THE ARKANSAS INSURANCE DEPARTMENT

Order 89-44

Workers compensation rate filing by the national council on compensation insurance

October 9, 1989

On the 15th day of August 1989, a hearing commenced in the hearing room of the Arkansas Insurance Department in the University Tower Building, Little Rock, Arkansas, pursuant to the provisions of Arkansas Code Annotated s 23-67-119 and s 23-61-303, on the matter of the rate filing made by the National Council on Compensation Insurance ("NCCI") seeking approval of an increase in advisory rates for workers compensation insurers in the State of Arkansas. The requested increase was 18.9% in the overall premium level. Also considered was a proposal filed by the NCCI to double the "upset payroll" factors for Class Code 2702 -- Logging or Lumbering and Drivers.

The hearing was held before The Honorable Ron Taylor, Insurance Commissioner for the State of Arkansas. The Petitioner, NCCI, was represented by its attorneys W. H. L. Woodyard, III, and Doak Foster of the firm of Mitchell, Williams, Selig and Tucker. Also present on behalf of the Petitioner were Bruce Spidell, Bob Maxwell, Jim Gerofsky and David Durbin. The Insurance Department was represented by Lee Douglass, Deputy Commissioner and Chief Counsel. Also present were Allyn C. Tatum, Workers Compensation Commissioner, George Harris and Jan Taylor of the Arkansas Workers Compensation Commission.

At the conclusion of the hearing on August 16, 1989, the record in the matter was held open for submission of revised rate pages by the NCCI. Those rate pages were received on September 7, 1989 and record was closed.

Based upon the evidence and testimony received at the hearing the Commissioner finds as follows:

FINDINGS OF FACT

1. The Commissioner has jurisdiction over the Petitioner and the rate filing considered at the hearing.

2. The rate filing was originally made on March 24, 1989, pursuant to applicable provisions of the Arkansas Insurance Code.

3. The filing requested an overall premium level increase of 18.9%, and approval of a 20% premium surcharge applicable to all risks written through the Arkansas Workers Compensation Insurance Plan which develop an annual premium of $3,000 or more.

4. The filing was amended on April 3, 1989, to correct a typographical error, and again on August 11, 1989, to withdraw the portion of the filing pertaining to the 20% surcharge.

5. By letter dated June 14, 1989, the NCCI filed a revision to the upset payroll factors used for Class Code 2702, to double those factors for the "Logging and Lumbering and Drivers" classification.

6. By letter dated April 4, 1989, Allan Schwartz, an independent actuary with AIS Risk Consultants and Assistant Commissioner with the New Jersey Department of Insurance was retained to review the rate filing on behalf of the Arkansas Insurance Department.

7. Timely notice of the referenced hearing was given Petitioner by letter dated July 14, 1989, from Deputy Commissioner Douglass. Said notice was received by the Petitioner on July 18, 1989.

8. The Petitioner is a licensed advisory rate service organization pursuant to A.C.A. s 23-67-101 et seq.

9. The Petitioner used five (5) principal components to promulgate the requested rate increase; changes in experience, trend, general expenses, loss adjustment expenses, and benefits.

10. No increase in the current factor of 2.5% for profit and contingencies was requested by the Petitioner.

11. The independent actuary retained by the Insurance Department developed factors lower than the Petitioner's in all areas other than the benefit change increase. In addition, the actuary found that the current factor used for profit and contingencies should be lowered.

12. Various methodologies are used by actuaries to determine to the experience factors for workers compensation rates.

13. The Petitioner used the total incurred basis for the subject rate filing which includes loss payments, case reserves, and reserves for losses incurred but not reported (INBR).

14. IBNR reserves have increased at a much greater rate than actual paid losses during the period used by the Petitioner to develop the factor included in the subject filing.

15. Use of the total incurred method of loss development results in a higher rate factor than the other methods.

16. The total incurred method of loss development is not the standard method used by the Petitioner to derive experience factors for rate filings in all states in which it files rates.

17. The actuary retained by the Insurance Department averaged three (3) methodologies for determining the experience factor for Arkansas, and retained an appropriate safety factor for insurer insolvency protection.

18. The Insurance Department actuary recommended an increase in the experience factor included in the existing rates of +11.3%.

19. A trend factor is included in the subject rate filing to adjust the rates to compensate for the time lag between the loss data in the filing and losses in the period for which the rates will be in effect.

20. Indemnity costs and medical costs vary as to the term of the payments and must be analyzed separately to determine appropriate differences when comparing benefit costs versus premiums in the determination of trend factors.

21. The Petitioner afforded actual Arkansas experience regarding indemnity payments a credibility factor of 29%, and used countrywide data for the remaining 71% in their calculation.

22. A credibility factor of 22% was assigned to actual Arkansas experience applicable to medical costs, and the remaining 78% was derived from countrywide data.

23. Workers compensation premiums are determined by using units of payroll, which is an inflation sensitive measure of the exposure base. To determine the appropriate trend factor for a rate, the increase in benefit costs must be measured against the increase in wages during the experience period utilized to substantiate the rate.

