



April 29, 2014

DCRB CIRCULAR NO. 896

To All Members of the DCRB:

Re: APPROVAL OF AMENDED FILING NO. 1305 – BACKGROUND AND CONSIDERATIONS

Executive Summary

- Amended Filing No. 1305 (February 21, 2014) reflects a settlement between the DCRB, the Delaware Department of Insurance and the Delaware Ratepayer Advocate. The settlement called for overall average increases in voluntary market loss costs and residual market rates that were significantly lower than those that had been presented in the initial Filing No. 1305.
- There has been public speculation as to whether the DCRB initially proposed higher-than-needed increases in order to gain some negotiating advantage in the filing review process.
- There has also been public comment to the effect that the DCRB did not timely or fully communicate requested information during the review of Filing No. 1305.
- This Circular sets out the facts relating to this speculation and commentary. As discussed in greater detail in the remainder of this Circular:
 1. One of the DCRB's main responsibilities is to collect data, analyze it using accepted actuarial methods and submit objective filings to the Department of Insurance.
 2. The DCRB collects data under the direct oversight of the Delaware Department of Insurance. The DCRB was examined as recently as a target examination conducted in November and December of 2012 by the Department of Insurance, and that examination concluded with a determination that the data used by the DCRB was accurate, based upon the information provided from member companies.
 3. The increases in loss costs and residual market rates initially presented in Filing No. 1305 were developed using only well-established and accepted loss development methods – the same methods that had been used by the DCRB for more than a decade.
 4. DCRB's approach of using accepted actuarial methods and consistently applying them from year-to-year allows for meaningful comparison of statewide loss experience over time.
 5. These increases directly reflected documented, progressively increasing costs of workers compensation claims in Delaware, not a change in the method(s) used in preparing the filing.

6. The DCRB's acceptance of increases that are lower than those called for by the data reflects the DCRB's anticipation that additional and meaningful reforms of the Delaware workers compensation system will be made. (The data has confirmed that the reforms instituted in 2012 (SB 238) and 2013 (HB 175) produced only nominal reductions in the costs of workplace injuries.)
 7. The increases initially presented in Filing No. 1305 were the result of incorporating the most recent available experience and analyzing it using the same loss development methods that the DCRB had consistently used for many years. Notably, the DCRB's use of these methods has resulted in DCRB proposals for rate and loss cost reductions when the data supported that outcome (reductions were sought by the DCRB in 2003, 2007, 2008, 2009 and 2010). This context reflects that the DCRB did not artificially change its indications for negotiating or other purposes. In order to have accomplished such a change, the DCRB would have had to employ a new loss estimation method or methods, and it did not do so.
 8. The record reflects that the DCRB publicly informed all parties, at the outset when submitting Filing No. 1304, that it was not requesting approval of the full increases indicated in that filing (increases developed using the DCRB's standard methods). Specifically, the DCRB openly advised that because it anticipated the implementation of meaningful legislative reforms, lower than indicated increases were being recommended.
 9. During the review of Filing No. 1305, the only requested information that the DCRB did not immediately and unconditionally provide consisted of, or included, private healthcare information and/or confidential business information that could be disclosed only under conditions designed to protect against its inappropriate dissemination. This was of direct benefit to employers as well as insurers, as both rightfully expect that private health care information be kept confidential and that competition be maintained in the insurance marketplace.
- The DCRB has been responsibly serving as Delaware's government-appointed workers compensation rating bureau since 1917. It operates in a direct and transparent fashion, and has been retained for almost 100 years by a long succession of Delaware's Insurance Commissioners in recognition of the integrity and quality of its performance in all respects. The DCRB will continue to invite regulators, legislators, and the Ratepayer Advocate to provide advance input concerning all aspects of its work, including the actuarial method(s) to be used in estimating past and future losses. Consistency in approach, however, must remain a key consideration. The DCRB will also continue to make itself available at all times, to answer to the best of its ability, questions about its work and methods.

