

**TO:** The Honorable Trinidad Navarro  
 Delaware Insurance Commissioner

**FROM:** Brent Otto, FCAS, MAAA  
 Vice President of Actuarial Services and Chief Actuary

**DATE:** August 12, 2022

**RE:** DCRB Filing No. 2202  
 Workers Compensation Residual Market Rate and Voluntary Market Loss Cost Filing  
**Proposed Effective December 1, 2022 (Selected Portions Effective June 1, 2023)**

This actuarial memorandum provides a discussion of the analysis performed by the Delaware Compensation Rating Bureau, Inc. (DCRB) that results in proposed changes in Residual Market Rates, Voluntary Market Loss Costs, rating values and supplementary rate information for Workers Compensation insurance in Delaware.

**SUMMARY OF THE PROPOSAL IN THIS FILING**

This filing proposes an overall change in Residual Market Rates and Voluntary Market Loss Costs. The changes vary by class. Associated rating values will also be revised.

Indicated and Proposed Changes	
Residual Market Rates	Voluntary Market Loss Costs
-16.14%	-10.96%

In this year’s filing, the underlying losses are again adjusted to reflect Delaware law after House Bill 373 of 2014 (HB373) (a “post-HB373” basis). The full impact of HB373 contemplated in the law is reflected in this filing. This is discussed further in the Technical Discussion and Supporting Information section of this memorandum.

The filing included several considerations related to the COVID-19 pandemic. Regarding the treatment of COVID-19 claims, consistent with last year’s filing, the claims were excluded from the December 1, 2022 indications. Also, several economic impacts that resulted in unusual changes due to the pandemic during Calendar Years 2020 and 2021 were excluded or smoothed in the analysis. The primary factors influencing this decision were:

- 1.) COVID-19 claims are not a reliable predictor of future losses given this event is viewed as being an unusual event that will not re-occur on an annual or regular basis.
- 2.) There is still uncertainty given that the event is still ongoing.
- 3.) This provides consistent handling between claims and economic impacts of the event as both are being excluded.
- 4.) There are not yet any reliable pandemic modeling results for a “pandemic load” given that the claim adjudication process will take time to evolve.

- 5.) This approach is similar to how terrorism evolved over time with the exclusion of claims and an eventual terrorism charge.

Three COVID-19 claims from Policy Year 2019 totaling \$8,386 and 25 claims from Policy Year 2020 totaling \$46,653 were excluded. These claims were reported in Delaware Financial Call #15 as of December 31, 2021. Adjustments were also made to the Policy Year 2019 Unit Statistical data used in the Filing. Given the limited number and amount of these claims, the decision to include or exclude these claims in this year's filing was not material.

The filing included a few COVID-19 economic-related adjustments due to the unusual nature of the economic shutdowns resulting in some abnormal data patterns that are not expected to continue into future periods. This required considerations for Indemnity and Medical severity, policy year weights, the average wage projections and premium development.

First, due to Policy Year 2020 being abnormally skewed as a result of the economic shutdowns from the pandemic, special considerations were necessary relating to Indemnity and Medical severity. The selection for Indemnity Severity used a 6-point fit excluding Policy Year 2020 rather than a 7-point fit, which would have included that year. Excluding this abnormal point has a 3.8% estimated impact on the overall indication. Second, the Medical Severity was impacted by the addition of a new method. The new method was necessary since the historical data does not reflect future costs due to the economic effects of the pandemic. Higher medical fee schedules tied to the Consumer Price Index-Urban (CPI-U) changes will impact future periods differently from the patterns contained in the historical filing data. The estimated effect of this change in costs is 2.5%. Third, also due to anomalies in the Policy Year 2020 data, the weight placed on this year was reduced to 10% rather than 25%. 30% weight was therefore placed on the other three years (2017 to 2019) used in the indications. Since some of the effects related to the pandemic are expected to continue into the future (i.e., workplace trends that support telecommuting workers), this year was not totally excluded from the indications. The effect of this change is 1.1%.

