

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
DEPARTMENT OF BUSINESS REGULATION  
233 RICHMOND STREET  
PROVIDENCE, RHODE ISLAND 02903**

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**IN RE: NCCI Loss Costs and Rating Values  
Workers' Compensation**

**DBR No. 05-I-0175**

**(Filed September 9, 2005)**

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**DECISION**

**I. INTRODUCTION**

The above-entitled matter came before the Department of Business Regulation ("Department") as the result of proposed revisions to the Workers' Compensation Loss Costs and Rating Values submitted by the National Council on Compensation Insurance ("NCCI") on September 9, 2005 ("Filing"). The Filing requested approval of a reduction of the overall advisory loss costs level for Industrial Classifications by two and three tenths percent (-2.3%),<sup>1</sup> and an increase in the advisory loss costs level for "F" Classifications of two and eight tenths percent (+2.8%). "Loss costs" as defined in this Filing include loss based expenses (also known as "loss adjustment expenses").

An Order appointing Elizabeth Kelleher Dwyer and Paula M. Pallozzi as Co-Hearing Officers and Joel S. Chansky, FCAS, MAAA as the Department's consulting actuary was issued on September 9, 2005. The September 9, 2005 Order further joined Beacon Mutual Insurance Company ("Beacon") as a party to these proceedings requiring that Beacon "...appear by counsel at the initial prehearing and ...fully participate in the hearing

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<sup>1</sup> This is the average decrease. NCCI files advisory loss costs by "class codes" in which the loss costs vary by the type of business in which the insured is engaged. For each class code, NCCI has proposed specific

providing the Department with all information relevant to the evaluation of the NCCI filing.”

An initial prehearing conference was held on September 20, 2005. The Hearing Officers ordered that discovery be completed and Motions to Intervene filed no later than November 2, 2005, that alternative rate calculations be filed by November 9, 2005 and that the public hearing be held on November 16, 2005.

Beacon filed an Objection to Order Requiring Joinder of Beacon Mutual Insurance Company as Party to Rate Hearing on October 25, 2005. The Hearing Officers entered an Order denying Beacon’s motion on November 5, 2005. Beacon appealed this Order to the Providence County Superior Court. After briefing of the parties and oral argument, on November 22, 2005 the Providence County Superior Court entered an Order upholding the Department’s Joinder of Beacon. Beacon thereafter filed a Writ of Certiorari with the Rhode Island Supreme Court. At a conference with the Supreme Court duty judge, the Department was informed that if the Writ were granted, the Supreme Court would likely enter an Order staying the entire NCCI proceeding. Recognizing that the Filing represented an overall decrease in advisory loss costs, the Department determined that such an Order could adversely affect Rhode Island employers and, therefore, decided to withdraw the Joinder of Beacon in these proceedings. An Order to that effect was entered on December 1, 2005.<sup>2</sup>

The public hearing on the Filing was scheduled for November 16, 2005. The Notice of Public Hearing was published in the *Providence Journal* on October 14, 2005, in

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advisory loss costs, as well as average percentage changes for the five corresponding industry groups. The largest decrease for an individual class in the proposal is –30.5% and the largest increase proposed is 27%.

<sup>2</sup> The Order further required that Beacon file its own rate case on or before January 16, 2006 or adopt the then approved NCCI loss costs. The Order was amended on December 7, 2005 after conference with the Rhode Island Supreme Court duty judge to omit the reference to adoption of the NCCI loss costs. The omitted portion of the Order was entered as a separate Order of the Director solely involving Beacon.

accordance with R.I. Gen. Laws § 27-7.1-5.1. A joint motion was filed to continue the public hearing due to the adverse effect that the hurricanes in Florida had on NCCI's ability to fully prepare for the proceeding.<sup>3</sup> The Department ordered that the proceeding would be opened on November 16, 2005 for the taking of public comment and would thereafter be continued until December 14, 2005. The Department noted this along with the public notice posted on its website.

Both NCCI's time to respond to discovery and the Attorney General's time to file a statement pursuant to Insurance Regulation 39(9)(b) were continued from the dates set at the prehearing. The Attorney General filed a statement of Areas of Disagreement and Alternative Rate Calculations pursuant to Insurance Regulation 39(9)(b) on December 9, 2005. The Attorney General took issue with five (5) areas of NCCI's methodology and recommended an average decrease in loss costs of ten and three tenths percent (-10.3%) with the exception of "F" Classifications, which the Attorney General recommended be decreased ten and six tenths percent (-10.6%).

