DRAFT: Not yet reviewed by the Actuarial and 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 Salon C of The Spencer Hotel (formerly the Wyndham Garden Hotel), 700 King Street, Wilmington, Delaware on Tuesday, July 26, 2005 at 10 a.m.

The following members were present:

Actuarial Committee

Ms. M. Gaillard*	American Home Assurance Company
Not Represented	CNA Insurance Company
Ms. M. Sperduto	Harleysville Mutual Insurance Company
Not Represented	Hartford Accident & Indemnity Company
Mr. D. Lawton*	Liberty Mutual Insurance Company
Mr. L. Artes	Travelers Property & Casualty Company

Classification and Rating Committee

Ms. M. Gaillard*	American Home Assurance Company
Mr. R. Edmonds	Amguard Insurance Company
Mr. H. Jacobs	Harleysville Mutual Insurance Company
Mr. D. Lawton*	Liberty Mutual Insurance Company
Mr. J. Fitzgerald**	New Castle County Chamber of Commerce
Mr. S. Foltz	National Federation of Independent Business
Ms. B. Flaherty	PMA Insurance Company
Not Represented	Zenith Insurance Company
Mr. T. Wisecarver	Chair - Ex Officio

Also present were:

Mr. E. Reed	Delaware Department of Insurance
Mr. R. Heffron	Delaware State Chamber of Commerce
Mr. J. Randall	Delaware State Chamber of Commerce
Mr. S. Cooley	Duane, Morris LLP
Mr. J. Neidermyer	INS Consultants, 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
** Present for Part of Meeting

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 15, 2005 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 were being maintained in conformance with prevailing wage levels.

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

Question: A committee member inquired about the status of members of Limited Liability Companies (LLCs) for purposes of coverage and premium computation.

Answer: Staff indicated that Delaware law was silent with respect to LLCs, allowing alternative treatments of such individuals.

Comment: The committee member noted instances that they had encountered involving six or seven LLC members, each of whom might or might not be compensated in any particular policy period.

Answer: Staff indicated that the Delaware Department of Labor might be better able to advise parties involved in such circumstances than could the Bureau.

Partners, Officers and Other Exclusion Endorsement – WC 00 03 08
Sole Proprietors, Partners, Officers and Others Coverage Endorsement – WC 00 03 10
Mid-Term Application and Procedures for Changes in Status or Carrier Group Providing Coverage

A staff memorandum dated June 13, 2005 described questions that had arisen regarding mid-term application of these endorsements. It was proposed to clarify existing procedures that generally limited attachment of the desired endorsement(s) to the policy effective date and required written approval of any exceptions by the carrier. Staff presented this issue to the Committees for discussion.

Delaware Construction Classification Premium Adjustment Program

A staff memorandum dated June 6, 2005 proposed updating the schedule of calendar quarters used as the basis for determining qualifying wages for the DCCPAP. Staff presented this issue to the Committees for discussion. A handout was provided expanding the proposed language and making the Manual entry more illustrative and generic for subsequent updates to the DCCPAP.

The Committee discussion then moved to a review of staff work supporting the December 1, 2005 Residual Market Rate and Voluntary Market Loss Cost Filing.

Question: Staff was asked whether the Bureau felt that the DCCPAP program had been successful.

Answer: Staff responded affirmatively, noting the utility of this program as an alternative to the use of hours worked as an exposure base. It was further observed that, with the benefit of the existing DCCPAP, comparisons could be made of experience for relatively high-wage and low-wage employer groups.

Comment: The possibility that some employers might be intimidated by the administrative aspects of the program, inhibiting participation, was raised.

Answer: While staff was admittedly not privy to the thoughts of individual eligible employers, communication efforts maintained in support of the program were substantial, and no evidence had been obtained to date suggesting that participation in the program was artificially or inappropriately low due to the requirements of making application for credits. It was noted that the nature of the program was to realign premium payments between high-wage and low-wage employers, and, thus, many employers would not be expected nor intended to apply for credits.

Question: Staff was asked who set the qualifying wage rates and associated credits.

Answer: Since inception of the program, qualifying wages and credit levels had been adjusted periodically in response to changes in the statewide average weekly wage.

