

**DRAFT: Not yet reviewed by the Actuarial & Classification & Rating Committees or accepted by the Governing Board.**

**ACTUARIAL & CLASSIFICATION AND RATING COMMITTEES -  
RECORD OF JOINT MEETING**

A meeting of the Actuarial and Classification & Rating Committees of the Delaware Compensation Rating Bureau, Inc. was held in the Brandywine Room of the Doubletree Hotel Wilmington, 4727 Concord Pike, Wilmington, Delaware on Tuesday, August 17, 2004 at 10 a.m.

The following members were present:

Actuarial Committee

Ms. B. Higgins	American Home Assurance Company
Mr. R. Whitlock	Harleysville Mutual Insurance Company
Mr. B. Clancy	Hartford Accident & Indemnity Company
Mr. P. DeMallie*	Liberty Mutual Insurance Company
Mr. S. Warfel	PMA Insurance Company
Not Represented	Travelers Property & Casualty Company

Classification and Rating Committee

Ms. E. O'Hara	American Home Assurance Company
Mr. J. Zoerkler	Harleysville Mutual Insurance Company
Mr. J. Binkowski	Insurance Company of North America
Mr. P. DeMaillie*	Liberty Mutual Insurance Company
Mr. S. Foltz	National Federation of Independent Business
Mr. J. Fitzgerald	New Castle County Chamber of Commerce
Mr. A. Zysk	PMA Insurance Company
Not Represented	Zenith Insurance Company

Mr. T. Wisecarver	Chair - Ex Officio
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Also present were:

Mr. I. Feuerlicht	American Home Assurance Company
Mr. D. Yashar	CNA Insurance Company
Mr. D. Reese	Delaware Department of Insurance
Ms. K. W. Stewart	Delaware Insurance Commissioner Candidate
Mr. R. Heffron	Delaware State Chamber of Commerce
Mr. J. Randall	Delaware State Chamber of Commerce
Mr. E. Doroshov	Doroshov & Pasquale
Mr. J. Neidermyer	INS Consultants, Inc.
Ms. W. Gainor	Medical Society of Delaware
Mr. R. Stokes	Property Casualty Association
Ms. K. Bodine	Wood Byrd, Inc.
Ms. F. Barton	Bureau Staff
Ms. D. Belfus	Bureau Staff
Mr. B. Decker	Bureau Staff
Mr. M. Doyle	Bureau Staff
Mr. P. Yoon	Bureau Staff

\* Member of both committees

The Antitrust Preamble was read at the beginning of the meeting for the benefit of all participants. Participants gave brief self-introductions. Staff encouraged interactive questions and comments as the meeting progressed. The more substantive elements of dialogue precipitated during the meeting in that regard are set forth as inserted “Question,” “Comment” and/or “Answer” exchanges in the description of the meeting proceedings following below.

### **Minimum and Maximum Corporate Officer Payrolls**

A staff memorandum dated June 5, 2004 and proposed Manual language revisions updating the current limitations on payrolls reported by corporate officers for premium determination purposes was referenced. That memorandum was part of the initial mailing of agenda materials for the meeting. With the proposed revisions, staff noted that these parameters had been brought into conformance with prevailing wage levels intended to be used as ongoing benchmarks for maintenance of these Manual values.

The following staff proposals for revision or addition to existing Manual language, endorsement forms and related matters were presented for Committee consideration and comment.

**Comment:** The observation was offered that policyholders may have concerns when they compare the maximum payroll for premium computation purposes with the maximum indemnity wage loss benefit and the earnings required to qualify for that maximum.

**Answer:** If payrolls were capped for premium computation purposes, rates would necessarily increase to offset the reduction in reported exposure. It was further noted that workers compensation benefits include both indemnity and medical components and that wage levels are not as directly connected with medical costs as for indemnity payments.

### **Executive Officers Exclusion Agreement**

A staff memorandum dated May 24, 2004 described the purpose of a proposed new form for the purpose of memorializing elections not to be subject to the Delaware Workers Compensation Act by certain executive officers. Staff presented this issue to the Committees for discussion.

### **Manual Revisions to Section 1**

A staff memorandum dated July 23, 2004 describing Delaware legislation amending Seduction 2307 of the Delaware Workers Compensation Act was noted, with proposed revisions to Manual language to conform with new requirements pertaining to casual workers.

### **Notification Endorsement of Pending Law Change to Terrorism Risk Insurance Act – WC 00 01 12**

Item Filing P-1392 from the National Council on Compensation Insurance, Inc. (NCCI) was presented with a staff memorandum dated August 4, 2004. This endorsement form was perceived as a countrywide procedure allowing carriers to advise insureds about possible implications of the scheduled sunset of federal backstop provisions of the Terrorism Risk and Insurance Act of 2002 effective December 31, 2005.

### **Manual Revisions to Section 2 – Subclassifications**

A staff memorandum dated August 5, 2004 described recent Delaware legislation (H.B. 430) authorizing carrier development of subclassifications and provided proposed additional Manual language responsive to provisions of that legislation.

**Employers Liability Coverage Endorsement – WC 00 03 03 B and Federal Employers Liability Act Coverage – WC 01 01 04**

Item Filing P-1389 from the NCCI was presented with a staff memorandum dated August 5, 2004 addressing proposed changes in the captioned coverages.

The Committee discussion then moved to a review of staff work supporting the December 1, 2004 Residual Market Rate and Voluntary Market Loss Cost Filing.

**ITEM (1) REVIEW OF THE PROPOSED DECEMBER 1, 2004 RESIDUAL MARKET RATE AND VOLUNTARY MARKET LOSS COST FILING**

Participants had been provided in advance of the meeting with agenda materials providing supporting information, analysis and results of Bureau staff's preparation of a residual market rate and voluntary market loss cost filing effective December 1, 2004. The Committee heard summary descriptions of those materials organized in topical groups as shown following. Questions posed during the meeting, with staff responses given and participant discussion ensuing, are set forth in the chronology of the presentation below.

**Overall Indicated Changes in Collectible and Manual Rating Values**

Exhibit 12

Exhibit 12 was reviewed. Estimates of historical ultimate on-level policy year loss and loss adjustment expense ratios (Lines (1a) through (1e)) and ultimate on-level policy year loss and loss -adjustment expense ratios trended to the mid-point of the prospective rating period (Lines (2a) through (2e)) were noted as having been evaluated subject to a limitation of \$1,500,000 loss per claim. Staff outlined considerations leading to the adoption of a limited-loss analysis for purposes of the December 1, 2004 filing proposal.

An excess loss factor (Line 3(a)) had been introduced into the analysis to account for the effects of that limitation. Comparison of the trended loss and loss-adjustment expense ratio to a permissible loss and loss adjustment expense ratio based on econometric analysis (Lines (4a) and (5), respectively) produced an indicated overall average change in residual market rate level prior to effects of the July 1, 2005 benefit change. Adjustment for the estimated effects of the July 1, 2005 benefit change (Line (7)) resulted in the indicated change in residual market rates (Line (8)).

The proposed change in voluntary market loss costs (Line (9)) was derived from the indicated change in residual market rates by adjusting the latter indication for the effects of changes in the permissible loss ratio, including loss-adjustment expense and loss-based assessments.

Staff pointed out the proposed overall changes in residual market rates (22.80 percent increase) and voluntary market loss costs (26.23 percent increase).