NCCI submitted Exhibits 1 through 31 at the hearing, all of which were admitted into evidence without objection. Subsequent to the hearing, NCCI submitted a response to a request for information made by the Department during the hearing that was marked as NCCI Exhibit 32. The Attorney General submitted AG Exhibits A through J, all of which were admitted into evidence without objection.

No member of the public appeared at the hearing to offer public comment and no written public comment was received.

## **II. JURISDICTION**

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<sup>3</sup> NCCI is headquartered in Boca Raton, Florida.

The Department has jurisdiction over this matter pursuant to R.I. Gen. Laws § 27-7.1-5.1, R.I. Gen. Laws § 27-9-10, R. I. Gen. Laws § 42-14-1 *et seq.*, and R.I. Gen. Laws § 42-35-1 *et seq.*

### **III. ISSUES**

1. In determining advisory loss costs, should the loss development factors based on the latest 5 factors excluding the high and low values as filed by NCCI be accepted or modified?
2. Should there be an additional adjustment to loss development factors to reflect the statutory reforms made in 1992?
3. Should the “trend” utilized by NCCI be accepted or modified?
4. Should the large loss limit factor utilized by NCCI be accepted or modified?
5. Should the experience modification offset used by NCCI for “F” Classifications be accepted or modified?

### **IV. MATERIAL FACTS AND TESTIMONY**

NCCI is a “rating organization” licensed by the Department pursuant to R.I. Gen. Laws § 27-9-22. Carriers licensed to write workers’ compensation insurance in Rhode Island have the option of “adopting” the loss costs and/or rates approved by the Department for NCCI rather than making their own individual rate filings with the Department.

In 2004, NCCI filed to decrease advisory loss costs by an average of eighteen and three tenths percent (-18.3%). A full hearing was held and on December 30, 2004 a Decision was issued approving an overall decrease of twenty and two tenths percent (-20.2%).

As mentioned above, the NCCI Filing under consideration requests an average decrease in loss costs for Industrial Classifications of two and three tenths percent (-2.3%) and an increase in loss costs for “F” Classifications of two and eight tenths percent (+2.8%). The Attorney General’s recommendation is a decrease in loss costs for Industrial Classifications of ten and three tenths percent (-10.3%) with the exception of “F” Classifications, which the Attorney General recommended be decreased ten and six tenths percent (-10.6%). The difference for the Industrial Classifications (where Industrial Classifications are defined as all classifications excluding “F” Classifications) is based upon four (4) differences between the methodology and/or assumptions used in NCCI’s calculations and the methodology and/or assumptions proposed by the Attorney General. The difference with respect to the “F” Classifications is based upon two (2) differences between the methodology and/or assumptions used in NCCI’s calculations and the methodology and/or assumptions proposed by the Attorney General. The Department has carefully reviewed all methodology, assumptions, and calculations in the remainder of the Filing and has determined that no other adjustments are warranted at this time. The Attorney General agreed with all other aspects of the Filing. Therefore, the following discussion is limited to the four (4) areas of contention set forth by the Attorney General for the Industrial Classifications, and the two (2) areas of contention for the “F” Classifications.

In support of its position, NCCI offered the testimony of Carolyn Bergh, ACAS, MAAA.<sup>4</sup> In support of its position, the Attorney General offered the testimony of Anthony Grippa, FCAS, MAAA.

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<sup>4</sup> NCCI also offered the testimony of Laura Hall, NCCI state relations executive of Rhode Island. Ms. Hall’s testimony did not relate to any of the issues noted above to be in controversy in this matter and will not, therefore, be recounted in this decision.

## **Selection of Loss Development Factors**

In the discussion of estimating loss costs and changes in loss costs, the concepts of stability and responsiveness were addressed (Transcript of hearing of December 14, 2005, page 16). With respect to loss development factors, NCCI's approach is geared more towards stability and assumes that high or low factors represent random fluctuations. NCCI utilized the average of the latest 5 years excluding the highest and lowest values for loss development factors for each of indemnity and medical. NCCI testified that there is volatility in the data and that there is a relatively limited volume of data in Rhode Island (Transcript of hearing of December 14, 2005, pages 36-37). When asked about the apparent downward movement in indemnity loss development factors, NCCI testified that if this is actually a trend and not random fluctuation, a five year average excluding the highest and lowest value "will systematically let it work its way into the numbers over time" (Transcript of hearing of December 14, 2005, page 37).