Background and Discussion

- *Chronology of DCRB Submissions*
 - In September 2013, the DCRB made its annual loss cost and residual market rate filing – Filing No. 1304 – with the Delaware Department of Insurance.
 - In the filing, the DCRB demonstrated that the use of well-established and accepted actuarial methods indicated the need for average increases of 42.75 percent in loss costs and 39.50 percent in residual market rates. However, the DCRB further explained that because it anticipated meaningful legislative reforms that could significantly reduce the cost of workers compensation claims, it was taking the unprecedented step of proposing much lower overall increases – specifically, 17.00 percent in loss costs and 14.33 percent in residual market rates (additional detail concerning this history can be found in DCRB Circular No. 891).
 - The Insurance Commissioner asked the DCRB to withdraw Filing No. 1304 and replace it with a filing that did not include the DCRB's lower proposed changes in loss costs and residual market rates.

- The DCRB did so, and submitted Filing No. 1305 in October, 2013. As had Filing No. 1304, Filing No. 1305 presented indicated overall changes in voluntary market loss costs and residual market rates based on the most recent available experience and the application of well-established and accepted actuarial methods. (Filing No. 1305 reflected nominal revisions to the DCRB's original estimates of the impacts of prior Delaware legislation on system costs, and proposed overall average increases of 41.75 percent in voluntary market loss costs and 38.52 percent in residual market rates.)
- *Independent Reviews of Filing No. 1305*
 - The review of Filing No. 1305 by the actuarial firm retained by the Department of Insurance, INS, was presented in a report that accepted or closely agreed with most of the DCRB's analysis. However, INS applied a different method than that used by the DCRB for estimating the ultimate losses that Delaware insurers, collectively, would be required to pay on claims arising under policies written in policy years 2010 and 2011. By employing that method, INS developed significantly lower estimates of ultimate losses for those two policy years than those developed by the DCRB. INS then relied on those lower estimates in estimating the ultimate losses to be paid under the insurance policies to be written during the policy year commencing on December 1, 2013, which was the policy year for which Filing No. 1305 proposed loss costs and residual market rates. INS concluded that average increases of 23.80 percent in voluntary market loss costs and 20.98 percent in residual market rates were required.
 - In its written testimony in support of its use of a different loss estimation method than the one traditionally used by the DCRB (INS expressly acknowledged the DCRB's method to be a "**generally accepted actuarial practice**"), INS, in essence, said that because the DCRB's traditional method projected losses for policy years 2010 and 2011 that were significantly higher than losses projected for prior policy years, INS had chosen a method that would "**produce more stable results.**"
 - The actuarial firm retained by the Ratepayer Advocate, AIS, also accepted or closely agreed with most of the DCRB's analysis, but it also used different methods than those applied by the DCRB to estimate ultimate losses for recent policy years. By using those different methods, AIS produced estimates of ultimate losses for policy years 2010 and 2011 that were significantly lower than those derived by the DCRB. Based on those lower estimates of losses for policy years 2010 and 2011, AIS arrived at an estimate of ultimate losses for the policy period commencing December 1, 2013 that was significantly lower than the estimate calculated by the DCRB. Using this lower estimate of ultimate losses, AIS proposed average increases of 17.12 percent in voluntary market loss costs and 14.45 percent in residual market rates.
 - In a short supplement to its original report, AIS presented a partial analysis of selected "medical call data." Relying on that partial analysis, AIS judgmentally selected (rather than calculated) a reduced trend in the severity of medical claims. Using this selected, reduced trend, AIS further lowered its proposed overall average increases in voluntary market loss costs and residual market rates to 11.58 percent and 9.04 percent, respectively.
 - In its written testimony, AIS stated that it had decided to use a different method to estimate ultimate losses because its selected method "**tends to be more stable**" than the method used by the DCRB, which "**tends to be more responsive.**"

