

Delaware Compensation Rating Bureau, Inc.



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August 31, 2004

VIA OVERNIGHT DELIVERY

The Honorable Donna L. Williams
Insurance Commissioner
State of Delaware
Department of Insurance
841 Silver Lake Boulevard
Dover, DE 19904-2465

Attention: Ann Lyon

RE: Bureau Filing 0405 - F-Classification and USL&HW Rating Value Filing
Proposed Effective December 1, 2004

Dear Commissioner Williams:

On behalf of the members of the Delaware Compensation Rating Bureau, Inc. (DCRB), I am filing herewith proposed revisions to rates and rating values pertaining to F-Classification and United States Longshore and Harbor Workers (USL&HW) Compensation Act coverages. These revisions are proposed to be **effective** on a new and renewal basis as of 12:01 a.m., **December 1, 2004**.

DEFINITION OF COVERAGES SUBJECT TO THIS FILING

F-Classification coverages provide insurance for liability under the USL&HW Compensation Act for maritime or federal employment subject thereto. Examples of employment generally subject to this Act are longshoremen, harbor workers, ship repairmen, shipbuilders, ship breakers and other employees engaged in loading, unloading, repairing or building a vessel(s). Businesses predominantly subject to this law are assigned a classification(s) designated by an "F" suffix, and insurance provided to these employers is thus commonly referred to as F-Classification business.

On occasion, employer operations not subject to assignment to an F-Classification(s) may involve some employees whose duties are subject to the USL&HW Act. State Act classifications (those not designated by an F suffix) do not contemplate liability under the USL&HW Act. Accordingly, a United States Longshore and Harbor Workers Compensation Coverage Percentage is provided in the DCRB Manual to adjust rating values otherwise applicable to State Act classifications for the different (and higher) benefits payable under the USL&HW Act.

SUMMARY OF PROPOSALS ADVANCED IN THIS FILING

The following points identify the key proposals submitted for approval in this filing:

- An overall average decrease of 5.08 percent in collectible F-Classification residual market rates is proposed.
- Consistent with the proposed overall average change in collectible rates, an overall average decrease in manual residual market rates for F-Classifications of 3.16 percent is proposed.
- Proposed decreases in manual residual market rates for individual F-Classifications range from 3.8 percent (Classification 7366F) to 3.1 percent (Classifications 7309F and 8709F). All 11 existing F-Classifications are proposed to receive decreases in manual rates falling very close to the overall average proposed change due to the very limited amount of individual F-Classification experience available in Delaware.
- An overall average decrease of 3.94 percent in collectible F-Classification voluntary market loss costs is proposed.
- Consistent with the proposed overall average change in collectible loss costs, an overall average decrease in manual voluntary market loss costs for F-Classifications of 2.00 percent is proposed.
- Proposed decreases in manual voluntary market loss costs for individual F-Classifications range from 2.5 percent (Classifications 7327F and 7366F) to 1.9 percent (Classification 8726F). All 11 existing F-Classifications are proposed to receive increases in manual loss costs falling very close to the overall average proposed change due to the very limited amount of individual F-Classification experience available in Delaware.
- The United States Longshore and Harbor Workers Compensation Coverage Percentage is proposed to change from 44.6 percent to 49.2 percent. This proposed percentage would apply a factor of 1.492 to the approved carrier rate(s) in State Act classifications to produce appropriate rates for employees whose duties are subject to USL&HW Act benefits.

DISCUSSION OF THIS FILING'S METHODS, ANALYSIS AND FINDINGS

This narrative will provide detail in regard to the Bureau's preparation and presentation of this filing. It is organized in the following sections:

- Data Used for Loss and Exposures
- Analysis of Loss Experience
- Data Used for Expenses
- Analysis of Expense Experience
- Derivation of Permissible Loss, Loss Adjustment and Fixed Expense Ratio

- Analysis of USL&HW Factor
- Proposed Classification Rates
- Miscellaneous Rating Values

Data Used for Loss and Exposures

This filing has used loss and exposure data attributed to F-Classification business, as submitted on unit reports under the approved Statistical Plan in Delaware. Unit statistical data has been used in lieu of financial data because the DCRB has found this information to be more consistent, accurate and reliable than the separate reporting for F-Classification business in Financial Calls.