The Attorney General argued for a more responsive approach. Specifically, for indemnity, the Attorney General noted a consistent pattern in the factor, and concluded this was not likely to be random fluctuation. This was supported with a trend calculation on the loss development factors. The Attorney General recommended a time weighted average, giving more weight to the latest factor (a weight of 5) and progressively less weight to the older factors (finishing with a weight of 1 for the oldest factor). NCCI's expert testified that "a responsive methodology would be a three year average not weighting the latest point five times as high as something else." (Transcript of hearing of December 14, 2005, page 92). Further NCCI supplied the Hearing Panel with a summary of approaches taken in other states (NCCI Exhibit 32). For those states where the paid

loss development method is used (both large and small states), virtually all use either a 2 year average or a 3 year average. Only one other state utilizes a latest 5 years excluding high and low average when applied to paid data.

Based on the information provided, the Hearing Panel believes that there is justification for using a more responsive approach to selecting paid loss development factors for indemnity for this Filing. However, the Hearing Panel believes that a 3 year average approach is a better approach than the time weighted average as recommended by the Attorney General since a) there is no precedent for the Attorney General's approach, b) NCCI uses 3 year averages in a number of other states, and c) NCCI testified that a 3 year average would be a "responsive approach". For medical, both NCCI and the Attorney General propose to use the latest 5 years excluding high and low average values and the Hearing Panel accepts this for medical.

The overall change in loss costs moves from -2.3% to -4.2% when substituting the latest 3 year average loss development factors for indemnity. *See Attached Exhibit.*

#### **Additional Adjustment to Loss Development Factors for 1992 Statutory Reforms**

In 2004, NCCI proposed an adjustment to loss development factors to reflect the impact of the 1992 statutory reforms. The proposed adjustment was a factor of 1.015 for indemnity to provide for additional loss development that was not captured in historical data that only reflected pre-reform loss experience. NCCI's proposed factor, all else equal, had the effect of increasing loss costs. While the Attorney General did not dispute this exact point in 2004, the Attorney General and the Hearing Panel did raise some concerns at the hearing and the Hearing Panel did not accept the factor of 1.015. In the current Filing, NCCI is not proposing such an adjustment. However, the Attorney

General is proposing an adjustment for indemnity and medical. The Attorney General's adjustments have the effect of decreasing 11<sup>th</sup>-ultimate loss development factors, and hence, decreasing loss costs. The Hearing Panel has now heard arguments in consecutive years, on the same topic, from different parties – one party testifying that the data suggests an increase in loss costs, and the other party testifying that the data suggests a decrease in loss costs.

The Attorney General's argument was conceptually based on the belief that the 1992 statutory reforms have “reduced the duration of indemnity benefits when people are injured” (Transcript of hearing of December 15, 2005, page 18). Specifically, the Attorney General testified that he believed that the 1992 statutory reforms have “reduced the frequency of instances where a person is injured and then receives workers' compensation benefits for periods in excess of 12 years, including through lifetime” (Transcript of hearing of December 15, 2005, page 17). The Attorney General supported his argument with claim frequency statistics showing large decreases in the number of permanent disability claims in Rhode Island for years immediately following the reforms.

NCCI testified that claim counts by injury type (death, permanent total disability, permanent partial disability, temporary total disability, medical only) were not necessarily being recorded in a consistent manner. Specifically, NCCI testified that they, too, noticed an apparent decrease in permanent disability claims and they “contacted some carriers to try and investigate what was going on” (Transcript of hearing of December 14, 2005, page 36). NCCI learned that “regardless of whether the injured worker had a permanent or a partial injury, they were reporting everything as temporary” (Transcript of hearing of December 14, 2005, page 36). This, in turn, was creating an

increase in temporary claims. Essentially, NCCI argued that serious injuries were still occurring, but they were not being classified the same way as they were pre-reform.

The Hearing Panel asked the Attorney General questions about the data, information, and methodology associated with analyzing this complex issue. When asked what data might be used if there were no constraints on time or availability of data, the Attorney General indicated that NCCI's detailed claim information core, which tracks claims for a longer period of time, would have been a preferable data source. The Attorney General further testified that this data source "did not occur to me, unfortunately, until a couple of days ago. I had forgotten about it." (Transcript of hearing of December 15, 2005, page 39).