ITEM (1) REVIEW OF THE PROPOSED DECEMBER 1, 2005 RESIDUAL MARKET RATE AND VOLUNTARY MARKET LOSS COST FILING

Participants had been provided in advance of the meeting with electronic 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, 2005. 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 schedule of loss limitations by policy year reflecting the expectation that loss size would increase over time as wages, benefits and prices were subject to both ongoing economic inflation and changes in utilization. Staff outlined considerations that had led to the adoption of a limited-loss analysis for purposes of the December 1, 2004 filing proposal and noted that those considerations had persuaded staff to apply similar procedures in developing the December 1, 2005 filing.

An excess loss factor (Line 3(a)) was included in the analysis to account for the effects of the limitations applied in the Bureau's loss development and trend analyses. 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, 2006 benefit change. Adjustment for the estimated effects of the July 1, 2006 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 (10.22 percent increase) and voluntary market loss costs (9.15 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 17) had been derived by also accounting for the nominal impact of changes in the offset to voluntary market rating values for continuation of the approved surcharge program in the Delaware Insurance Plan (Lines 15 and 16).

Question: The distribution of benefits between indemnity and medical was thought to be noteworthy, and a question was posed about recent and/or possible future changes to the Delaware system that would account for the historical experience or address the trend toward increasing proportion of total loses being attributable to medical going forward.

Answer: Historically, staff thought that discussions about possible system changes had been primarily focused on medical issues. It was pointed out that Delaware had no workers compensation fee schedule or formal managed care provisions. The maximum indemnity benefit in Delaware was set at two-thirds of the statewide average weekly wage (whereas most jurisdictions used 100 percent of the statewide average weekly wage for that purpose), increasing the apparent bias toward medical losses within the Delaware system. However, staff was aware of concerns that had been expressed regarding administration of indemnity benefits that might also give rise to proposals for system changes.

Comment: An attendee expressed the view that, in having increasing concentration in medical benefits, Delaware was following a national trend. This person opined that, countrywide, medical now accounted for approximately 57 percent of total workers compensation benefits.

Question: An attendee asked whether there was currently pending legislation focused on workers compensation issues in Delaware.

Answer: Staff expected that in future legislative sessions there would be discussion of fee schedules, direction of choice for medical service providers, stacking of permanent partial awards, maximum indemnity benefits and other related topics. It was uncertain whether and/or when action would be taken on any of these matters. Staff observed that workers compensation rates did tend to be higher in Delaware than in nearby jurisdictions, serving as a possible incentive for action to change the system and its ongoing costs.

Loss Development

Exhibits 1 (Limited Loss), 1a, 1b, 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, 2000 through 2004, 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 selected limit values in paid and/or incurred values had been identified using large claim data separately reported by carriers, and adjustments had been made to reflect those limits in the combined paid and/or incurred amounts in Table I. This adjustment process was described as having affected every policy year except 1991, 1996, 1998, 2000 and 2001 on a paid basis, and every policy year on an incurred basis, for at least one evaluation. Exhibit 1a provided background analysis from the December 1, 2004 filing and the series of loss limits applied by policy year in producing Exhibit 1 on a limited basis. Exhibit 1b showed the reductions to reported loss amounts produced by application of the limits from Exhibit 1a.

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 Incurred Development Factors:

Third order logarithm

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

In the above expression, “y” represents the variable to be estimated and “x” is an index of the maturity for the observed and/or projected stages of policy year development at which the values of “y” were observed. 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.

Better results were obtained by subtracting unity (1.000) from the observed indemnity paid loss development factors before using the above curve form. The estimated or smoothed “y” values were then added to unity to derive smoothed indemnity paid loss development factors.

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 and "x" is an index of the maturity for the observed and/or projected stages of policy year development at which the values of "y" were observed. 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.

Better results were obtained by subtracting unity (1.000) from the observed indemnity paid loss development factors before using the above curve form. The estimated or smoothed "y" values were then added to unity to derive smoothed indemnity paid loss development factors.

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, as was the case for the December 1, 2004 filing, 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 limitations by policy year. Staff noted that, although the base losses shown on Page 2.4 had been limited in advance 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 on a limited basis.

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, 2006, 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 six-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 Incurred Development Factors:

Third order logarithm

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

In the above expression, "y" represents the variable to be estimated, and "x" is an index of the maturity for the observed and/or projected stages of policy year development for which the variable values were observed. 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.