Staff noted the proposed filing's accounting for effects of the Experience Rating Plan in the determination of proposed changes in manual rating values, as presented on Exhibit 12. This analysis started with the collectible premium ratios underlying presently-approved rating values (Line 10). The Bureau had then measured the collectible premium ratios that the Experience Rating Plan was expected to produce during the proposed rating period (Line 11). Using the relationships between these current and estimated future collectible premium ratios (Line 12), staff had derived indicated changes in manual residual market rates (Line 13). Indicated changes in manual voluntary market loss costs (Line 16) had been derived by also accounting for the nominal impact of offsetting voluntary market rating values for continuation of the approved surcharge program in the Delaware Insurance Plan (Line 15).

**Question:** Does Exhibit 12 show what the indication would be if loss development and trend analyses had been done using unlimited losses?

**Answer:** Exhibit 12 as presented did not show results of an unlimited analysis, but staff had performed that work for comparison purposes and stated that the resulting indications were approximately four points higher than those shown on Exhibit 12, mostly due to differences in those respective calculations' trend provisions.

**Question:** Why had a loss limitation of \$1.5 million been used?

**Answer:** Staff had been aware that the NCCI had suggested considering loss limitations in the range of one to two percent of statewide premium. A limitation of one percent of total premium would be approximately \$1.5 million in Delaware and had seemed reasonable. The intent was to limit extreme cases but to retain a significant working layer of experience data.

**Question:** Regarding the percentage of loss costs attributable to indemnity and medical benefits, respectively, shown on Exhibit 12, what were the comparable values for NCCI jurisdictions?

**Answer:** Staff did not have the requested data at-hand for the meeting but noted that it would be available and opined that this statistic would show significant variation on a state-by-state basis. A comment was offered that, in general, the portion of workers compensation benefits attributable to medical had been increasing in recent years for most states. Staff indicated that Delaware's medical portion of loss (62 percent for the December 1, 2004 filing) was likely to be in the high end of the range among all states and observed that, in the Exhibit 12 supporting the December 1, 2003 Delaware filing, 41 percent of loss was attributed to indemnity and 59 percent had been medical.

**Comment:** An attendee thought that NCCI was reporting countrywide splits reflecting over 50 percent of losses being attributable to medical benefits.

### **Loss Development**

#### **Exhibits 1 (Limited Loss), 2 (Limited Loss), 2a (Limited Loss), 2b and 7**

Staff described the content of each of the referenced exhibits from the meeting agenda materials. Highlights from those descriptions are set forth below.

Exhibit 1 (Limited Loss) (Table I) provided summaries of financial data reported by Bureau members for the calendar years ending December 31, 1999 through 2003, inclusive. Successive calendar year evaluations of premiums, indemnity-incurred losses, medical-incurred losses, indemnity-paid losses and medical-paid losses were compared to derive age-to-age development factors or "link ratios" to be used in the Bureau's estimation of ultimate premiums and losses for prior policy years. In making the comparisons producing specific link ratios, data for all carriers with available and credible data were used, with the result that each calendar year end evaluation could show two different amounts; one for purposes of comparison to the prior calendar year end and the other for purposes of comparison to the subsequent calendar year end.

Staff noted that the data in Table I, consistent with previous Bureau filings, excluded data for large deductible coverages. That exclusion was noted as being responsive to the lack of independent sources for loss data gross of large deductible reimbursements and the potential for significant differences in underlying hazard and loss potential inherent in large deductible business, as compared to business insured on a first-dollar basis.

Claims exceeding \$1,500,000 in paid and/or incurred values had been identified using large claim data separately reported by carriers, and adjustments had been made to limit the combined paid and/or incurred amounts in Table I to a maximum of \$1,500,000. This adjustment process was described as having affected some eight policy years on a paid basis with each policy year including one claim requiring limitation. On an incurred basis, 21 claims affecting 14 policy years had required limitation.

Exhibit 2 (Limited Loss) presented premium and loss development experience from Table I, supplemented by age-to-age factors taken from calendar evaluations of financial data predating those included in Table I, to review development patterns and ultimately derive estimates of prior policy year premiums, losses and loss ratios. Staff described procedures used to develop estimates of ultimate premiums stated at a constant (current) rate level on Page 2.1 of this exhibit. Pages 2.2 through 2.14 presented the derivation of estimates of ultimate indemnity loss and loss adjustment expense ratios for prior policy years.

Indemnity age-to-age paid loss development factors, incurred loss development factors and paid-to-incurred development factors were shown on Page 2.2. Factors for the most recent four development periods were based on the limited loss data from Table I (Limited Loss). Factors for previous development periods were taken from prior Bureau filings and were shown on an unlimited basis.

In application of each loss development method, the Bureau had sought to smooth the observed age-to-age link ratios in a variety of ways. Methods applied in this endeavor included the use of multi-year averages (generally the most recent four years) as the basis for selecting age-to-age factors and the fitting of mathematical curves through the observed average actual ratios. A broad variety of curve forms had been tested for this purpose. The curves that had given better and generally consistent results in this fitting process had been selected for use in support of the proposed filing. The selected curve forms used to smooth observed indemnity loss development age-to-age factors in the proposed filing were described as follows:

Indemnity Paid Development Factors:

Fourth order inverse polynomial

$$y = a + b/x + c/(x^2) + d/(x^3) + e/(x^4)$$

In the above expression, “y” represents the variable to be estimated (the age-to-age link ratios) and “x” is an index of the maturity for the observed and/or projected stages of policy year development for which the ratios were to be estimated. The terms “a,” “b,” “c,” “d” and “e” are constants derived using the curve-fitting procedures and are established to obtain the best possible fit of the selected curve to the observed actual data.

Indemnity Incurred Development Factors:

Third order logarithm

$$y = a + b \cdot \log(x) + c \cdot \log(x)^2 + d \cdot \log(x)^3$$

In the above expression, “y” represents the variable to be estimated (the age-to-age link ratios) and “x” is an index of the maturity for the observed and/or projected stages of policy year development for which the ratios were to be estimated. The terms “a,” “b,” “c” and “d” are constants derived using the curve-fitting procedures and are established to obtain the best possible fit of the selected curve to the observed actual data.

Indemnity Paid-to-Incurred Development Factors:

The actual average paid-to-incurred average age-to-age factor was selected for this transition. In this year's analysis, unlike prior filings, loss development approaches converting to a case-incurred basis at varying points in development were not used, given the complexities of doing loss development analysis on a limited-loss basis.

Page 2.3 showed selected incremental development factors, cumulative development factors computed by successive multiplication of the incremental factors, and factors to bring indemnity losses on-level (benefit change factors) by policy year and to add loss adjustment expense to loss.

Page 2.4 presented indemnity limited paid and incurred losses by policy year, projected ultimate losses using both paid-loss development, case-incurred loss development and an average of those two separate approaches, and reductions to ultimate losses required in each case to maintain the selected loss limitation of \$1,500,000 per claim. Staff noted that, although the base losses shown on Page 2.4 had been limited to \$1,500,000 in Table I (Limited Loss), application of development factors could result in projected ultimates in excess of the selected limited level, and thus a secondary limitation process was required.

Page 2.5 showed the results of applying on-level factors and loss-adjustment expense provisions to estimated ultimate indemnity losses limited to \$1,500,000 per claim.

Page 2.6 showed the calculation of limited severity ratios from ultimate limited loss ratios using an index of claim frequencies per unit of on-level expected losses derived from unit statistical data. Claim frequency trend factors for selected policy years to December 1, 2005 based on a review of unit statistical data were also shown on this page. Staff noted that additional detail concerning the Bureau's analysis of claim frequencies would be discussed in the context of trend analysis later in the meeting.