The Hearing Panel also asked the Attorney General about using excerpts from Beacon Mutual's financial statements to calculate post reform loss development factors. These excerpts of Beacon Mutual's financial statements were submitted by the Attorney General in support of the proposed adjustment for the impact of the 1992 statutory reforms. The Attorney General responded that it didn't occur to him at the time but that it would be "an interesting step of arithmetic" (Transcript of hearing of December 15, 2005, page 58).

Finally, the Hearing Panel asked if it was hypothetically possible for this adjustment to loss development factors to be positive (i.e., a factor that increases loss costs), as argued by NCCI in 2004. The Attorney General indicated that it "would be a possibility, but highly unlikely" (Transcript of hearing of December 15, 2005, page 49).

The Hearing Panel believes that an adjustment to loss development factors to reflect the 1992 statutory reforms is a valid item to consider. One of the goals of the

1992 statutory reforms was to reduce the duration of workers' compensation claims in Rhode Island, and intuitively, this should result in lower loss development factors, especially as time passes (in this Filing, in the 11<sup>th</sup>-ultimate loss development factors). However, based on the testimony provided related to claim counts and other data sources that were not used/considered, the Hearing Panel is not convinced that the approach used by the Attorney General is properly quantifying the magnitude of adjustments to the loss development factors. Also, while some adjustment may be merited for indemnity, it is not clear why an adjustment would be required for medical.

The Hearing Panel has decided to reject the Attorney General's proposed adjustments to reflect the impact of the 1992 statutory reforms on loss development factors. The Hearing Panel further recommends that this issue be more fully studied and addressed in NCCI's next loss cost filing.

### **Selection of Indemnity and Medical Trends**

Regarding trends, both NCCI and the Attorney General presented strong arguments in support of their selected trend factors for each of medical and indemnity. NCCI filed for annual trends of 0.0% and +1.5% for indemnity and medical respectively, while the Attorney General is recommending annual trends of -1.3% and +0.7% for indemnity and medical respectively.

NCCI reviewed a variety of statistics, including loss ratio trends, and separate frequency and severity trends (the components of the loss ratio trends). NCCI also reviewed policy year and accident year data, including accident year 2004. NCCI testified that the 2004 accident year can be "thought of as an early indicator" (Transcript of hearing of December 14, 2005, page 25) and that the use of accident year data

influenced their judgmental selections of trend factors. While the selected trend factors were higher than those indicated by the statistical tests/results displayed in their Filing, NCCI pointed out that the selected values were in line with other tests/results that were reviewed (Transcript of hearing of December 14, 2005, pages 82-83).

The Attorney General's position on trend is that it is inconsistent to introduce accident year data into a filing that otherwise relies on policy year data (Transcript of hearing of December 14, 2005, pages 130-131). When pressed on the issue of introducing additional information that post dated the data in the Filing, the Attorney General conceded that "it should certainly be taken into consideration" on the premise that this new information was credible (Transcript of hearing of December 15, 2005, page 60). Further, the Attorney General expressed some concern over the consistency of the wage data used by NCCI to decompose the loss ratio trends into the underlying frequency and severity components. The Attorney General's conclusion was to use only loss ratio statistics and create an average of 5, 6, 7, and 8 year/point trends, weighted by the corresponding R-Squared/goodness of fit factors. NCCI questioned the weighting approach and whether the R-Squared figures indicated poor fits. The Attorney General testified that in cases of poor fits, these values got low weights. The Hearing Panel noted that for medical, the highest value among the four R-Squared values was .352, which does not represent a statistically good fit of the trend calculation to the underlying data. However, since this was the "best" of the four methods (5, 6, 7, and 8 year/point trends), it ended up getting 57.5% of the weight.

The Hearing Panel appreciated the efforts that both sides put into the difficult area of selecting trends. Based on the information presented, the Hearing Panel is persuaded

that the NCCI selected trends should be accepted. NCCI's selected trends incorporated later, more responsive data and information, and is preferable, under these circumstances, to the Hearing Panel. Also, the Attorney General's trend calculations for medical produced low R-Squared values and did not appear to the Hearing Panel to be an optimal approach for selecting trend factors.