Unit statistical data has historically been limited to case-incurred losses, separately reported for indemnity and medical benefits, for a series of five successive annual evaluations beginning 18 months after the inception of each policy period. With the benefit of changes approved in the DCRB's Statistical Plan in the mid-1990s, statistical reports spanning up to ten annual evaluations for some policy years were available for use in the filing.

Supporting information for this filing includes standard earned premium from unit statistical data for the Policy Periods 1988 through 2001. Incurred loss data for varying periods of development were available for Policy Years 1988 through 2001.

Unit statistical data used for the analysis of the overall indicated rate level change in this filing is presented on Exhibit 5 enclosed.

Analysis of Loss Experience

Because of the extremely limited volume of experience available in Delaware, loss development experience supporting an F-Classification rate filing in Pennsylvania was consulted as a possible point-of-reference in the preparation of this filing. This procedure had been used in the three most recent previous F-Classification filings in Delaware. However, review of Pennsylvania and Delaware data this year found such substantial differences in the loss development patterns in the two states, limited volume of data notwithstanding, that the DCRB has decided to use Delaware data without reference to Pennsylvania experience to develop and support this filing.

A brief discussion of the loss development analysis performed for this filing is provided below.

The DCRB performed incurred loss development analyses separately for indemnity and medical benefits. All available development points at each maturity (i.e., development factors for policy years containing reported loss amounts) were computed and formed the basis for a selected series of loss development factors. Those selected factors were smoothed by fitting curves of the following form to the differences between selected loss development factors and unity (1.0000):

$$y = a + b/x + c/(x^2) + d/(x^3)$$

For this curve fitting process, development factors beyond 8th report were selected to be unity (1.0000) to control the shape and behavior of the final fitted curve.

The fitted values for loss development factor residuals were adjusted by adding back the value of unity (1.0000) removed prior to application of the curve fitting process, and development factors derived by cumulatively multiplying the resulting age-to-age factors were used to estimate ultimate losses for indemnity and medical benefits by policy year.

Linear and exponential trend models were applied to the developed indemnity and medical loss ratio points using all possible numbers of policy year data points from four to eight. After consideration of the metrics of the various trend models, the most recent four-year average loss ratios were selected as the basis for the indicated change in F-Classification rates.

The Bureau's loss development and trend analyses are included in the pages of Exhibit 5 enclosed.

The estimated effect of the anticipated October 1, 2005 benefit change for USL&HW benefits is derived in Exhibit 14 enclosed.

Data Used for Expenses

Expense data is not reported to the DCRB separately for F-Classification business. Accordingly, much of the expense data used in preparation of this filing is either agency stock company or total Delaware workers compensation expense data, related to total Delaware workers compensation premiums.

The Bureau's Expense Study performed in support of this filing is enclosed as Exhibit 3. Provisions were separately measured therein based on either agency stock company or total Delaware workers compensation experience for the following expense components:

- Commission and Brokerage
- Other Acquisition
- General Expense
- Loss Adjustment Expense

In this filing, the Bureau has included an expense provision reflecting the potential for uncollectible premiums. Based on six years of data for the Delaware Insurance Plan, an average rate of uncollectibility of approximately one percent was observed. Recognizing that the incidence of collection problems in the Plan appear to have been correlated to Plan market share in recent years and because the portion of the F-Classification business resident in the Plan is not readily available, a conservative provision of one-half of one percent was selected as an uncollectible premium provision in this filing.

Using unit statistical data, an indicated provision in proposed rates for premium discounts was obtained separately and specifically for F-Classification business. This derivation is also presented within Exhibit 3 enclosed.

Analysis of Expense Experience

Historical ratios of expense to premium were obtained from the most recent available three years of experience. Provisions for the Federal Assessment and Premium Tax were based on current assessment levels. Miscellaneous taxes were estimated based on historical relationships between such taxes and premiums. Loss adjustment expenses were measured in relation to losses on the basis of the most recent available three years' experience.