Similar to last year, other considerations were made related to the selection of the most recent premium development factor, which was 1.0048. This selection was between the 3-year average and a unity factor. Projected employment and wage levels also exclude the disruption from calendar year data when calculating the expense constant (\$345) and qualifying wage for the Delaware Construction Classification Premium Adjustment Program (DCCPAP). Lastly, consideration was given to adjust the increase in SAWW when estimating the effect of the 2023 benefit level due to the unusual increase related to the shift in employment by sector. The resulting benefit level change is 1.23%.

The DCRB feels these adjustments were reasonable and necessary to limit the unusual nature of the pandemic from impacting the projection of future rate and loss cost levels.

This filing also includes some proposed methodology changes that impact the indication, compared to last year's filing. These are listed and supported in detail below.

Both of the methods for determining the incurred tail factors changed. Tail Method 1, the Traditional Incurred Tail, was changed from a 9-year average to a 10-year average. This carried an overall impact of 0.1%. Tail Method 2, the Curve Fit, was changed from using an Exponential Decay curve to a Weibull curve. This carried no overall impact (further discussion on Page 11).

There was also a change in methodology related to the calculation of the Profit and Contingency load used in the residual market rates. The change added debt capital as part of the weighted average cost of capital along with the equity capital. This carried an overall -2.3% impact on the rates only (further discussion on Page 15).

The supporting exhibits and other attachments accompanying this actuarial memorandum comprise the balance of the filing and provide pertinent information regarding the proposed residual market rates, voluntary market loss costs, rating values, supplementary rate information and supporting information for this filing. An index of exhibits appears at the end of this memorandum.

### **ADHERENCE TO ACTUARIAL PRINCIPLES AND STANDARDS OF PRACTICE**

This filing has been developed using actuarial methods that are consistent with all applicable actuarial principles and standards of practice. Rates and loss costs, as developed, filed and distributed by the DCRB represent estimates of future costs. These estimates rely on projections of loss experience (claim costs) to the prospective time period during which they will be in effect. That is, they are estimates of the costs of claims that are made under workers compensation insurance policies to be in effect from December 1, 2022 to November 30, 2023. The ultimate, true value of these claims is uncertain and will not be known until they have all closed, several decades from now. As a result, estimates of the future costs must be used. Adherence to actuarial principles and standards of practice ensures the reasonableness of the estimates, along with their compliance with regulatory requirements.

Four principles are provided in the Casualty Actuarial Society's Statement of Principles Regarding Property and Casualty Insurance Ratemaking. The fourth principle states:

"A rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer."

In addition, core principles for estimating future payments on claims are found in the Casualty Actuarial Society's Statement of Principles Regarding Property and Casualty Unpaid Claims Estimates. The first principle states:

"An unpaid claims estimate for a defined group of claims is reasonable if it is derived from reasonable assumptions and appropriate methods or models and the reasonableness of the estimate has been validated by appropriate indicators or tests, all evaluated consistent with the review date and valuation date in the context of the intended measure."

There are many Actuarial Standards of Practice (ASOPs) applicable to this filing. These documents set forth the standards, including appropriate considerations, that guide an actuary in developing and presenting the methods and calculations contained in this filing. These include ASOPs regarding data quality, credibility, trend, risk classification, and communications.

This filing relies on data provided by our member companies; however in accordance with ASOP No. 23 Data Quality, the data has been reviewed for reasonableness and consistency. Some examples of review include, but are not limited to: Identifying and investigating questionable data from the 15 largest carrier groups in Delaware as well as in total for all carriers; comparing the current premium and loss data to the data used in the prior analysis; comparing loss development patterns and several reserving diagnostic triangles.

## DISCUSSION OF THIS FILING'S METHODS, ANALYSIS AND FINDINGS

The proposed residual market rates, voluntary market loss costs and minimum premiums by classification submitted in this filing reflect the DCRB's actuarial analysis of all available experience data, enacted legislation and other relevant factors to establish appropriate and lawful rating values for the policy period beginning December 1, 2022.