24. The Petitioner analyzed the five (5) year period from 1982 to 1986 to compare benefit costs versus wage increases, assigned credibility based on that analysis, and found that the trend factor should be increased by +2.4%.

25. The Insurance Department actuary reviewed benefit costs and wages over a ten (10) year period and afforded greater weight to Arkansas data, resulting in the opinion that the trend factor currently included in the rates should be lowered by - 4.3%.

26. The actuary for the Insurance Department considered four (4) different reserve methodologies when analyzing the Petitioner's calculations and found that, based upon Arkansas data only, the total incurred method was the only one developing a positive trend over the five (5) year period used by the Petitioner.

27. The Petitioner's use of the total incurred method of loss development and the assignment of very limited credibility to actual Arkansas data resulted in the highest trend factor of all of the methods reviewed.

28. The Petitioner utilized countrywide data for stock companies only, to calculate the expense factor in the subject rate filing.

29. The Petitioner included a "budgetary allowance" for production costs rather than a factor based upon numerical analysis.

30. Stock company data was used to calculate the expense factor even though evidence produced by the Petitioner indicated that the largest volume of premium in Arkansas during the period used to substantiate the rate filing was written in mutual companies.

31. The Petitioner requested a decrease in the general expense factor of - 1.3%.

32. The Department actuary recommended a decrease in the factor for general expenses of - 6.2%.

33. The expense factor included in the subject rate filing is higher than the actual average expenditures for insurers writing workers compensation in Arkansas when stock and mutual company data is combined.

34. The Petitioner and the Insurance Department actuary agree that an additional factor of +1% for an increase in mandated weekly benefits is justified.

35. In the computation of the profit and contingencies factor, the Petitioner gave consideration to actual underwriting results without giving proper credit for investment income earned on the premiums the companies receive.

36. The Petitioner did not request an increase in the current factor of +2.5% for profit and contingencies.

37. The actuary for the Department recommended that the factor for profit and contingencies be reduced by - 12.3%.

38. For the period from 1984 through 1988, insurers in Arkansas posted consistent underwriting losses ranging from a - 7.1% to - 18.5%.

39. During the period from 1984 through 1988, dividends paid to policyholders steadily decreased from 5.9% to 2.6%.

40. The National Association of Insurance Commissioners data taken from insurer reports indicates that, overall, companies in Arkansas have had positive profitability factors in ten (10) of the past twelve (12) years, with an average factor of 6.2.

41. Arkansas law allows insurers to file deviations to advisory rates which provides them the opportunity to request the use of higher or lower rates.

42. The Petitioner requested a change in the "upset payroll" factors used to convert production to payroll when computing premiums for Class Code 2702, "Logging and Lumbering and Drivers."

43. The current upset payroll factors have not been adjusted in over twenty (20) years and do not reflect exposure on an equitable basis with risks using actual payroll.

44. Approximately ninety percent (90%) of the premium received from Class Code 2702 is based on an upset payroll.

45. A change in the upset payroll factors is needed at some time in the future to provide for an equitable distribution of the premium received from all risks falling under Class Code 2702.

46. Doubling the upset payroll factor at this time would benefit approximately ten percent (10%) of the insureds in Class Code 2702.

CONCLUSIONS OF LAW

1. An increase in the experience factor of +16.4% is not supported by substantial evidence and would result in a rate that is excessive.

2. An increase of +2.4% in the trend factor is not supported by substantial evidence and would result in a rate that is excessive. The evidence substantiates that a reduction in the trend factor included in the current rates is justified.

3. Substantial evidence supports a decrease in the factor for general expenses and loss adjustment expenses. The requested decrease of - 1.3% is not sufficient to prevent a resulting rate that is excessive.

4. The requested increase of +1.0% for benefit changes is supported by substantial evidence.

5. A reduction in the current factor of 2.5% for profit and contingencies is not supported by substantial evidence.

6. Doubling the upset payroll factor for Class Code 2702 at this time would be unfairly discriminatory.

7. The Petitioner, NCCI, should bear the cost of the Insurance Department's actuarial review pursuant to A.C.A. s 23-67-119.

THEREFORE, IT IS ORDERED, that the requested increase of 16.4% in the experience factor is DENIED; that the trend factor included in the existing rates be lowered in the amount of - 4.3%; that the total of the factors for general expenses and loss adjustment expenses in the current rates be lowered in amount of - 3.75%; that the requested increase of 1.0% due to benefit changes is APPROVED; that the current factor for profit and contingencies remain at +2.5%; that the proposal to double the "upset payroll" factor for Class Code 2702 is DENIED; and that the expense of the Insurance Department's actuarial review be paid by the Petitioner.

Petitioner, NCCI, is hereby directed to amend its current advisory rate filing to reflect the above rate factor changes not later than forty-five (45) calendar days from the issuance of this order.

It is so ORDERED this 9th day of October, 1989.

Ron Taylor
Insurance Commissioner