### **Large Loss Limit Procedure**

In 2004, NCCI proposed to add a Large Loss Limit Procedure. The Attorney General agreed with the concept, but rejected the methodology, primarily due to an inconsistency when the method is applied to "paid+case" data. The Department rejected the Attorney General's position on this issue noting that since the "paid+case" data was not being used in the Filing, there was no inconsistency and that the methodology proposed by NCCI had already been approved in twenty-one (21) other states. In its Decision in DBR No. 04-I-0174 effective December 30, 2004, the Department approved NCCI's proposed Large Loss Limit Procedure.

NCCI is proposing to continue the use of its Large Loss Limit Procedure in this Filing. The Attorney General again criticizes NCCI's methodology and requests that the Large Loss Limit Procedure charge be reduced from one and seven tenths percent (1.7%) to one percent (1%). The 1.7% figure represents NCCI's estimate of what percentage of losses will exceed a predetermined threshold, over the long term. The formula then excludes actual large losses from the data in the Filing, and replaces these with a factor of 1.017 (the 1.7% referenced above).

The Attorney General is not questioning NCCI's estimate of large losses as a percentage of total losses (where the estimate is based on the average of many years of

experience). Instead, the Attorney General is arguing that it is not appropriate to increase loss costs by this full amount. The argument is based on the fact that no losses in Rhode Island (using paid data) were actually limited and that therefore, there is apparently some sort of double counting (i.e., no losses are removed, but a factor is added on). Specifically, the Attorney General testified that there is a gap to be bridged: since losses in the Filing are limited on a paid basis and the large loss adjustment of 1.7% is on an ultimate basis, the large loss adjustment should therefore also be adjusted to a paid basis (Transcript of hearing of December 14, 2005, page 148). As such, the Attorney General proposed a methodology that tempers the large loss factor. Using the Attorney General's approach, this tempering would occur regardless of the magnitude of the large loss factor (Transcript of hearing of December 14, 2005). Finally, NCCI testified that the indicated change in loss costs of -2.3% would be unchanged if the large loss procedure had been removed altogether.

The Hearing Panel has decided to accept NCCI's large loss factor of 1.7%. The factor of 1.7% is applied to ultimate losses, i.e., paid losses, developed to ultimate, limited by the large loss adjustment. The fact that no paid losses had actually been limited does not necessarily invalidate the calculation. The NCCI formula did include an adjustment to the 19<sup>th</sup>-ultimate loss development factor (incurred basis), so there was an adjustment to loss development factors to account for the impact of large losses.

### **NCCI's Filed Charges for "F" Classifications**

NCCI filed for an overall increase of +2.8% for "F" Classifications loss costs. NCCI testified that most of the data used to derive the "F" Classifications loss costs is countrywide data as opposed to data specific to Rhode Island. One exception to this is trend, where NCCI uses trend factors based on Rhode Island data for the Industrial Classifications. The

Attorney General argued that their selected trend factors should be used both for the Industrial Classifications and for the “F” Classifications. Since the Hearing Panel accepted NCCI’s trend factors for the Industrial Classifications, the same trend factors should be used for the “F” Classifications.

The Attorney General also argued that the offset for the anticipated impact of experience modifications should also be Rhode Island specific rather than being based on countrywide data as proposed by NCCI, on the premise that credits for loss experience in other states was not applicable for Rhode Island. The Attorney General testified that there is “no logic in charging Rhode Island F class employers for the level of experience rating credits being provided in Louisiana, Illinois, Florida, etc.” (Transcript of hearing of December 14, 2005, page 152). The Attorney General proposed to use the same experience modification offset of .976 used for the Industrial Classifications. NCCI testified that the value of .976 was based on total Rhode Island data, and included both Industrial Classification data as well as “F” Classification data (Transcript of hearing of December 15, 2005, page 73).

NCCI argued that since the “F” Classifications calculations were based on countrywide data, this adjustment was not appropriate. However, this did not apply to trend, i.e., Rhode Island trend factors were used by NCCI in the “F” Classifications calculations.