### Delaware Workers Compensation Insurance Plan - Residual Market Rates

Delaware law requires that a "residual market plan" be filed with the Insurance Commissioner by the advisory organization. Residual market coverage is provided under the auspices of the Delaware Workers Compensation Insurance Plan (Plan). Employers unable to obtain workers compensation insurance in the voluntary market may apply to the Plan. An insurance carrier is then assigned to administer coverage for that employer, either as a servicing carrier, on behalf of the Plan, or on a direct assignment basis.

In this filing, as in filings since the inception of the surcharge program (discussed below in Exhibit 19), the expected amounts of the Plan surcharges are accounted for in the form of offsets to voluntary market loss costs. The average change in collectible rate level for the residual market, prior to the effect of Plan surcharges proposed in this filing, is a decrease of 16.14%.

The components of the proposed overall change in residual market rates are shown below with their impact on the filing indication.

Components of Indicated Change in Residual Market Rates		
	Component	Impact on Indication
1	Limited Medical Loss	-6.60%
2	Limited Medical Trend	-0.80%
3	Medical Excess Loss	-0.36%
	<b>SUBTOTAL: MEDICAL LOSS</b>	<b>-7.68%</b>
4	Limited Indemnity Loss	-2.27%
5	Indemnity Excess Loss	+0.16%
6	Limited Indemnity Trend	+0.55%
	<b>SUBTOTAL: INDEMNITY LOSS</b>	<b>-1.57%</b>
7	Loss Adjustment Expense	-3.40%
8	Loss-Based Assessments	+0.47%
9	July 1, 2023 Benefit Level Change	+1.23%
10	Underwriting Expense	-6.07%
	<b>SUBTOTAL: OTHER</b>	<b>-7.71%</b>
	<b>OVERALL INDICATED RATE CHANGE</b>	<b>-16.14%</b>
Note that the total results from converting the percentages to factors (e.g., --6.60% is 0.9340, in factor form) and calculating the product of the 10 factors.		

### Voluntary Market Loss Costs

Since the enactment of House Bill 241 in 1993, Delaware law has applied a "loss cost" approach to pricing of workers compensation insurance written in the voluntary market. Under this system,

the advisory organization (i.e., the DCRB) filings are limited to prospective loss costs, which reflect loss and loss adjustment expense, as well as policy forms, uniform classification and experience rating plans and rules, and supporting information. Advisory organization filings specifically exclude provisions for profit and expenses, other than loss adjustment expenses and loss-based assessments. Provisions for profit and expenses, other than loss adjustment expenses and loss-based assessments, are incorporated into voluntary market workers compensation rates by virtue of competitive filings made by each insurer. Insurer expense filings may adopt loss costs filed by the advisory organization or the rates and supplementary information filed by another insurer, by reference, with or without deviation.

Consistent with past practice, in this filing, the DCRB has derived indicated changes in voluntary market loss costs directly from the proposed residual market rate change discussed above. This derivation is accomplished by removing from those rate proposals the combined effects of all provisions for profit and expenses, other than loss adjustment expenses and loss-based assessments. As a result, like the proposed changes in Plan rates, these proposed revisions in overall voluntary market loss costs are based on statewide experience.

The relationship between collectible residual market rates and voluntary market loss costs is based on a loss cost multiplier (LCM) derived from industry underwriting expenses (Exhibit 11), including the underwriting profit provision from the internal rate of return analysis (Exhibit 9). Under Delaware law, loss adjustment expenses and loss-based assessments are included in the loss costs filed by the DCRB. The LCM is the reciprocal of the ratio of loss, loss adjustment expense and loss-based assessments to premium. In the previous filing, the proposed LCM was 1.4094 (=  $1 \div 0.7095$ ).

The loss cost multiplier in this filing is 1.3275 (=  $1 \div 0.7533$ ). Exhibit 12, Page 12.1, Line (9), reflects this modification to the DCRB's standard calculations. The table below provides the details.