- *Policy Year Loss and Loss Adjustment Expense (LAE) Ratio Estimates in Filing No. 1305 and Independent Reviews*
 - In considering the different estimates for policy years 2010 and 2011 that were calculated by each of the DCRB, AIS and INS, it is important to note that the DCRB used the same actuarial methods that it has been using for over a decade. In contrast, in their reviews of the DCRB's 2012 and 2013 filings, AIS and INS adopted new methods that required more extensive use of judgment than did the method used by the DCRB. (The methods used by AIS and INS in their reviews of recent DCRB filings require the actuary to select the "expected loss ratio," a selection not made or required in the methods used by the DCRB).
 - In recent years, the DCRB, AIS and INS have each been increasing their prior estimates of ultimate losses and LAE that Delaware workers compensation insurers can be expected to incur in connection with past policy years. For example, a review of each actuary's past estimates of ultimate medical losses and LAE is instructive. Stating those estimates in terms of loss and LAE ratios, adjusted to be on-level with the 2012 level which underlies DCRB Filing No.1305, allows direct comparison of year-to-year estimates by removing the effects of intervening changes in rates and loss costs from the comparisons.
 - The following tables show the DCRB, AIS and INS estimates of ultimate, on-level medical loss and LAE ratios (a) for policy year 2008 that were made in 2010 and 2013; (b) for policy year 2009 that were made in 2011 and 2013; and (c) for policy year 2010 that were made in 2012 and 2013. For each of these policy years, the first estimates shown were made when that policy year first entered the DCRB's ratemaking experience, while the second estimates are those made when preparing (in the case of the DCRB) or reviewing (in the case of AIS and INS) Filing No. 1305. Thus, the comparisons are between the earliest and most recent estimates of on-level medical loss and LAE ratios for those three policy years.

Policy Year 2008 On-Level Medical Loss and LAE Ratios

	<u>2010 Estimate</u>	<u>2013 Estimate</u>
DCRB	0.4214	0.4603
AIS	0.4214	0.4571
INS	0.4191	0.4565

Policy Year 2009 On-Level Medical Loss and LAE Ratios

	<u>2011 Estimate</u>	<u>2013 Estimate</u>
DCRB	0.4776	0.5157
AIS	0.4776	0.5054
INS	0.4898	0.5111

Policy Year 2010 On-Level Medical Loss and LAE Ratios

	<u>2012 Estimate</u>	<u>2013 Estimate</u>
DCRB	0.6752	0.6351
AIS	0.5319	0.5845
INS	0.5502	0.5924

- Of the nine comparisons between the original estimates and the 2013 estimates of on-level medical loss and LAE ratios shown above, one decreased while eight increased.
- These progressive upward revisions of prior estimates suggest that most initial projections of ultimate losses and LAE for recent policy years made by the actuaries considering Filing No. 1305 were too low.
- Not only have estimates of ultimate losses and LAE associated with prior policy years been increasing over time, but Filing No. 1305 showed that the costs of workers compensation benefits in Delaware have been rising at an accelerated pace. Particularly for medical benefits, which comprise approximately 72 percent of total Delaware benefits, these increases have been very pronounced.
- The DCRB's filing presents on-level loss and LAE ratios (key statistics for ratemaking which, as previously discussed, allow the use of past years' data to estimate future rating value needs, and also allow direct comparisons of past policy year results).
- For medical benefits, on-level loss and LAE ratios have changed to the extent that in Filing No. 1305 the newest of the last ten completed policy years (2011) has the highest on-level medical loss and LAE ratio, the prior policy year (2010) has the second highest on-level medical loss and LAE ratio, and the policy year before that (2009) has the third highest on-level medical loss and LAE ratio.
- As noted above, two independent actuarial firms have scrutinized DCRB Filing No. 1305. While those firms each recommended smaller increases in loss costs and residual market rates than those proposed by the DCRB, both of those firms presented the identical rankings of medical on-level loss and LAE ratios for policy years 2009, 2010 and 2011 among the most recent ten completed policy years. Thus, while there was disagreement about how much worse 2009, 2010 and 2011 have been than the previous seven policy years, each of the three actuarial analyses showed policy year 2011 as having the highest on-level medical loss and LAE ratio in the past ten years, while 2010 had the second highest and 2009 had the third highest.
- The following table shows the medical on-level loss and LAE ratios from Filing No. 1305, the AIS report and the INS report over the most recent ten completed policy years, from which the above observations were obtained.