Page 2.7 showed fitted limited severity ratios for indemnity loss using linear models applied over various numbers of policy years. Severity ratios consistent with paid-loss development, case-incurred loss development, and an average of these two approaches were presented separately.

Page 2.8 showed trended limited severity ratios for indemnity loss based on various combinations of development approach and number of policy year points used as the basis for trending, all using a linear trend model. Trend factors derived from these trended loss ratios were shown for each of the most recent four policy years for each of the previously-mentioned loss development approaches.

Pages 2.9 and 2.10 were described as being alternatives to Pages 2.7 and 2.8, using an exponential model rather than the linear model previously discussed.

Page 2.11 showed indicated loss ratio trend factors derived by combining linear severity trend factors with the claim frequency trend factors from Page 6.

Page 2.12 showed indicated loss ratio trend factors derived by combining exponential severity trend factors with the claim frequency trend factors from Page 6.

Page 2.13 showed trended limited loss ratios based on the linear loss ratio trend factors from Page 2.11.

Page 2.14 showed trended limited loss ratios based on the exponential loss ratio trend factors from Page 2.12. The four-year average trended loss ratio based on a seven-point exponential model applied to limited loss ratios consistent with the average of paid-loss and case-incurred loss development approaches was highlighted with a border on this page, indicating that this was the basis for the discussion proposal's rate level change indication.

Pages 2.15 through 2.27 provided analysis of medical loss in the same fashion and organization as described previously for indemnity loss (Pages 2.2 through 2.14). Medical loss development factors had been subject to the same complement of smoothing techniques as had been used for indemnity loss, for much the same reasons. The curve forms used to accomplish smoothing of four-year average medical loss development factors were as follow:

Medical Paid Development Factors:

$$y = a + b^x \cdot x^c$$

In the above expression, “y” represents the variable to be estimated (the age-to-age link ratios) and “x” is an index of the maturity for the observed and/or projected stages of policy year development for which the ratios were to be estimated. The terms “a,” “b” and “c” are constants derived using the curve-fitting procedures and are established to obtain the best possible fit of the selected curve to the observed actual data.

Medical Incurred Development Factors:

Third order logarithm

$$y = a + b \cdot \log(x) + c \cdot \log(x)^2 + d \cdot \log(x)^3$$

In the above expression, “y” represents the variable to be estimated (the age-to-age link ratios) and “x” is an index of the maturity for the observed and/or projected stages of policy year development for which the ratios were to be estimated. The terms “a,” “b,” “c” and “d” are constants derived using the curve-fitting procedures and are established to obtain the best possible fit of the selected curve to the observed actual data.

Medical Paid-to-Incurred Development Factors:

The actual average paid-to-incurred average age-to-age factor was selected for this transition. In this year’s analysis, unlike prior filings, loss development approaches converting to a case-incurred basis at varying points in development were not used, given the complexities of doing loss development analysis on a limited loss basis.

Page 2.28 showed indicated annual limited severity trends based on both linear and exponential models applied to each of the three loss development methods previously discussed.

Page 2.29 showed indicated annual limited loss ratio trends based on both linear and exponential models in the same format as used on Page 2.28 for limited severity trends.

Exhibit 2a provided graphical comparisons of the results of the limited loss development approaches used in the preparation of the filing, separately for indemnity and medical losses.

Exhibit 2b provided additional graphs comparing the application of paid-loss development, case-incurred loss development and the average of those two methods sequentially to the financial data available for the December 1, 2003 filing and the proposed filing. The presentations so provided had been adjusted for the effects of intervening rate and benefit changes and for differences in the observed relationships between loss-adjustment expense and loss in the 2003 and proposed filings. Thus, the comparisons were reflective only of differences in the underlying loss experience data used in these separate filings. It was noted that, because the 2003 filing had not included loss development analysis on a limited basis, these comparisons were shown on an unlimited basis.

Staff reviewed pertinent portions of Exhibit 7 with the participants. Based on available unit statistical data, Exhibit 7 showed claim closure rates, claim frequencies per million dollars of payroll, and ratios of paid losses to case-incurred loss and to estimates of ultimate-incurred loss. Payout ratios were shown on both limited and unlimited bases, with the policy year cells with notable differences attributable to the limiting process highlighted on the limited exhibits. Staff commented that the loss limitation procedures affected medical losses much more often and more profoundly than was the case for indemnity loss.

Staff noted that the financial data valuations at 12 months maturity were not used in producing ultimate estimates for proposed filings in Delaware.

Average claim cost statistics were shown for open indemnity claims, closed indemnity claims and all indemnity claims. These pages exhibited considerable volatility, due in substantial part to the limited amount of experience data available in Delaware.

Staff advised participants that, based on the collective information presented in the exhibits described above, the Bureau had selected ultimate loss estimates based on the average of a case-incurred loss development method and a paid-loss development method applied over as long a development period as possible, converting to a case-incurred approach for the remaining development to ultimate.

**Question:** A Committee member inquired whether the Bureau had considered applying loss limitations that would vary by policy year, recognizing that changes in benefits and utilization would affect loss distributions over time.

**Answer:** Staff indicated that some preliminary work had been done to test the affect of indexing loss limits. While it was thought that more work would be appropriate if a decision was made to pursue this approach, results obtained thus far had given rating value change indications that were about six points lower than those shown on Exhibit 12. The indexing procedure used thus far produced lower loss limitations for older policy years.

**Question:** Why had there been a noticeable increase in the number of large claims for the most recent completed policy year?

**Answer:** Staff began a response profiling the large losses in question. Of the six claims in the latest policy year (Policy Year 2002 valued as of December 31, 2003) exceeding \$1.5 million, the largest case had an incurred value of \$6.5 million. Three other first-dollar coverage claims had incurred amounts of \$4.4 million, \$2.5 million and \$2.4 million, respectively. Two large deductible cases (not included in the Bureau's Table I data for filing analysis) had incurred amounts of \$2.3 million and \$1.8 million.

**Question:** A question was posed about the extent to which these cases involved jury awards.

**Answer:** The injuries involved in these cases were described as being burn victims, quadriplegics and spinal cord injuries. A substantial majority of the dollar losses in these large cases were devoted to medical benefits.

**Question:** An attendee followed up on the most recent question to suggest that Policy Year 2002 was so recent as to preclude completion of litigation at a level(s) that could precipitate extremely large awards.

**Comment:** It was noted that in one case medical payments already made had exceeded \$900,000.

**Question:** An attendee asked which industry or industries had given rise to these claims.

**Answer:** The construction industry had been involved in several of the cases of interest.



**Question:** How many large claims were there in the year or years prior to Policy Year 2002?

**Answer:** There were no claims over \$1 million for Policy Year 2001, one such claim for Policy Year 2000, one for Policy Year 1999, three for Policy Year 1998 and three for Policy Year 1997.

**Question:** How many dollars were eliminated by application of the selected \$1.5 million limit?

**Answer:** For Policy Year 2002 the selected loss limitation procedure would retain \$9 million out of \$15 million total losses, thus removing \$6 million from the data. It was noted that the loss limitation procedures added an expected provision for large losses into the proposed rate level change, so the procedure was handling large losses differently but was not ultimately “eliminating” large losses from consideration. It was noted that a very large medical loss had also occurred in Policy Year 1992. That case had involved some \$6 million in loss, predominantly for medical expense. The Bureau had omitted Policy Year 1992 from its trend analyses for several filings to avoid disruption that would otherwise have occurred due to that claim. Upon reflection this year, staff had concluded that a limitation procedure would be preferable to an alternative of omitting selected policy years from the analysis.