<b>Delaware Loss, Loss Adjustment Expense, Underwriting Expense and Profit</b>		
<b>Item</b>	<b>Current Provision as a Percent of Premium</b>	<b>Proposed Provision as a Percent of Premium</b>
Loss	53.26	56.87
Loss Adjustment Expense	14.86	15.29
Commission	5.32	4.83
Other Acquisition	1.77	1.57
General Expenses	2.47	2.48
Premium Discount	8.53	8.38
State Premium Tax	2.00	2.00
Other State Taxes	0.31	0.30
Uncollectible Premium	2.86	2.62
Administrative Assessment *	2.83	3.17
Workers Compensation Fund	2.00	2.00
Underwriting Profit	3.79	0.49
Loss, LAE, Administrative Assessment	70.95	75.33

\* Denotes loss-based assessment

Using the proposed provision for loss, loss adjustment expense and loss-based assessments (the provision for loss costs), the indicated change in voluntary market loss costs is -10.96%, which is computed as follows:

$$0.8386 \times 0.7533 / 0.7095 = 0.8904$$

The proposed decrease in voluntary market loss costs is attributable to the same factors as those that impact residual market rates, except that the effects of expense provisions, other than loss adjustment expense and loss-based assessments, do not apply to loss costs.

It is important to note that the net effect of the proposed loss costs on ultimate prices for employers that will be insured in the voluntary market (the majority of all insured risks) may differ significantly from employer to employer and from insurer to insurer. Workers compensation insurance prices for these employers will be a function of individual carrier decisions. Each carrier may elect to use the DCRB's loss costs by reference, to deviate from those loss costs, to file independent loss costs, or to use loss costs filed by another insurer by reference. In addition, employers may obtain their future workers compensation insurance from a different insurance carrier than the carrier providing their current policy, further expanding the range of possible price changes that individual risks may experience. These variables in the determination of the ultimate price impact of the DCRB's filing are natural consequences of the competitive pricing system implemented in Delaware.

### **Residual Market Surcharge, Exhibit 19**

Experience of employers insured under the Plan in Delaware has historically presented an aggregate loss ratio higher than that of employers insured in the voluntary market. As shown in Exhibit 19, the loss ratio of the Plan accounts was about 71% higher than the loss ratio for voluntary business in the 5-year period 2015-2019.

During the late 1980s and early 1990s, Delaware had seen persistent increases in the portion of the market insured in the Plan. In previous response to these concerns, the DCRB filed, and the Insurance Commissioner approved, a Plan surcharge program in 1997 that incorporated the following features:

- Surcharges are limited to risks eligible for experience rating and only apply to risks with debit experience modifications (i.e., those employers with demonstrably higher than average experience).
- To avoid redundant or inequitable penalties, surcharges are applied only to the extent that each employer is not fully credible in the Experience Rating Plan. This procedure assesses larger proportional surcharges to small employers, who are largely protected from the effects of their own experience in the Experience Rating Plan but reduces surcharges applicable to larger employers whose premiums significantly respond to their own loss records.
- Surcharges are limited to the debit portion of each risk's experience modification. This limitation provides a smooth transition from non-rated to experience-rated risks and/or from small experience rating credits to small experience rating debits.

The surcharge expressed as a factor to be applied to standard premium is computed using the following formula:

0.50 x (1.000 - risk credibility in the Experience Rating Plan)

As noted above, Plan loss ratios continue to be higher than those of the voluntary market. Since 2005, the portion of the Delaware workers compensation market insured under the Plan declined from a high of approximately 20% to a current low of about 3.80% in 2021 for this filing. This represents a decrease compared to last year's market share of 4.65%.

This filing retains the Plan surcharge program as a disincentive for employers to have their Delaware workers compensation insurance coverage placed in the Plan.

The DCRB estimates that the surcharge program will produce an average surcharge for subject risks of approximately 20.4% of premium. Recognizing that some employers insured in the Plan do not qualify for experience rating and that other employers insured in the Plan qualify for experience rating but produce credit modifications, the surcharges produced by the proposed procedure would represent approximately 6.8% of total Plan premium.

