter and filed public comment on March 8, 2011 indicating that it supported NCCI's filing. The Attorney General provided additional comments in response to NCCI's and Beacon Mutual's comments on March 15, 2011. NCCI provided final comments on March 15, 2011. No other comments were received.

The Attorney General raised three issues that are discussed in detail below. If all three issues were accepted, the Attorney General would recommend rejection of NCCI's proposed average loss cost increase of 3.9% and, approval of loss costs with a proposed average decrease of -0.6%. NCCI does not agree with the three 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 Annual Medical Trend Factor

The Attorney General argues that NCCI's selected annual medical trend factor of 0.0% is excessive. The Attorney General recommends instead that the Department require NCCI to use the annual medical trend factor of 0.990 (i.e., -1.0%), reducing the proposed average increase in loss costs from 3.9% to an average increase of 2.2%.

The medical trend factor has two components: Medical Claim Frequency Trend (number of claims) and Medical Claim Severity Trend (cost per claim). The Attorney General argues that NCCI does not display in its filing what it has calculated as the appropriate medical claim frequency and claim severity trends. Instead, the Attorney General believes NCCI arbitrarily selects a combined annual medical trend of 0.0%.

NCCI indicates that its selection was not arbitrary. NCCI states that in order to determine medical trend it reviewed the results of several different trend projections including various policy year and accident year estimates, using both loss ratios and separate projections of claim frequency and severity. NCCI also gave consideration to the latest data available. The NCCI data presented indicates that while claim frequency continues to decline in Rhode Island, the most recent accident year shows the decline may be moderating. Additionally, medical claim severity in the latest year has increased significantly. Combining the frequency and severity, the filing shows the projected medical loss ratio for accident year 2009 at its highest level since policy year 2003. Based on this information, NCCI does not believe it is reasonable to expect that trends for the proposed policy period will be lower than the current approved trend.

The Attorney General recommends that the unweighted average of the medical claim frequency trends based on the latest 5, 6 and 7 policy years (-4.3% as displayed in column (b) of AG Exhibit A, Schedule 1 (b)) be the selected annual claim frequency trend. The Attorney General recommends that the unweighted average of the trends based on the latest 5, 6 and 7 policy years (3.5% as displayed in column (d) of AG Exhibit A Schedule 1(b)) be selected for annual medical claim severity trend. Combining the Attorney General's medical frequency trend of -4.3% and the recommended medical severity trend of 3.5% results in the Attorney General's recommended annual medical trend factor of 0.990 (i.e., -1.0%). As noted above, the average change in loss costs using the medical trend factor of 0.990 decreases the proposed increase from 3.9% to an increase of 2.2%.

NCCI argues that the Attorney General's recommendation relies solely on "goodness of fit" as justification for a medical trend of -1.0%. "Goodness of fit," by itself, is not a guarantee of predictability of the model. NCCI argues there is no actuarial basis to support the Attorney General's recommendation that "trends relying less on older data are more likely to produce a reasonable estimate of the future change in costs".

Moreover, the Attorney General recommends changing the trending methodology only for the medical losses. The effect of changing the medical trend period from 8-years to 7-years reduces the overall indicated medical trend by 0.3% (frequency is reduced by 0.4% while severity is increased by 0.1%). If the Attorney General's recommended methodology was also applied to the indemnity losses, the indemnity trend would increase by 0.7% (frequency would also be reduced by 0.4% while the severity would increase by 1.1%). The Department finds the stability of the NCCI methodology desirable and does not find the Attorney General's arguments regarding the responsiveness of a shorter trend period compelling enough to overcome such a finding. In addition, we find no justification to utilize a different methodology for medical versus indemnity trend.

<u>Selected Allowance for Loss Adjustment Expense (LAE)</u>

The Attorney General disagrees with NCCI's selection of 19.1% allowance for LAE. The Attorney General recommends instead that the Department require NCCI to use the allowance for LAE of 18.6%. This change by itself alters the proposed average increase in loss costs by – 0.5% from an average increase of 3.9% to an average increase of 3.4%.

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 no change to the AOE component (7.8% of expected losses). NCCI is proposing an increase in DCCE component from 11.0% to 11.3% of expected losses, and thus, the allowance for LAE from 18.8% to 19.1%.

The Attorney General argues that the countrywide ratio of LAE to loss by calendar year for a ten-year period shows that only once in those ten years has the LAE ratio exceeded 19% (in 2006). The latest three-year average based on Annual Statement Insurance Expense Exhibit (IEE) data is 18.2%, and latest 5-year average is 18.4%. The Attorney General argues that the IEE data does not support increasing the Rhode Island allowance for LAE to NCCI's proposed 19.1%. The Attorney General recommends that 12.0% be selected as the countrywide ratio of DCCE to loss in lieu of NCCI's 12.7%. The Attorney General argues that 12.0% is appropriate because the substitution recognizes that the developed DCCE to loss ratios for the most recent accident years are likely to be lower when recalculated next year, just as happened this year for years 2006-2008. This change results in the Attorney General's recommended allowance of LAE of 18.6%.