**Question:** How many cases had fallen into the \$1 million to \$1.5 million loss range?

**Answer:** None for Policy Years 2002 or 2001, one for Policy Year 2000, none for Policy Year 1999, three for Policy Year 1998, two for Policy Year 1997 (plus one other claim above \$1.5 million), one for Policy Year 1996 (plus one other claim above \$1.5 million). Policy Year 2003 was noted to be an incomplete year as of December 31, 2003, with one claim having been reported as over \$1 million in loss. That claim had \$1.7 million paid and \$2.4 million incurred.

**Question:** What would be the impact of capping losses at \$1 million rather than \$1.5 million?

**Answer:** Staff responded by saying that a specific loss limit of \$1 million had not been tested to date. It was observed that such a limit would be expected to result in somewhat lower limited losses, with a correspondingly larger excess loss provision. Theoretically, different levels of loss limitation would not be intended to produce different overall results, as the goal of a loss limitation process would be to stabilize rating value change indications, not to raise or lower those indications.

**Question:** In light of the previous discussion regarding the treatment of Policy Year 1992 in prior filings, why couldn't Policy Year 2002 be handled similarly?

**Answer:** In 1992 the large loss impact was predominantly attributable to a single claim. Policy Year 2002 presents several separate losses. Also, discussions that were ongoing at the NCCI seemed to be suggesting adoption of loss limitation procedures as a standard approach in smaller jurisdictions.

**Question:** Had Pennsylvania seen a similar increase in large losses for Policy Year 2002?

**Answer:** The Pennsylvania analysis, including a complete Policy Year 2002, had not been done as of the date of the meeting, but it was probable that, if a loss limitation of one percent of statewide premium were selected for Pennsylvania, no loss would qualify for limitation. If Pennsylvania premium were \$2 billion, a one percent loss limit would be \$20 million.

**Question:** If the suggested approach of limiting losses were adopted and Policy Year 2003 did not present the number or amount of large losses as Policy Year 2002, staff was asked what would likely occur in terms of the December 1, 2005 rating value change filing indication.

**Answer:** Future filings' indications using a limited loss approach would depend on the frequency and amount of losses reported within the applicable limitation(s). It was thought that year-to-year indications might be somewhat more stable using a loss limitation methodology than if unlimited losses were used without adjustment.

**Question:** How many years of data were used in establishing the excess loss provision?

**Answer:** Analysis of the excess loss factor was done using the NCCI approach and loss distributions. Three years of data are used in deriving the loss distributions and average costs. It was noted that the NCCI loss distribution is built on a countrywide database vastly larger than Delaware's year-for-year.

**Question:** Does the filing analysis provided in Exhibit 12 consider premium trend as well as loss trend?

**Answer:** Premiums underlying the computations in Exhibit 12 would reflect exposure trends and have been put on level as regards rating value changes over time. No separate trend procedure is applied to premiums.

**Question:** Was a seven-point exponential model chosen last time as the basis for trend analysis in both indemnity and medical components?

**Answer:** Yes.

**Question:** Staff was asked to explain the procedure used to analyze claim frequency.

**Answer:** Claim frequencies derived from reported unit statistical data are normalized to the 1990 level. Estimated ultimate loss ratios are then adjusted for those observed changes in claim frequency to derive severity ratios. Based on a review of changes in claim frequency over time (reported indemnity claims per unit of on-level expected losses), an annual reduction of 7.7 percent in frequency was selected for purposes of this filing. In the December 1, 2003 filing, the comparable claim frequency trend was an annual reduction of 6.7 percent.

**Question:** Are claim files staying open longer now?

**Answer:** Exhibit 7 uses unit statistical plan data to look at claim closure rates. This exhibit suggests that the most recent two or three policy years have shown slower closure rates at early maturities than had applied to earlier policy years.

**Question:** Are claim outcomes becoming more erratic in recent policy years?

**Answer:** The average claim size (even on a limited basis) has been persistently increasing for both indemnity and medical benefits. It is uncertain now whether the emergence of several large losses in Policy Year 2002 will be repeated in the near-term or prove to be an unusual phenomenon.

**Comment:** Exhibit 2b shows large differences in ultimate loss estimates between this year's filing and comparable estimates made a year ago.

**Answer:** Loss development has been significant and adverse, and that effect can be seen in the age-to-age development factors, even after the capping process has been applied.

**Question:** If you index loss limitations for prior policy years, will development factors increase even more?

**Answer:** Loss limitation will not necessarily affect loss development in a consistent and predictable fashion. For example, if a \$1 million claim changes in value to \$2 million, then losses double for that claim on an unlimited basis. When you limit losses, the development from this change may go down or disappear altogether. While loss development experience under various loss limitation levels would have to be observed to be understood, staff noted that its preliminary work for this filing suggested that rating value change indications were lower using an indexing procedure for loss limits as compared to having a flat \$1.5 million limit for all policy years.

**Question:** Are the last two pages of Exhibit 7 shown on a limited basis?

**Answer:** No, these pages are based on unit statistical data which is presented unlimited.

**Comment:** A Committee member observed that the lower ultimate loss estimates being obtained using the paid-loss development method might be understating ultimate, if and to the extent that closure rates were slowing down.

**Question:** Another attendee questioned this relationship, asking whether having claims remain open longer would not mean that reserves would be larger and held in effect longer.

**Comment:** The Committee member agreed that, as claims that stay open longer, they would tend to cost more, but stated the expectation that case-incurred loss development methods would respond more promptly and fully to shifts in closure patterns than would paid-loss development. With slower closure rates, the concern was that the paid-loss development method would understate ultimate losses. Case-incurred loss development methods might be more accurate when closure rates appear to be slowing down. It was suggested that, under these circumstances, the Bureau could consider giving more weight to the case-incurred loss development method than simply averaging it with paid-loss development on an equal basis.

**Answer:** Staff observed that consistent use of a common method, for example the average of paid-loss development and case-incurred loss development, was thought to be unbiased and less judgmental than would alternatives resting on an understanding or speculation about the extent and implications of shifts in various data parameters such as closure rates.

### **Trend**

Exhibits 2 (Limited Loss), 3b (Limited Loss), 5, 6b (Limited Loss) and 23

Staff referred to the cited exhibits as they pertained to the trend provisions included in the proposed filing. Key observations made are summarized below.

Portions of Exhibit 2 pertinent to trend analysis and presented in the discussion of loss development were noted.

Exhibit 3b showed various measures of the goodness-of-fit obtained by applying linear and exponential trend models to varying numbers of policy year limited severity ratio points from the loss development approaches considered in preparing the proposed filing. R-squared statistics were derived for each such trend model application (Page 3b.1). Successive pages developed fitted values for linear and exponential models (Pages 3b.2 through 3b.5), followed by “residuals” (the result of subtracting fitted values from the actual observed values for policy year severity ratios) on Pages 3b.6 through 3b.9.

Exhibit 6b applied the tested trend methods to project policy year limited severity ratios for which subsequent estimates were available based on the Bureau's loss development analyses. This exercise tested the comparative ability of such methods to predict subsequent severity ratios.

Page 6b.1 showed indemnity severity ratios by policy year for each loss development approach.

Page 6b.2 showed trended limited indemnity severity ratios using various numbers of policy years applying a linear trend model.