Policy Year 2002 through 2011 On-Level Medical Loss and LAE Ratios

Policy Year	Filing No. 1305 Estimate	AIS Estimate	INS Estimate
2002	0.4971	0.4925	0.4924
2003	0.5073	0.5000	0.4991
2004	0.4664	0.4638	0.4622
2005	0.4560	0.4522	0.4517
2006	0.4346	0.4284	0.4303
2007	0.4791	0.4779	0.4729
2008	0.4603	0.4571	0.4565
2009	0.5157 ^a	0.5054 ^a	0.5111 ^a
2010	0.6351 ^b	0.5845 ^b	0.5924 ^b
2011	0.7176 ^c	0.5858 ^c	0.6196 ^c

^a – Third highest ratio in column
^b – Second highest ratio in column
^c – Highest ratio in column

- *Context and Purpose of DCRB Filings*
 - There have been some recent comments to the effect that the DCRB and its members may have submitted change indications purposely set at higher-than-needed levels in order to obtain more advantageous offers and/or decisions.
 - The DCRB collects and uses extensive bodies of data in support of its statutorily required annual pricing proposals. It collects this data under the oversight of the Delaware Department of Insurance, and it is subject to regulation and examination by that agency.
 - The DCRB's proposed increases in average loss costs and residual market rates were developed using what all of the actuaries involved in the review process have acknowledged to be accepted actuarial methods. These same methods have been used by the DCRB over the course of the past decade.
 - Being derived from consistent application of recognized actuarial methods, the proposed loss cost and residual market rate changes in any DCRB filing are a reflection of Delaware workers compensation insurance experience as reported by insurers to the DCRB, the Department of Insurance and other authorities, and they provide a continuing series of benchmarks for past performance and future outlook for this important social insurance mechanism.
 - Going forward, the DCRB will continue its long-standing practice of considering the merits of using various actuarial methods and techniques in an effort to appropriately estimate future losses, and will invite DCRB members, regulators, and the Ratepayer Advocate to provide advance input concerning the actuarial method(s) to be used in the process. However, the importance of consistency in approach will remain a key consideration.
- *Communication and Respect for Confidentiality*
 - The subject of communication has also been raised over the past months during which the DCRB and others interested in the subject of workers compensation insurance pricing have worked together toward the resolution of Filing No. 1305.
 - Specifically, there have been public comments to the effect that the DCRB has not timely, fully or effectively communicated requested information to some of the persons or groups that have requested information from it. These comments are unfounded.
 - Neither the Department of Insurance, which regulates the DCRB, nor the Ratepayer Advocate, who was responsible for representing the interests of ratepayers in the review of Filing No. 1305 and in the hearing process, made such comments.
 - It is the case that the DCRB did not immediately and unconditionally provide all information that was requested of it during the review of Filing No. 1305. However, the only reason for this was that, in some cases, the requested information included private healthcare information and/or confidential business information that should be disclosed only under conditions designed to protect against the inappropriate dissemination of the information.
 - This care on the part of the DCRB should be respected by citizens, employers, regulators and legislators alike. It would be highly inappropriate for the rate filing review process to involve avoidable disclosure of personal healthcare information, or of competitive business information. Consumers – both individuals and businesses – have strong interests in the protection of privacy rights and competitive markets, and the DCRB will continue to act responsibly by disseminating information in a way that protects those interests.

- There have also been comments to the effect that the DCRB has not adequately described or clarified the meaning of the data that it has provided in response to requests for data. These comments are also inaccurate. The DCRB has directly and promptly answered all questions posed to it regarding the data that it has produced.
- Some of the data that was requested from the DCRB is technical in nature, and some of the recipients of that information may not possess technical backgrounds. However, the DCRB has been available, at all times, to answer questions to the best of its ability, and it remains committed to doing so.

Any questions regarding this circular should be directed to Timothy L. Wisecarver, President, at 302-654-1435 or twisecarver@dcrb.com.

Timothy L. Wisecarver
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