The Hearing Panel believes that the Attorney General’s adjustment for the experience rating offset is appropriate. The resulting change in loss cost would be -4.4% derived as follows:

NCCI Filed Change in Loss Costs: +2.8%

Attorney General’s Adjustment:  $(1/.976)/(1/.907) = 1.025/1.102 = .930$

Revised Change in Loss Costs:  $1.028 \times .930 = .956 = -4.4\%$

## V. FINDINGS OF FACT

The Hearing Panel makes the following findings of fact:

1. NCCI has satisfied all regulatory prerequisites with regard to this Filing.
2. With regard to selection of loss development factors, the Hearing Panel concludes that a more responsive approach to selecting paid loss development factors for indemnity should be used. The approach chosen by the Hearing Panel is a 3-year average approach that NCCI agreed would be a “responsive approach”. For medical, the latest 5 years excluding high and low average values as proposed by NCCI and the Attorney General is appropriate.
3. The Hearing Panel recommends that any additional adjustments to loss development factors for 1992 statutory reforms should be more fully studied and addressed in NCCI’s next loss cost filing. However, the Hearing Panel does not accept the Attorney General’s proposed adjustments to reflect the impact of the 1992 statutory reforms on loss development factors at this time.
4. With regard to selection of indemnity and medical trends, the Hearing Panel concludes that the NCCI selected trends should be accepted, in part, because NCCI’s selected trends incorporated later, more responsive data and information, and is preferable under these circumstances.

5. The Hearing Panel accepts NCCI's large loss factor of 1.7% as the factor of 1.7% is applied to ultimate losses, i.e., paid losses, developed to ultimate, limited by the large loss adjustment and the fact that no paid losses had actually been limited does not necessarily invalidate the calculation.

6. With regard to NCCI's filed charges for "F" classifications, the Hearing Panel concludes that the Attorney General's adjustment for the experience rating offset is appropriate.

7. Average reductions in advisory loss costs of -4.2% for Industrial Classifications and -4.4% for "F" Classifications would result in loss costs that are not excessive, inadequate or unfairly discriminatory.

## **VI. CONCLUSIONS OF LAW**

1. The Department has jurisdiction over this matter pursuant to R.I. Gen. §27-7.1-5.1, R.I. Gen. Laws § 27-9-10, R.I. Gen. Laws § 42-14-1 *et seq.*, and R.I. Gen. Laws § 42-35-1 *et seq.*

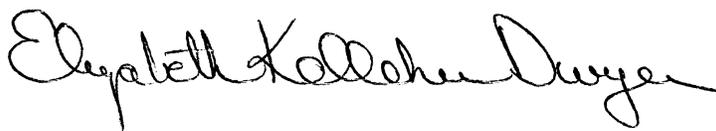
2. Reductions of advisory loss costs by an average of -4.2% for Industrial Classifications and -4.4% for "F" Classifications would result in loss costs that are not excessive, inadequate or unfairly discriminatory.

## **VII. RECOMMENDATION**

Based on the above analysis, the Hearing Officers recommend that

1. Advisory loss costs be approved for NCCI with average reductions of -4.2% for Industrial Classifications and -4.4% for "F" Classifications.

2. NCCI be directed to file a schedule consistent with this Decision by class code and by industry group.



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Elizabeth Kelleher Dwyer  
Hearing Officer

Dated January 5, 2006



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Paula M. Palozzi  
Hearing Officer

Dated January 5, 2006

I have read the Hearing Officer's Decision and Recommendation in this matter, and I hereby

ADOPT  
 REJECT  
 MODIFY

the Decision and Recommendation.



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A. Michael Marques  
Director

Dated: January 5, 2006

**NOTICE OF APPELLATE RIGHTS**

**THIS DECISION CONSTITUTES A FINAL ORDER OF THE DEPARTMENT OF BUSINESS REGULATION PURSUANT TO R.I. GEN. LAWS § 42-35-12. PURSUANT TO R.I. GEN. LAWS § 42-35-15, THIS ORDER MAY BE APPEALED TO THE SUPERIOR COURT SITTING IN AND FOR THE COUNTY OF PROVIDENCE WITHIN THIRTY (30) DAYS OF THE MAILING DATE OF THIS DECISION. SUCH APPEAL, IF TAKEN, MUST BE COMPLETED BY FILING A PETITION FOR REVIEW IN SUPERIOR COURT. THE FILING OF THE COMPLAINT DOES NOT ITSELF STAY ENFORCEMENT OF THIS ORDER. THE AGENCY MAY GRANT, OR THE REVIEWING COURT MAY ORDER, A STAY UPON THE APPROPRIATE TERMS.**