Page 6b.3 showed differences between linear trended and actual policy year limited indemnity severity ratios. It was noted that all trend projections save one (five point trend applied to paid-loss development) were lower than actual results, regardless of trend period or loss development method chosen.

Page 6b.4 showed trended limited-indemnity severity ratios using various numbers of policy years applying an exponential trend model.

Page 6b.5 showed differences between exponential-trended and actual policy year limited-indemnity severity ratios. The vast majority of differences shown indicated that the exponential trend model understated subsequent actual results but that differences tended to be smaller than those seen in the linear model.

Pages 6b.6 through 6b.10 presented results for limited medical severity ratios in the same sequence and format as had been discussed for indemnity losses above. Staff noted that the exponential model came closer to achieving a balance between understatements and overstatements of actual results than did the linear model.

After consideration of the collective information discussed above, staff had selected an annual severity ratio trend of approximately +7.6 percent for use in projecting for indemnity loss ratios and had selected an annual severity ratio trend of approximately +10.3 percent for use in projecting medical loss ratios. Each of these trends was based on results of applying a seven-point exponential trend model to severity ratios taken from the average of the paid-loss and case-incurred loss development approaches.

Claim frequency data based on unit statistical plan reports was presented in Exhibit 23. Staff described the exposure base used in this analysis as being on-level expected losses and noted that this measure included wage level changes, exposure growth and shifts in employment between different kinds of businesses. Consistent with the severity trend approach described above, the Bureau had derived a historical indemnity claim frequency trend by application of an exponential trend model through observed indemnity claim frequencies over the seven most recent available policy years. The Bureau had then applied the indicated severity and claim frequency trend rates in combination to indemnity and medical loss ratios for each of the most recent four policy years and had selected the average of the resulting trended loss ratios for purposes of the proposed filing.

Exhibit 5 presented a time series of limited loss ratios points indexed to Policy Year 1990 based on the selected trends and models described. Fitted points and projected future results were superimposed on Exhibit 5 as dashed lines through and extending beyond the policy year loss ratios from which they had been derived.

**Question:** Does Exhibit 3b include claims over \$1.5 million in loss?

**Answer:** No. This exhibit is based on limited losses. Bureau testing to date suggested that severity trends would be higher than those shown in Exhibit 3b if total losses were included, largely due to the effect of Policy Year 2002 on trend estimates.

**Question:** On Exhibit 23, Page 1, the decline in claim frequency for Policy Year 2001 compared to Policy Year 2000 was almost double that for Policy Year 2000 compared to Policy Year 1999. Does the Bureau know why such a large reduction occurred in Policy Year 2001?

**Answer:** No. It is difficult to determine reasons for year-to-year shifts in claim frequencies or severities. Policy Year 2001 was obviously a very good year for claim frequency, and then Policy Year 2002 showed a small increase. This kind of circumstance (flattened or increasing claim frequency) had also occurred in other older years, such as Policy Year 1993 and Policy Year 1995, with subsequent experience continuing the longer-term favorable trends.

### **Unlimited Loss Exhibits Presented for Purposes of Comparison**

Exhibits 1 (Unlimited Loss), 2 (Unlimited Loss), 2a (Unlimited Loss), 3b (Unlimited Loss) and 6b (Unlimited Loss)

Staff noted that Table I and selected exhibits pertaining to loss development and trend had been provided to the Committees on an unlimited basis, as well as on a limited basis. This methodology was consistent with the supporting information from prior filings and gave some perspective regarding the effects of the change to a limited basis for the current proposal. Staff indicated that applying the selected loss development and trend approaches but using unlimited losses would have resulted in an overall rate level indication approximately four points higher than that presented for discussion, with the difference attributable to higher trend provisions arising in the unlimited approach.

### **Expenses and Benefit On-Level Factor**

Exhibits 8, 9, 10 and 11

Staff reviewed these exhibits to summarize the measurement and estimation of expense provisions incorporated into the proposed filing.

Exhibit 8 showed historical experience used to measure the following expense components:

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

The first four items noted above were reviewed over the three calendar years, 2000, 2001 and 2002. The three-year average ratio of commission and brokerage expense to standard earned premium at Bureau rate level, including large deductible business on a net basis and excluding expense constant income, was used for that expense component of the proposed filing. Other acquisition and general expenses were determined based on the three-year average ratio of those respective expenses to standard earned premium at Bureau rate level, including large deductible business on a gross basis and excluding expense constant income. The relationship between loss-adjustment expense and loss was derived based on the three-year average ratio of loss-adjustment expense to incurred losses, including large deductible on a gross basis. The premium discount provision in the proposed filing was based on size-of-risk distribution for Schedule Y carriers in Manual Year 2001, the most recent available year from unit statistical data.

Exhibit 8 also showed the derivation of the provisions for residual market expense constant income attributed to various expense components. The residual market expense constant proposal of \$240 was based on the currently-approved value of \$235 and recognition of the effects of wage inflation since approval of the current value.

Exhibit 10 derived a provision in the proposed rates and loss costs to offset the impact of expected adjustment in benefit minimums and maximums effective July 1, 2005. As comparable prior effects of revisions in benefit schedules had been removed from the policy year loss ratios derived in loss development analysis and used to select trend provisions for the proposed filing, a separate explicit provision for the prospective change was needed.

Exhibit 9 provided detail of the application of an internal rate-of-return analysis to the proposed filing. Expense provisions for commission and brokerage, other acquisition, general expense, premium and other taxes, premium-based assessments and premium discount were based on Bureau analysis as described above, budgetary provisions or the most recent available assessment levels. Premium collection and loss-payout patterns were also provided from Bureau analysis.

The Bureau inputs were combined with an economic consultant's analysis of the following inputs and parameters to construct a cash flow model appropriate for the business of underwriting workers compensation business in Delaware:

- Pre-Tax Return on Assets
- Investment Income Tax Rate
- Post-Tax Return on Assets
- Reserve-to-Surplus Ratio
- Cost of Capital

The internal rate-of-return model thus constructed was provided in detail within Exhibit 9. Key outputs derived there from for use in the proposed filing were:

- Permissible loss ratio, including loss-adjustment expense and loss-based assessments – 75.52 percent
- Profit and contingencies – minus 5.96 percent

Staff noted that the profit and contingencies provision proposed in the filing was somewhat lower than the provision in currently-approved rates (minus 3.57 percent).

Exhibit 11 provided side-by-side comparison of the expense structure underlying current approved residual market rates and proposed rates. Staff observed that overall expense costs reported by its members were lower than those incorporated in the last Delaware filing (27.09 percent, as compared to 29.25 percent last year), and that the difference was essentially the result of a lower (more negative) profit and contingency provision in the current filing.

**Question:** Is the provision for uncollectible premium part of the proposed voluntary market loss costs?

**Answer:** No. The provision for uncollectible premium is treated as an expense, and, as such, it impacts the residual market rates but not the voluntary market loss costs in the draft filing proposals.

**Question:** What were the cost of capital, profit and pre-tax return on assets parameters for the December 1, 2003 filing?

**Answer:** In the December 1, 2003 filing, cost of capital was 9.14 percent, profit and contingencies were negative 3.97 percent, and the pre-tax return on assets was 4.9 percent.

**Comment:** It was observed that the provision for loss adjustment expense in the draft filing had gone down about a point from the currently-approved level.

**Answer:** Staff concurred that loss-adjustment expense was down as a percent of both premium and loss but observed that, because premium would be higher under the proposal and losses were projected to increase, the amount of loss-adjustment expense would increase from the current level.