Better results were obtained by subtracting unity (1.000) from the observed indemnity paid loss development factors before using the above curve form. The estimated or smoothed "y" values were then added to unity to derive smoothed indemnity paid loss development factors.

Medical Paid Development Factors:

NOTE: DURING THE COMMITTEE MEETING, STAFF DESCRIBED THE CURVE USED TO FIT MEDICAL PAID LOSS DEVELOPMENT FACTORS AS BEING A FIFTH ORDER INVERSE POLYNOMIAL, AS SHOWN BELOW:

Fifth order inverse polynomial

$y = a + b/x + c/(x^2) + d/(x^3) + e/(x^4) + f/(x^5)$

In the above expression, "y" represents the variable to be estimated, and "x" is an index of the maturity for the observed and/or projected stages of policy year development for which the variable values were observed. The terms "a," "b", "c", "d", "e" and "f" 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.

SUBSEQUENT TO THE MEETING, IT WAS DESCOVERED THAT THE CURVE ACTUALLY APPLIED FOR THIS PURPOSE WAS A FIFTH ORDER LOGARITHM OF THE FOLLOWING FORM:

y = a + b*log(x) + c*log(x)^2 + d*log(x)^3 + e*log(x)^4 + f*log(x)^5

Better results were obtained by subtracting unity (1.000) from the observed indemnity paid loss development factors before using the above curve form. The estimated or smoothed "y" values were then added to unity to derive smoothed indemnity paid loss development factors.

Medical Paid-to-Incurred Development Factors:

The most recent actual three-year average paid-to-incurred age-to-age factor was selected for this transition. In this year's analysis, as was the case for the December 1, 2004 filing, 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, 2004 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 2004 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 2004 filing had also included loss development analysis on a limited basis, these comparisons were shown on a limited basis. Staff noted in particular the adverse development occurring over the most recent calendar year for medical case-incurred loss development, as illustrated on Page 4 of Exhibit 2b.

Question: Staff was asked how the Bureau obtained the data used to accomplish the limitations of large losses.

Answer: The Financial Data Calls collected by the Bureau include a Large Claim Call, the threshold for which was below the limits shown in Exhibit 1b and applied in the filing analysis.

Question: An attendee asked about how the limitations had affected indemnity and medical losses, respectively.

Answer: Staff indicated that the capping of losses was much more significant for medical losses than for indemnity.

Question: Inquiry was made as to how the limitations and remaining loss amounts after capping were apportioned between indemnity and medical loss.

Answer: Staff indicated that the capping procedures recognized amounts of paid and incurred losses attributable to indemnity and medical on a claim-by-claim basis, with effects of the capping being applied accordingly.

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.

Comment: One attendee advised that they had been informed by claims professionals working in Delaware and other jurisdictions that workers compensation claims tended to be closed much faster in other states than in Delaware.

Comment: Another attendee attributed this observation to a combination of different statutory provisions and the effects of litigation. In discussion it was noted that, while claim petitions were being heard and resolved more quickly than had previously been the case in Delaware, faster decisions did not necessarily result in claims being closed more quickly.

Trend

Exhibits 2 (Limited Loss), 3 (Limited Loss), 5, 6 (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 3 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 3.1). Successive pages developed fitted values for linear and exponential models (Pages 3.2 through 3.5), followed by “residuals” (the result of subtracting fitted values from the actual observed values for policy year severity ratios) on Pages 3.6 through 3.9.

Exhibit 6 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 6.1 showed indemnity severity ratios by policy year for each loss development approach.

Page 6.2 showed trended limited indemnity severity ratios using various numbers of policy years applying a linear trend model.

Page 6.3 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 6.4 showed trended limited-indemnity severity ratios using various numbers of policy years applying an exponential trend model.

Page 6.5 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 6.6 through 6.10 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 +6.6 percent for use in projecting for indemnity loss ratios and had selected an annual severity ratio trend of approximately +8.2 percent for use in projecting medical loss ratios. Each of these trends was based on results of applying a six-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 six most recent available policy years, resulting in an annual frequency trend of –6.0 percent. 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.

Question: Staff was asked how many large claims had been limited as a result of the processes applied this year.