The full amount of this surcharge premium is recognized in the calculation of proposed voluntary market loss costs for this filing. This approach allows a reduction of manual loss costs of less than 1% and essentially produces three different benchmark loss cost levels underlying workers compensation insurance rates in Delaware. These different underlying loss cost levels are as defined below:

1. Plan risks subject to surcharges (highest level depending on individual risk experience)
2. Plan risks not subject to surcharges (based on statewide average experience)
3. Voluntary market risks (based on statewide average experience reduced by offset for surcharges applied to first group above)

The DCRB believes that while the Plan surcharge approach does not fully address the loss ratio difference between the residual and voluntary markets, it is practical and represents a reasonable step toward reducing Plan subsidies and providing meaningful disincentives for placement of employers in the Plan.

#### **Delaware Construction Classification Premium Adjustment Program (DCCPAP), Exhibit 14**

This filing proposes to update the reference to calendar quarter(s) used as the basis for determining qualifying wages for the DCCPAP and update the table of qualifying wages underpinning that program with adjustments in the Statewide Average Weekly wage in Delaware, reflecting shifts in mix of workers by sector due to COVID-19 as discussed above.

#### **Other Filing Provisions**

In addition to proposed residual market rates, voluntary market loss costs and residual market surcharges, this filing addresses a number of rating values, programs, rules and procedures which are integral parts of the Delaware workers compensation insurance system. In general, the filing's proposals simply reflect parametric changes in various rating values consistent with the most recent available Delaware experience. Detailed information supporting each of these proposals is provided elsewhere in this filing. Here is a brief synopsis of these other changes:

Item	Filing Exhibit(s)	Proposed Change	Purpose
DCCPAP Program – Effective June 1, 2023	14	Revise manual rating value offsets & wage table	Maintain revenue balance of the program
Minimum Premium (residual market)	11, 27	Update parameters	Update for wage inflation
Excess Loss Factors	17b, 17c	Update ELFs	Maintain accuracy of rating values based on current data
Excess Loss Premium Factors	17d, 17e	Update ELPFs	Maintain accuracy of rating values based on current data
State and Hazard Group Relativities	18	Update Rating Values	Maintain accuracy of rating values based on current data
Experience Rating Plan	13, 20, 21, 27	Update Rating Values	Maintain accuracy of rating values based on current data
Small Deductible Program	16	Revise existing premium credit and loss elimination ratio schedules	Maintain accuracy of rating values based on current data
Workplace Safety Program	29	Revise manual rating value offsets	Maintain revenue balance in the program
Merit Rating Plan	29	Revise manual rating value offsets	Maintain revenue balance in the program
Retrospective Rating Plan	24, 25	Revise optional development factors and tax multiplier	Maintain accuracy of rating values based on current data

#### **TECHNICAL DISCUSSION AND SUPPORTING INFORMATION**

Attached to this filing are exhibits and materials that provide technical support for each of the proposals. In addition to the discussion that follows, each exhibit begins with one or more pages of discussion and technical details for the calculations that it contains. In order to highlight some of the more important aspects of the DCRB’s technical analysis, the following discussion will address each of the following topics:

- Treatment of legislative and regulatory changes
- Effects of large losses on the experience analysis
- Estimation of policy year ultimate loss and loss adjustment expense ratios
- Trend provisions: Frequency, Severity

- Determination of the permissible loss ratio for proposed residual market rates
- Considerations regarding the Experience Rating Plan

Unless otherwise stated, the discussion and exhibits use experience from financial data collected by the DCRB in its annual financial data calls. These are the major topics underlying the proposed changes in residual market rates and voluntary market loss costs.