**Question:** How did the implied loss cost multiplier for the residual market (i.e., the expense provision in residual market rates) change in the proposed filing?

**Answer:** The expense provision in residual market rates was proposed to decrease by somewhat more than two points, so the implied loss cost multiplier for the residual market would be reduced accordingly.

**Comment:** It was observed that consistency in trending procedures and selections from available alternative methods was important and made sense.

### **Delaware Insurance Plan**

#### **Exhibit 19**

Several features of the Delaware Insurance Plan (the residual market for workers compensation insurance in Delaware) were reviewed based on materials offered in this exhibit. These included the following:

- Comparative loss ratios in the Delaware Insurance Plan by policy size over a five-year period
- Comparative loss ratios in the Delaware Insurance Plan by policy year over a five-year period
- Market share in the Delaware Insurance Plan
- Effects of the approved surcharge program on risks insured in the Delaware Insurance Plan
- A residual market subsidy multiplier to be included in retrospective rating plan tax multipliers

***In response to a prior question about the impact of the DIP surcharge program, it was noted that Page 4 of Exhibit 19 showed DIP-rated risks with credit and debit experience modifications, respectively. The premium impact of the DIP surcharge was shown as approximately \$2.9 million. The average surcharge across all DIP insureds was 11.2 percent.***

**Question:** Would there be ways to collect an equivalent amount of premium through a broader rate or loss cost surcharge rather than to burden individual policyholders with the currently approved plan?

**Answer:** Staff felt that the primary intent of the DIP surcharge program was to provide an incentive to improve loss experience and/or to secure coverage in the voluntary market, rather than to accumulate funds to offset residual market experience. Collection of the same amount of premium through a uniform surcharge would significantly reduce those incentives now provided to the larger and more poorly performing risks.

**Question:** Recognizing the recent and apparently ongoing growth of the DIP, might it be beneficial to form an oversight committee to monitor servicing carrier performance?

**Answer:** Servicing carriers are already monitored on an annual basis through programs jointly administered and applied by the Bureau and NCCI. The Bureau can and does intercede if there are significant problems persisting between any risk and their assigned servicing carrier.

**Question:** What if there are problems with a classification assignment?

**Answer:** The Bureau administers the uniform classification plan and the DIP and will investigate and opine with respect to problems regarding classification assignments.

### **Experience Rating**

#### **Exhibits 13, 20 and 21**

Staff briefly discussed recent changes to the Experience Rating Plan in Pennsylvania. It was noted that counterpart proposals would be tested in Delaware for possible incorporation into future Delaware filings.

The interpretation of Exhibit 13 was described for the participants in the contexts of determining whether credit or debit ratings were appropriate and the extent to which credibility was and should be assigned to individual risk experience.

Exhibit 20 was discussed as the means of deriving anticipated collectible premium ratios for use in Exhibit 12. It was noted that three-year average collectible premium ratios had been used for this purpose. Exhibit 20 also illustrated the computation of expected loss rate factors to adjust proposed residual market rates back to appropriate expected loss factors for use in the Experience Rating Plan and the determination of selected parameters for Experience Rating Plan credibility.

Staff referred briefly to Exhibit 21, which set forth the credibility table proposed for use in the Experience Rating Plan over the proposed rate period.

### **Delaware Construction Classification Premium Adjustment Program**

#### **Exhibit 14**

The history and purpose of this rating program were briefly described using Exhibit 14. Staff reviewed the analytical exhibits reflecting the extent to which employers in the respective eligible classifications had participated in the program and the magnitude of premium credits granted to such employers. Proposed adjustments in offsets for DCCPAP credits by classification were noted.

The adjustment of the table of qualifying wages for recent wage inflation was reviewed for the participants. Staff noted that the proposed effective date for revisions to the DCCPAP was January 1, 2005.

**Question:** Has the Delaware Construction Classification Premium Adjustment Program (DCCPAP) been as active as the Bureau thought it would be when it was first introduced?

**Answer:** It was never expected that all construction risks would participate in the DCCPAP given the nature of the program, which is to identify and adjust premium payments for high-wage employers and redistribute the reductions in premium so provided to other, lower-wage employers. The Bureau stated that, with the DCCPAP in place, the exposure base for workers compensation has not been a controversial issue in Delaware. Toward the objective of providing easy and responsive access to the program, the Bureau issues notices and invitations to apply to all eligible employers annually.



**Question:** Is this program available in other states?

**Answer:** A number of other states, but clearly not all states, do have programs similar in design and/or intent to the DCCPAP. Specifically, it was noted that Pennsylvania, New York and Florida have very similar programs.

**Rating Values Based on Size-of-Loss Analyses**

Exhibits 16, 17A, 17B, 17C, 17D, 18 and 32

These exhibits dealt with the following subjects:

- Small Deductible Loss Elimination Ratios and Premium Credits (Exhibit 16)
- Excess Loss Pure Premium Factors (Exhibit 17A)
- Excess Loss Pure Premium Factors Including Allocated Loss Adjustment Expense (Exhibit 17B)
- Excess Loss Premium Factors (Exhibit 17C)
- Excess Loss Premium Factors Including Allocated Loss Adjustment Expense (Exhibit 17D)
- State and Hazard Group Relativities (Exhibit 18)
- NCCI Item Filing R-1385 – 2003 Update to Retrospective Rating Plan Parameters (Exhibit 32)

Staff outlined the processes and procedures applied in the derivation of the indicated factors, including reference to procedures and parameters provided for the Bureau's use by the NCCI. Within these exhibits, a general outline of approach was provided, and then key differences in the analysis between these exhibits were pointed out to participants. The implications of NCCI's item filing concerning expected loss size ranges were described to attendees.

**Question:** Is the excess loss factor used to provide recognition of losses in excess of \$1.5 million the average of the factors on the \$1.5 million line on Page 12 of Exhibit 17B?

**Answer:** No. The indicated excess loss factors before application of the risk load were weighted across hazard groups to derive the excess loss provision in Exhibit 12.

**Question:** Please explain the reasons for there being different percentage changes in excess loss factors, including and excluding allocated loss-adjustment expense.

**Answer:** The excess loss factors, including allocated loss-adjustment expense, are more consistent with the factor presented in Exhibit 12 as part of the derivation of an overall rate and loss cost change indication. In prior filings the Bureau had used average costs, including loss-adjustment expense, to enter the NCCI loss distributions to derive excess loss factors. The proposed filing enters the NCCI loss distributions at the same point for purposes of determining excess loss factors with and without loss adjustment expense. For example, if the average cost was \$100 and allocated loss-adjustment expense was six percent, prior filings deriving an excess factor including allocated loss-adjustment expense would have entered the loss distribution at \$106. For the proposed filing, the loss distribution had been entered at \$100. This change in procedure was mitigating the increases that would otherwise have occurred in the excess loss pure premium factors and excess loss premium factors, including provision for allocated loss adjustment expense.

**Question:** Are IBNR losses considered in determining excess loss factors?

**Answer:** All losses, including IBNR, are considered, but IBNR losses cannot be separately identified from the loss distributions provided.

**Comment:** Technically, different loss distributions including and excluding allocated loss-adjustment expenses, respectively, are needed.

**Answer:** That is correct, but, absent such separate distributions, allocated loss-adjustment expenses are assumed to be a constant proportion of loss.

**Question:** The differentials at the bottom of Page 1 of Exhibit 18 were questioned. An explanation was requested for why the state and hazard group relativities went down as costs went up.