The proposed expense loadings consistent with this filing are shown on the enclosed Exhibit 2.

Derivation of Permissible Loss and Loss-Adjustment Expense Ratio

The Bureau retained an economic consultant to accomplish the following portions of the analysis supporting this filing:

- Determination of an appropriate rate-of-return for the enterprise of writing workers compensation insurance in Delaware.
- Preparation of a model to account for all applicable cash flows attendant with the writing of workers compensation insurance business in Delaware.
- Using the aforementioned model, computation of a permissible portion of premium to be attributed to loss, loss-adjustment expense and loss-based assessments in combination and a separate provision for profit consistent with the anticipated cash flows and rate-of-return noted above.

This filing's supporting information includes details of the Internal Rate-of-Return Model applied to derive the permissible loss and loss-adjustment expense ratio as the enclosed Exhibit 4.

Analysis of USL&HW Factor

The USL&HW Factor is based on a comparison of benefit levels between State Act coverage and the USL&HW Act. This comparison is performed by type of claim and type of benefit to measure the respective potential obligations arising from injuries occurring under the jurisdiction of federal, as compared to state, law. Such a comparison then serves as the basis for the factor to adjust premiums in state classifications for the contingency of exposure to federal benefits.

The derivation of the proposed USL&HW Factor is presented on the enclosed Exhibit 6.

Proposed Classification Rates

The Bureau has applied the same classification pricing methods customarily used in loss cost filings for State Act coverage to derive rate relativities for the F-Classifications subject to this filing. The rate formulae used are set forth in Exhibit 10 enclosed. Summaries of unit statistical data for the experience period included in the derivation of F-Classification rate relativities in

this filing are shown in the enclosed Exhibit 7. Details of individual F-Classification experience and the application of the prescribed rating formulae are presented in the enclosed Exhibit 15. Proposed F-Classification rates are shown in Exhibit 12.

Miscellaneous Rating Values

Tax Multiplier – A factor to account for assessments made on losses when policies are written on retrospective rating plans for F-Classification business is derived as shown on the enclosed Exhibit 8.

Experience Rating Plan Parameters – The approved Experience Rating Plan applies to F-Classification business in Delaware. Expected loss rates are required for the F-Classifications in order to incorporate experience under those classifications into the determination of employers' experience modifications. Derivation of expected loss rate factors to be multiplied times proposed rates to produce the necessary expected loss rates by year in each F-Classification is shown in the enclosed Exhibit 11.

EXHIBITS AND SUPPORTING MATERIALS INCLUDED WITH THIS FILING

The following exhibits and supporting information are submitted with this filing:

- Record of Meeting - Actuarial and Classification & Rating Committees, August 17, 2004
Note that, per a recommendation of the most recent Department of Insurance examination of the Bureau, these minutes are in the process of being reviewed and approved by the two committees and accepted by the Governing Board. If there are any changes resulting from this process, a revised final copy will be promptly forwarded to the Department of Insurance.
- Exhibit 1 - Indicated Change in Rate Level
- Exhibit 2 – Expense Loading
- Exhibit 3 – Expense Study
- Exhibit 4 – Internal Rate of Return Model
- Exhibit 5 – Analysis of Experience
- Exhibit 6 – U. S. Longshoremen & Harbor Workers Coverage Factor
- Exhibit 7 – Table II – Unit Statistical Data
- Exhibit 8 – Tax Multiplier
- Exhibit 9 – Derivation of “F” Class Rates
- Exhibit 10 – Rate Formulae
- Exhibit 11 – Calculation of Expected Loss Rate Factors
- Exhibit 12 – Manual Rates and Expected Loss Rates
- Exhibit 14 – Estimated Effect of Benefit Change
- Exhibit 15 – Index to “F-Classification” Exhibits & Class Book

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CONCLUSION

The Bureau would be pleased to assist your offices in any way possible during your review of this filing. In order that appropriate notice be given to all parties in the marketplace, the Bureau would respectfully ask that the Department of Insurance's review of this filing be conducted and approval be given as expeditiously as possible.

Sincerely,

Timothy L. Wisecarver
President

TLW/kg
Enclosures