### **Treatment of Legislative and Regulatory Changes**

Four recent major legislative changes have impacted medical expenditures in Delaware: Senate Bill 1 of the 144<sup>th</sup> General Assembly (SB1), Senate Bill 238 of the 146<sup>th</sup> General Assembly (SB238), House Bill 175 of the 147<sup>th</sup> General Assembly (HB175) and House Bill 373 of the 147<sup>th</sup> General Assembly (HB373). The estimated impacts of each of these four laws were provided in previous DCRB filings. A fifth piece of legislation, House Bill 166 of the 148<sup>th</sup> General Assembly (HB166), supplemented changes in these other bills. The DCRB does not anticipate any impact on medical expenditures from HB166. The underlying losses are adjusted to reflect Delaware law after the impacts of those four laws (a post-HB373 basis). The calculations underlying the adjustment of unlimited losses to a post-HB373 basis are in [Exhibit 1 – Unlimited Losses](#).

The adjustment of losses to a common baseline in Delaware law allows the analysis of the underlying loss development and loss trend on a basis that is neutral to changes in law.

The law adjustment factors were developed separately for paid and incurred losses. The HB373 adjustment factors assume that payments were reduced consistent with the percentages stated in the law. The incurred factors also incorporate case adjustments to reflect the impact of HB373 as was done in past filings. Each reserve level change was distributed evenly over a 36-month period, beginning from the effective dates of the medical fee schedule changes in 2015 through 2017.

Additional details regarding legislative changes can be found in the Appendix at the end of this memorandum.

### **Effects of Large Losses on the Experience Analysis, Exhibit 1a**

The analysis of residual market rates and voluntary market loss costs performed by the DCRB includes methods to reduce the impact of a small number of large claims in a given year. Starting with its annual experience filings effective December 1, 2004, the DCRB has applied procedures that perform loss development and trend analyses on a “limited” basis and then account for the expectation that claims exceeding the selected limit would occur from time to time by adding an excess loss factor to the rate level analysis. This filing has again approached loss development and trend analysis on a limited loss basis.

Loss amounts are stated on a post-HB373 basis. Loss development and trend analyses are conducted using losses at the post-HB373 level. The loss limit was adjusted to be stated on a post-HB373 basis (reflecting benefit levels and system provisions expected to be attained after the successive changes to Delaware’s medical fee schedule were completed on January 31, 2017).

The methods and steps regarding loss limits and trend are outlined briefly below:

1. The December 1, 2004 loss limit (\$1,043,461 on a post-HB373 basis) and the associated excess loss factor (0.0757) were taken as a key reference point for determination of appropriate loss limitations for this filing.
2. Approved excess loss factor tables prior to December 1, 2004 were used to establish loss limitations consistent with an excess loss factor of 0.0757.
3. An annual trend rate was computed for the series of loss limits established in step 2 above.
4. Loss limits were interpolated for each policy period prior to December 1, 2004 based on the trend in loss limits through December 1, 2004.
5. Loss limitations consistent with an excess loss factor of 0.0757 for filings through December 1, 2021 were used to derive post-2004 annual trend rates. After review of recent changes in loss limitations, an average annual change of 2.92% was selected for Policy Years 2017 and subsequent. The filing continued to reflect a selected average annual change of 4.61% for Policy Years 2005 through 2016 and 6.27% for Policy Years 1983 through 2004.
6. Loss limits were projected for each policy period subsequent to December 1, 2004 based on the trends in loss limits through December 1, 2022.
7. A series of loss limitations was selected for previous policy years consistent with the trend through December 1, 2004, applied retrospectively from that date and consistent with the trend from December 1, 2004 through December 1, 2021, applied prospectively from December 1, 2004, such that losses were capped at successively lower levels for older policy years, recognizing the impacts of wage and price inflation and potential changes in utilization over time. For policy years prior to 1984, a constant loss limitation of \$275,196 was applied.
8. Reported paid and case incurred losses were adjusted, as needed, to limit underlying loss data to the selected limitations by policy year. These can be found in Exhibit 1 – Limited Losses.
9. Loss development analysis was performed using the limited loss data produced above.
10. Trend analysis was accomplished by dividing the observed limited loss ratios into separate components for claim frequency and claim severity, and prospective trends were selected for each component.
11. A loss limitation was selected for the prospective rating period based on the post-2004 projections. This selection was \$1,791,586 on a post-HB373 basis.
12. Based on the selected loss limitations, the portion of losses to be removed from Delaware experience was determined.
13. Trended limited loss ratios were adjusted to an unlimited basis by application of an excess loss factor, from which point the rate level analysis could proceed in the usual fashion.