**Answer:** The calculation of state and hazard group relativities produce lower factors as costs rise. The calculation underlying these relativities was the countrywide average claim cost relative to the Delaware average, i.e., Column (6) divided by Column (7) on Page 8 of Exhibit 18.

### **Retrospective Rating**

#### **Exhibits 24 and 25**

Exhibit 24 was described as providing indicated loss development factors proposed to be available for use on an optional basis. Specified factors were shown for no loss limitation and applicable to the expected loss portion of premium. In addition, a general procedure to derive loss development factors appropriate for use with various loss limitations was included in Exhibit 24.

Exhibit 25 presented the derivation of a retrospective rating plan tax multiplier, including the use of the Delaware Insurance Plan subsidy previously noted and shown on Exhibit 19.

### **Workplace Safety Program and Merit Rating**

#### **Exhibit 29**

The background of the Workplace Safety Program was reviewed, noting 1999 changes expanding the eligibility for the program, instituting an overall offset to manual rating values to fund operation of the program and implementation of a Merit Rating Program for small employers.

Page 29.1 showed recent historical experience for participation in the Workplace Safety Program and derived an indicated offset to manual rates based thereon. Page 29.2 showed anticipated distributions of merit-rated risks between credits, no adjustments and debits and combined the indicated offset for net merit rating credits with that for the Workplace Safety Program. The combined indication was for a 2.36 percent adjustment to manual rating values.

### **Classification Relativities**

#### **Exhibits 15, 22A, 22B, 22C, 26, 27, 28, Class Book, 30, 31A and 31B**

Exhibit 15 described the formulae and procedures used for analysis of classification experience in the proposed filing. Staff commented on ongoing enhancements to classification analysis procedures that would increasingly allow distributions of pure premiums to respond to underlying shifts in observed data and a secondary capping procedure intended to avoid large fluctuations about the average changes in rating values from year-to-year. This latter procedure, while applied in the proposed filing, had only affected the proposed rating value for three classifications.

Exhibits 22A, 22B and 22C each provided unit statistical data by manual year and industry group over the most recent available five years. These tabulations were used in the derivation of certain factors applicable to determining classification-specific rating values. Exhibit 22A showed losses trended and developed to an ultimate basis, Exhibit 22B showed losses developed to an ultimate basis but not trended, and Exhibit 22C showed reported losses without trend or loss development applied.

Exhibit 28 provided parameters derived for and applied in the execution of the prescribed procedures for derivation of classification rating values. The Class Book presented detailed five-year histories of experience by classification and showed calculation of indicated rating values based on Delaware experience alone. Staff noted that a separate procedure applied to those Delaware classifications where available experience warranted less than five percent credibility for non-serious losses and that the application of those special procedures was not reflected in the Class Book pages.

Five of the referenced exhibits were noted as providing various summaries of the results of the Bureau's derivation of proposed classification rating values. Exhibit 26 showed current, indicated and proposed residual market rates before DCCPAP and applicable surcharges for the Workplace Safety Program and Rating Plan. This exhibit also showed percentage changes in proposed rates before the DCCPAP, Workplace Safety Program and Merit Rating Plan surcharges and final proposed residual market rates. All classes were identified by code on Exhibit 26. Exhibit 27 showed proposed residual market rates, voluntary market loss costs and expected loss rates by classification number. Exhibit 30 was a histogram showing the incidence of indicated and proposed changes in residual market rates by percentage range. Exhibits 31A and 31B provided the same data as Exhibit 26 but added brief classification descriptions. Exhibit 31A was shown sorted by classification code number. Exhibit 31B was shown sorted in ascending sequence by proposed percentage change.

**Question:** What is the capping procedure employed in the filing?

**Answer:** Allowable changes in classification rating values must fall within 25 points of the associated industry group average change.

**Question:** When looking at a classification in the Class Book, would total actual losses or total expected losses be a more important parameter in determining a classification's rating value?

**Answer:** Expected losses are used to a lesser extent than was previously the case, since credibility assignments for almost all classifications are now a function of payroll. The Class Book pages provide comparisons of how pure premiums compare to current rating values, how they are changing year-to-year, and how those changes in a given classification compare to trends for the state as a whole.

## **ITEM (2) REVIEW OF PROPOSED DECEMBER 1, 2004 "F" CLASSIFICATION FILING**

### **Overall Indicated Changes in Collectible and Manual Rating Values for F Classifications**

#### **Exhibit 1**

Exhibit 1 was reviewed, with the following points highlighted:

- The estimate of a policy year loss ratio trended to the mid-point of the prospective rating period (Line 1)
- A credibility-weighting procedure recognizing the limited amount of available historical experience in Delaware and applying the complement of Delaware experience credibility to the permissible loss ratio underlying current rates (Lines 2, 3 and 4)

- Adjustment of the credibility-weighted trended loss ratio for loss adjustment expenses (Lines 5 and 6)
- Comparison of the trended policy year loss and loss adjustment ratio to a permissible loss and loss adjustment ratio based on econometric analysis (Lines 7 and 8)
- Adjustment for estimated effects of the October 1, 2005 benefit change (Lines (9) and (10))

In concert, the above steps produced the indicated change in F-Classification residual market rates. The proposed change in F-Classification voluntary market loss costs was derived from the indicated change in residual market rates by adjusting the latter indication for the effects of changes in the permissible loss ratio, including loss adjustment expense and loss-based assessments (Line 11).

Staff pointed out the proposed overall changes in F-Classification residual market rates (-5.08 percent) and F-Classification voluntary market loss costs (-3.94 percent) derived from the Bureau's analysis of the most recent available Delaware data.

Staff noted the proposed filing's accounting for effects of the Experience Rating Plan in the determination of proposed changes in manual rating values, as presented on Exhibit 1. This analysis started with the collectible premium ratios underlying presently approved rating values (Line 12). The Bureau had then measured the collectible premium ratios that the Experience Rating Plan was expected to produce during the proposed rating period (Line 13). Using the relationships between these current and estimated future collectible premium ratios, staff had derived indicated changes in manual F-Classification residual market rates (Line 14). Indicated changes in manual F-Classification voluntary market loss costs (Line 15) had been similarly derived by accounting for the impact of changes in anticipated collectible premium ratios.

### **Analysis of Loss Experience**

#### **Exhibit 5**

Staff described the content of the referenced exhibit. Highlights from that description are set forth below.

Due to limitations and questions pertaining to the reporting of Financial Call data for F-Classification business, the Bureau's F-Classification filings had historically been prepared using unit statistical data. This filing continued that past practice.

Loss development data available for this filing was limited in the following ways:

- Only case-incurred loss development was possible, as unit statistical reporting did not capture paid-loss amounts over the entire historical period in question.
- Data reported was limited to first through eighth reports.
- Several older policy years technically eligible for later reporting periods had reported zero losses and thus showed no loss development experience for use in this filing.

Delaware loss development experience had been used as the basis for this filing.

Staff had considered various trend models applied separately to the estimated indemnity and medical F-Classification loss ratios. Given the volatility of estimated loss ratios year-to-year and the effects of limited data on the exponential trend models in particular, a four-year average loss ratio had been selected to estimate indemnity and medical trended loss ratios.

## **Expense Provisions**

### Exhibits 2, 3 and 4

Expense data was not available to the Bureau separately for F-Classification and other business. Accordingly, the expense study supporting this filing was identical in many respects to that previously-discussed by the Committees with regard to the December 1, 2004 Residual Market Rate and Voluntary Market Loss Cost Filing. Minutes of that discussion of this study are replicated here for ease of reference, with appropriate modification for the F-Classification business used to review premium discount provisions for the F-Classification filing.