Answer: Staff reported that 170 claims in total had been affected by the limits selected. Forty of those claims were from Policy Years 1984 and prior. For Policy Year 2004 five claims had been limited, for Policy Year 2003 four claims had been limited, and for Policy Years 2002, 2001 and 2000, five, four and seven claims had been limited, respectively. It was noted that, for Policy Years 2000 and 2002, much larger dollar amounts were involved in the limitations than was the case for other recent policy years, even though the number of claims being limited was similar year-to-year.

Question: An attendee asked what countrywide experience was with respect to claim frequency.

Answer: Frequency was broadly reported and estimated to be improving countrywide, trends also observed in Delaware and Pennsylvania. The Bureau noted that it had obtained information from the Delaware Department of Labor in which 2005 showed significant declines in reported counts from the 2004 level, suggesting that claim frequency would continue to improve for insured data in the near term.

Comment: An attendee noted that the fact that claim frequency had been declining was almost, if not in fact, universal across all jurisdictions.

Question: Staff was asked what the selected trend for claim frequency had been in the previous year's filing.

Answer: For the December 1, 2004 filing the selected claim frequency trend had been –7.7 percent per year.

Exhibit 5 presented a time series of limited loss ratios points indexed to Policy Year 1991 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.

Comment: It was noted that, while fewer claims were entering the system over time, the cost per claim for claims that were reported was increasing.

Answer: Staff concurred, stating that, if claim frequency had not been materially and persistently improving, then system costs and rating values would be substantially higher than was presently the case.

Comment: The opinion was expressed that improvement in claim frequency had been more prevalent in the area of relatively small claims and that the observed trends were affected by shifts in employment over time from larger manufacturing risks to smaller service-oriented risks. These phenomena were described as contributing to the increase in Delaware's residual market share, because insurers were less likely to insure smaller employers.

Unlimited Loss Exhibits Presented for Purposes of Comparison

Exhibits 1 (Unlimited Loss), 2 (Unlimited Loss), 2a (Unlimited Loss), 2b (Unlimited Loss), 3 (Unlimited Loss) and 6 (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 22 points higher than that presented for discussion.

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, 2001, 2002 and 2003. 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 2002, 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 $250 was based on the currently-approved value of $240 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, 2006. 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 from Exhibit 9 for use in the proposed filing were:

- Permissible loss ratio, including loss-adjustment expense and loss-based assessments – 74.79 percent
- Profit and contingencies **–** minus 3.84 percent

Staff noted that the profit and contingencies provision proposed in the filing was somewhat less negative than the provision in currently-approved rates (minus 5.96 percent) and comparable to the provision included in December 1, 2003 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 nominally higher than those incorporated in the last Delaware filing (27.71 percent, as compared to 27.09 percent last year) and that the two most notable differences, moving in offsetting directions, were the provisions for the Workers Compensation Fund (down from 4.00 percent last year to 2.00 percent) and the profit and contingency provision discussed above.

Delaware Insurance Plan

Exhibit 19

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

Comment: An attendee stated that many of the risks in the DIP were not inherently "unsafe" risks.

Answer: Staff noted that there were many reasons that risks could be placed in the residual market, including poor historical loss experience, non-payment of premium for prior voluntary carriers, activity focused in classifications of business presenting high loss potential or servicing problems, and newness of risks (having no established track record for underwriting purposes). The Bureau noted that it was developing a "depopulation list" that carriers would be able to use to find risks in the DIP meeting their underwriting criteria. That utility was expected to be available by the close of the Third Quarter 2005. The Bureau had also recently published the Carrier Pricing Benchmark application to assist employers and producers in identifying attractively-priced carriers licensed in Delaware.

Comment: It was noted that residual market rates were actually lower than those of some carriers.

Answer: While some companies did have prices that exceeded the DIP rates, many carriers remained with prices lower than those of the residual market.

Question: Staff was asked whether it had considered the idea of applying a uniform surcharge to DIP risks.

Answer: Staff described the implementation of the existing surcharge program as an alternative to a uniform program that would apply to all DIP risks regardless of circumstances. The current plan offered relief from surcharges even if an employer remained in the residual market, so long as their experience improved to the extent that their experience modification no longer exceeded unity.