### **Estimation of Policy Year Ultimate Loss and Loss Adjustment Expense Ratios, Exhibit 2 – Limited Losses**

Much of the analytical effort required in workers compensation insurance ratemaking is devoted to the evaluation of loss experience from prior periods of time. Results of past experience form a vitally important base of information when developing the prospective estimates in this filing. Since workers compensation losses may be paid out over an extended period of time after an accident occurs and a claim is filed, results of recent periods of experience must be estimated before ratemaking analysis based on those prior periods of time may proceed.

The DCRB has considered the matter of estimating ultimate policy year loss and loss adjustment expense ratios at length in the preparation of this filing. In evaluating results of the methods in this filing, information gleaned from the DCRB's Unit Statistical Plan data was also used.

As mentioned above, two changes were made to the incurred tail methods. After researching several commonly used distributions and methods for determine workers compensation tail factors including the inverse power curve, growth methods, and others, the Weibull model was selected. This method is commonly used for workers compensation insurance, works with incurred loss factors below unity and allows for varying levels of development pattern stability (number of data points used in the model or year-over-year observed volatility in the data (number of years averaged) between indemnity and medical. Exhibit 3, Page 3 shows the curve fits for indemnity and medical. The historical incurred tail method was changed to a 10-point average for both indemnity and medical incurred loss factors for greater stability, instead of an 8-point average used last year. Stability is desired for any tail factor method, especially one that uses actual data points that can be volatile. A 10-point average would have been selected previously, however the necessary data points were not available until this year. The final incurred tail factor selections were the result of averaging the two methods as shown on Exhibit 3, Page 1.

The tail factors for paid loss development are based on the incurred loss tail factors and a paid-to-incurred ratio or paid "bridge factor". A curve fit is performed on a broader set of data based on the paid-to-incurred ratio triangle to better determine the bridge factors for indemnity and medical losses (Exhibit 3, Pages 4 and 5). The curve fit projected paid-to-incurred ratios to the 50th report level, when virtually all of the claims have been settled. Exhibit 3, Page 6 also shows graphically the two selected curve fits, and the resulting bridge factors based on the average of the points between the 20th and 50th reports. The bridge factors are then multiplied by the incurred tail factors to calculate the paid tail factors in Exhibit 3, Page 1.

Paid loss development factors are used through the 20th report and then developed to ultimate using the paid tail factor applied at the 20th report. The individual development factors for each report are accumulated into report-to-ultimate factors, shown in Exhibit 2 – Limited Losses as "Cum LDF". The product of the report-to-ultimate factors and the most recent valuation of paid loss or case incurred loss, as appropriate, produces estimates of ultimate loss for all policy years displayed. This process produces estimates of ultimate loss for both indemnity and medical on both an incurred basis and a paid basis. The resulting projected ultimate losses can be seen on Exhibit 2 – Limited Losses, Page 4 for indemnity and Page 8 for medical. The resulting projected ultimate loss ratios appear on Exhibit 2 – Limited Losses, Page 5 for indemnity and Page 9 for medical.

The DCRB continued to use a 4-year average of indemnity age-to-age development factors in its estimation of ultimate loss and loss adjustment expense ratios. For medical, an 8-year average continued to be used given the recent volatility and the difficulty in adjusting medical loss

development factors for the significant multi-year reforms and balances stability and responsiveness between the very low recent year factors impacted by the reforms and the higher prior year factors. For this filing, the latest available year of development experience available for this filing is Calendar Year 2021.

As has been the case in recent DCRB filings, a review of Unit Statistical Plan data showed claim closure rates that tended to be increasing in recent years. In addition, a review of the portion of reported losses that have been paid at successive annual stages, from financial data, also provides signs of improvement. Exhibit 7 provides both sets of results.