Exhibit 3 showed historical experience used to measure the following expense components:

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

The first four items noted above were reviewed over the three calendar years, 2000, 2001 and 2002. The three-year average ratio of commission and brokerage expense to standard earned premium at Bureau rate level, including large deductible business on a net basis and excluding expense constant income, was used for that expense component of the proposed filing. Other acquisition and general expenses were determined based on the three-year average ratio of those respective expenses to standard earned premium at Bureau rate level, including large deductible business on a gross basis and excluding expense constant income. The relationship between loss-adjustment expense and loss was derived based on the three-year average ratio of loss-adjustment expense to incurred losses, including large deductible on a gross basis. The premium discount provision in the proposed filing was based on size-of-risk distribution for F-Classification business written by Schedule Y carriers in Manual Year 2001, the most recent available year from unit statistical data.

Exhibit 3 also showed the derivation of the provisions for residual market expense constant income attributed to various expense components. The residual market expense constant proposal of \$240 was based on the currently-approved value of \$230 and recognition of the effects of wage inflation since approval of the current value.

Exhibit 4 provided detail of the application of an internal rate-of-return analysis to the proposed filing. Expense provisions for commission and brokerage, other acquisition, general expense, premium and other taxes, premium-based assessments and premium discount were based on Bureau analysis as described above, budgetary provisions, or the most recent available assessment levels. Premium collection and loss-payout patterns were also provided from Bureau analysis.

The Bureau inputs were combined with an economic consultant's analysis of the following inputs and parameters to construct a cash flow model appropriate for the business of underwriting F-Classification workers compensation business in Delaware:

- Pre-Tax Return on Assets
- Investment Income Tax Rate
- Post-Tax Return on Assets
- Reserve-to-Surplus Ratio
- Cost of Capital

The internal rate-of-return model thus constructed was provided in detail within Exhibit 4. Key outputs derived there from for use in the proposed filing were:

- Permissible loss ratio, including loss-adjustment expense and loss-based assessments – 75.30
- Profit and contingencies – minus 1.24 percent

Staff noted that the profit and contingencies provision proposed in the filing was nominally different from the provision in currently-approved rates (-0.62 percent).

Exhibit 2 provided side-by-side comparison of the expense structures underlying currently-approved F-Classification residual market rates and proposed F-Classification residual market rates. Staff observed that overall expense costs reported by its members were slightly lower than those incorporated in the last Delaware filing (37.39 percent, as compared to 37.90 percent last year). Staff noted that the most significant changes in individual expense components involved the areas of general expenses (3.12 percent in this filing, compared to 4.56 percent in the 2002 F-Classification filing), profit and contingency (minus 1.24 percent in this filing, compared to minus 0.62 percent in the 2002 F- Classification filing), commission (7.13 percent in this filing and 6.65 percent for the 2002 filing), and federal assessment (12.69 percent in this filing and 12.31 percent in the 2002 F-Classification filing).

#### **Effect of October 1, 2005 Benefit Change**

##### Exhibit 14

Staff reviewed this exhibit, which derived a provision in the proposed rates and loss costs to offset the impact of expected adjustment in benefit minimums and maximums effective October 1, 2005. As comparable prior effects of revisions in benefit schedules had been removed from the policy year loss ratios derived in loss development analysis and used to select trend provisions for the proposed filing, a separate explicit provision for the prospective change was needed.

#### **U. S. Longshore & Harbor Workers (USL&HW) Coverage Factor**

##### Exhibit 6

Staff noted that 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. This filing indicated an increase in the USL&HW coverage percentage from 44.6 percent to 49.2 percent.

#### **F-Classification Expected Loss Rate Factors**

##### Exhibit 11

Exhibit 11 illustrated the computation of expected loss rate factors to adjust proposed F-Classification residual market rates back to appropriate expected loss factors for use in the Experience Rating Plan.

### **F-Classification Tax Multiplier**

#### **Exhibit 8**

For policies underwritten on a retrospective (loss-sensitive) basis for F-Classification business, a tax multiplier is required. Exhibit 8 presented the derivation of the proposed tax multiplier for this filing, 1.2574.

### **F-Classification Residual Market Rates and Voluntary Market Loss Costs**

#### **Exhibits 7, 9, 10, 12, 15, Class Book**

While recognizing the limited experience data by classification available for purposes of this filing, an analysis of relative classification experience had been undertaken in support of these proposals. The rate formulae applied in that review were set forth in Exhibit 10.

Exhibit 7 provided unit statistical data by manual year, with exposures and losses trended and developed to an ultimate basis.

Individual F-Classification experience and the promulgation of indicated F-Classification residual market rates were presented in the Exhibit 15, the Class Book, Exhibit 9 and Exhibit 12.

**Question:** Could F-Classification rates be derived using rating values from other jurisdictions either completely or in part?

**Answer:** This approach had been considered in the past, but, despite the impression that the benefits and administrative systems for federal benefits should be similar across state boundaries, large differences in rating values had been observed from jurisdiction-to-jurisdiction. These observations called into question the relevance of other state rating values for Delaware.

### **General Questions**

**Question:** Have you been in touch with NCCI regarding their recent or pending domestic terrorism filing?

**Answer:** We haven't seen anything on that topic that was sufficiently complete as to be included with the Delaware filing.

**Comment:** NCCI had expressed the intention of making this filing on a countrywide basis shortly. It will reflect a uniform rating value per \$100 of payroll similar to the TRIA filing and will have a proposed effective date of January 1, 2005.

**Answer:** Bureau staff was a party to some committee discussions on this subject at NCCI but were not aware of this issue having matured to the point described. Staff expressed interest in this subject and indicated that reference materials documenting actual NCCI filings and procedures would be helpful in seeking approval of this program in Delaware.

**Question:** What is the timeframe for the December 1, 2004 filing after this meeting?

**Answer:** Staff review of comments made and possible additional analysis in response thereto would follow the meeting. The primary audience for any resulting filing would be the Delaware Department of Insurance. The expected proposed effective date would remain December 1, 2004.

**Question:** Is there any external frequency data that the Bureau might obtain that would be independent of and more current than available unit statistical data?

**Answer:** The Bureau indicated that it obtained data from the Delaware Department of Labor, Industrial Accident Board about first reports of injury. The number of such reports for 2004 was down 11.4 percent after 2003 had shown an increase. Frequency changes would appropriately be measured reflecting payroll changes and shifts between various types of work exposures.

**Question:** It was observed that small contractors currently paying workers compensation premium rates in the range of \$16 per \$100 of payroll would be paying \$19 to \$20 per \$100 of payroll if the filing were submitted and approved as discussed at the meeting. The opinion was expressed that cost-avoidance would subsequently precipitate more use of subcontractor relationships.

**Answer:** It was acknowledged that alternative market mechanisms and cost-containment strategies, both within and outside the law, were often invoked more frequently in periods of rising costs and hard insurance markets. Self-insurance and deductible coverages were cited as examples of allowed market alternatives. With respect to the issue of risks simply avoiding purchase of workers compensation insurance, it was noted that the Bureau worked closely and continuously with the Industrial Accident Board in support of that agency's work to enforce coverage requirements.

There being no further business for the Committee to conduct, the meeting was adjourned.

Respectfully submitted,

Timothy L. Wisecarver  
Chair - Ex Officio

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