Comment: An attendee observed that junior staff within agencies would often handle smaller businesses. Given the premiums and commissions at issue, the speaker opined that it might not be worth the required effort to the agency to move small employers out of the assigned risk pool.

Comment: Another attendee stated that, so long as carriers perceived Delaware as having a difficult system in terms of administrative burdens and the ability to manage and predict costs, the residual market share would tend to remain higher than for other states.

Experience Rating

Exhibits 13, 20 and 21

Staff briefly reviewed 2004 changes to the Experience Rating Plan in Pennsylvania. It was noted that counterpart proposals remained to be tested and revised as appropriate 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 June 1, 2006.

Question: An attendee inquired what the threshold wage was for qualification for credit under the DCCPAP.

Answer: Staff pointed out the current and proposed schedule of wages for DCCPAP credits. It was noted that the qualifying wage was, by design, at a point where some employers would be able to qualify but others would not. This was a necessary part of the intended result of reallocating premium payments between high-wage and low-wage employers. It was further noted that the qualifying wages had to be achieved for all workers in a given classification for an employer and that the wage test could not be done for individual employees or for selected groups of employees only.

Question: Staff was asked whether the effective date for changes to the Pennsylvania counterpart to the DCCPAP was also being revised.

Answer: Staff confirmed that the premium adjustment programs in both states were being managed in an attempt to coordinate the timing of effective dates for changes with revisions to other Manual rules.

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 2.60 percent adjustment to manual rating values.

Question: Staff was asked how the experience of risks participating in the Workplace Safety Program compared with that of other risks.

Answer: Staff noted that some comparative data on the point in question was published on the respective Delaware and Pennsylvania websites.

Comment: It was observed that, despite the philosophical similarities of the plans, the programs in Delaware and Pennsylvania were very different in several respects. In particular, it was stressed that Delaware used on-site surveys and inspections by outside parties as part of the certification and renewal processes.

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-1388 – 2004 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: Staff was asked to confirm an attendee's impression that the excess loss factors most recently derived by the Bureau were higher than those currently in effect.

Answer: Staff confirmed that these factors were increasing, especially in the higher layers of the published factors.

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.

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 a secondary capping procedure intended to avoid large fluctuations about the average changes in rating values from year-to-year. This procedure, while applied in the proposed filing, did not result in the capping of any additional 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 including loss-adjustment expenses trended and developed to an ultimate basis, Exhibit 22b showed losses including loss-adjustment expenses developed to an ultimate basis but not trended, and Exhibit 22c showed reported losses without loss-adjustment expenses.

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: Staff was asked how non-reviewed classifications could be identified within the agenda materials.

Answer: These classifications were designated with an "NR" entry in Exhibits 26, 31a and 31b. Non-reviewed classifications were described as having very small amounts of exposure (generally measured using reported payrolls).

Question: The selection procedures applied for temporary staffing classifications were noted, and staff was asked whether the rating values for temporary staffing classifications would always be set equal to those of the associated non-temporary codes?

Answer: Retaining separate classifications allows collection of experience data for temporary staffing businesses and could ultimately support differences in rating values for Delaware, as had recently been the case in Pennsylvania.

Question: Interest was expressed in how rating values for temporary staffing classifications compared to those of non-temporary counterparts in Pennsylvania?

Answer: Staff reported that the temporary staffing classifications consistently reported higher claim frequency than did the non-temporary codes.

Question: An attendee asked how long temporary staffing codes had been in place in Delaware.

Answer: Staff was uncertain as to precisely how long the temporary staffing codes had been in effect, noting that these codes were not newly-established and had been in effect for some time.

Domestic Terrorism, Earthquake and Catastrophic Industrial Accident Provision

A staff memorandum dated July 20, 2005 was noted in the context of this agenda item.

Filings establishing statistical codes and rating values for the described hazards had been submitted in most jurisdictions countrywide and were approved in a majority of those states where they had been filed. The lack of available Delaware data pertinent to these potential causes of loss was pointed out, and key parameters of the analysis supporting filings from other jurisdictions and their proposed application to Delaware's circumstances was discussed.

Staff indicated an expectation that the resulting rating values would be included in the December 1, 2005 filing.

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

Respectfully submitted,

Timothy L. Wisecarver
Chair - Ex Officio