NCCI argues that its methodology for determining the proposed LAE provision is unchanged from that used in the previous three filings approved by the Department. Recognizing that circumstances of each filing need to be considered, NCCI's proposed LAE is derived from the most recent accident year data submitted to NCCI through Financial Data Call 19. The provision contained in the filing reflects the average of the latest two accident years.

The following table displays the changes in developed LAE from NCCI's prior filing. Although the latest three years as selected by the Attorney General are decreasing, all of the prior years are increasing or flat. Based on this, we cannot conclude that there is a bias in the selection process. However, we do have some concerns regarding the latest three years that underlie the calculation of the selected LAE provision.

Year	(1) Accident Year Developed LAE Ratio from NCCI's 2009 Filing	(2) Accident Year Developed LAE Ratio from NCCI's 2010 Filing	(3) Change (2) - (1)	(4) % Change (3) / (1)
2000	15.8%	16.0%	0.2%	1.3%
2001	16.4%	16.6%	0.2%	1.2%
2002	17.1%	17.2%	0.1%	0.6%
2003	18.1%	18.2%	0.1%	0.6%
2004	17.7%	17.8%	0.1%	0.6%
2005	18.7%	18.7%	0.0%	0.0%
2006	19.2%	19.0%	-0.2%	-1.0%
2007	19.9%	19.5%	-0.4%	-2.0%
2008	20.1%	19.5%	-0.6%	-3.0%

NCCI argues that each year's analysis takes a fresh look at the loss development factors resulting from the latest evaluations. NCCI acknowledges that the projected DCCE ratios for some years are slightly lower than projected for those same years in NCCI's previous filing, yet there is nothing inherent in the methodology to suggest that the projections will continue to decrease. Further, NCCI notes that, more importantly, the indications for the latest several years show that the ratio of DCCE/loss is increasing. NCCI notes that with the significant reductions in claim frequency that have occurred in the last several years, losses have been decreasing at a greater rate than DCCE.

NCCI notes that the Attorney General's DCCE ratio would actually result in a lower LAE provision than is currently approved and finds that in light of the countrywide data, this doesn't appear reasonable or actuarially sound. NCCI also notes that the display of numbers in the Insurance Expense Exhibit (IEE) are purely informational and not comparable to filed provisions. NCCI states that IEE are calendar year numbers, and the proposed provision is the accident year result intended to cover LAE needed for the proposed policy period.

The Department believes that 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. Therefore, the Department will require NCCI to use the average of it's own provision of 19.1% and the Attorney General's provision of 18.6%.

The results are displayed in the Table below:

	NCCI's Filing	AG's Proposal	Average of NCCI & AG
Selected Loss Adjustment Expense Allowance	19.1%	18.6%	18.85%
Indicated Loss Cost Level Change	3.9%	3.4%	3.6%
Change from NCCI's Initial Filing	0.0%	-0.5%	-0.3%

In addition, NCCI is directed in its next filing to provide additional analysis on 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. If the calendar year data is not used, NCCI should explain why it is included in the filing.

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 alters the proposed average increase in loss costs by – 2.4% from an average increase of 3.9% to an average increase of 1.5%.

In prior filings the Attorney General has disagreed with the inclusion of the "Large Loss Limitation" process utilized by the 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 noted that the NCCI's proposed provision for large losses was larger than the amount of large losses eliminated from the actual developed ultimate losses. This same situation occurred in the prior filing where the issue was discussed and resolved.

2. The Attorney General questioned the credibility of using Rhode Island experience due to the state's size. This same issue of the volatile nature of Rhode Island's experience was discussed and resolved in the prior filing.

3. The Attorney General displayed the ratio of paid to date losses to ultimate developed losses by state for recent policy years and argued that this ratio was lower than NCCI's proposed large loss provision. This same issue was discussed and resolved in last year's filing.

4. The Attorney General displayed the ratio of paid losses to premium by state for recent policy years and argued that this ratio was lower than NCCI's proposed large loss provision. This is the same analysis as above, with the denominator of ultimate developed losses being replaced by premium.

5. The Attorney General asserts that NCCI's methodology is flawed because policy year 2005 excess losses that were reported in NCCI's prior filing for Arkansas were not reported this year. NCCI explained that policy year 2005 Arkansas experience was not used in its current filing and that the Attorney General's assumed decrease in experience was therefore erroneous.

6. The Attorney General provided a table demonstrating that claims classified as "Permanent Total Disability Claims" are increasing for the later policy years. NCCI explained that a problem with Beacon Mutual's reporting of permanent total disability claims has been corrected. As in prior years,

the Department finds that NCCI's method for dealing with large losses is reasonable, and reasonably applied. The Attorney General raises no new issues that would change that outcome.

Conclusion

The Department hereby approves an overall increase in advisory loss costs of 3.6% for use in Rhode Island beginning June 1, 2011, consistent with the discussion in this correspondence. NCCI is hereby directed to make a compliance filing consistent with this approval no later than May 2, 2011. NCCI shall issue a Circular advising member insurers to notify the Department no later than June 10, 2011 of its intention to adopt NCCI's advisory loss costs along with proposed loss cost multipliers. Any insurer electing to not adopt the 2011 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