Consistent with historical practices, the DCRB has based estimates of ultimate indemnity and medical losses in the filing on the average of the case incurred loss development method and paid loss development.

As in prior analyses, the DCRB used the following approach to smooth fluctuations arising due to the limited volume of data available for the analysis:

- Use of 4-year averages for indemnity and 8-year averages for medical when selecting loss development factors
- Smooth loss development factors using various mathematical models and curves fitted through the observed multi-year averages
- Use trend procedures which rely on multi-year averages rather than individual year ultimate loss and loss adjustment expense ratios

A comparison of results of loss development methods used in the filing may be seen on the enclosed Exhibit 2 – Limited Losses at the top of Page 5 for indemnity loss and at the top of Page 9 of the same exhibit for medical loss.

### **Trend Provisions, Exhibit 12**

Each DCRB filing applies to a prospective time period. Since historical data is used in the analysis, it is necessary to account for any anticipated changes in loss ratios over the time between the end of the available data and the policy period to which the proposed rates will apply. This is known as “trend” analysis.

Since 2002, the DCRB has used a trend approach that separates policy year loss ratio trends into frequency and severity components. Frequency is measured on the basis of indemnity claims per unit of expected loss at a constant DCRB rate level. The use of expected loss in the calculation of frequency incorporates exposure trend, however is not affected by loss cost changes.

Policy year on-level ultimate loss ratios are adjusted to a series of severity ratios by removing the effects of actual observed changes in the frequency of indemnity claims. The series of resulting severity ratios represent the policy year loss ratios that would have applied if all years had the same claim frequency. The result is a series of indices of claim severity. Loss ratio trends can then be derived as the combined result of separately determined claim frequency and claim severity trends.

In both the frequency and severity trend analyses, the goal is to develop the best estimate of frequency and severity in the upcoming policy period.

### **Frequency**

Frequency analysis by the DCRB is based on Unit Statistical Data as shown in Exhibit 23. The changes in claim frequency by policy year range from +4.3% to -14.3% with seven of the 10 years showing decreases. The average annual change over the 10 years is -5.4%. The newest data includes Policy Year 2020, which changed by -4.6% compared to Policy Year 2019. While there is variability in the year-to-year changes, overall frequency continues to decline.

It is considered actuarial best practice to develop claim counts to an ultimate level where reasonable and consistent factors can be determined. Exhibit 23, Page 2 shows the reported claim count development triangle and development factors. The statewide volume of data produces very stable and consistent factors for the selections. There was limited development beyond the 5th report, so the factors result in unity beyond that point.

Given the volatility in Delaware claim frequency data, the DCRB considered several approaches to estimate claim frequency trend for this filing. A 7-point exponential trend model, which has been used in previous DCRB filings, was applied to the claim frequency data, resulting in a selected frequency trend of -5.4%, which is 0.5 percentage point lower than in last year's filing (-4.9%).

### **Severity**

In estimating claim severity trends, the DCRB applied exponential trend models to the policy year severity ratios produced by the loss development methods discussed above. Indemnity and medical ratios were treated separately and, for each method, the exponential models were applied to all possible numbers of policy years from three through ten.

For indemnity benefits, the DCRB applied a 6-point exponential trend model, which gave a severity trend of 0.1%, based on Policy Years 2014 to 2019. When combined with frequency trend, the resulting indemnity loss ratio trend is -5.3% per year.

As discussed above, Policy Year 2020 was not included in the normal 7-point fit due to being skewed by the effects of the pandemic.

Indemnity loss ratios for this filing were then trended to December 1, 2023, the midpoint of the prospective rating period, by applying the claim frequency and claim severity trends to each of the most recent four policy year loss and loss adjustment expense ratios. The final projected indemnity loss and loss adjustment expense ratio, 0.2737, is based on the selected policy year weights of 10% placed on 2020 and 30% on each of the years 2017 to 2019. The 2020 year was extremely low compared to recent years and clearly impacted due to the pandemic event.

The same claim frequency trend analysis used for indemnity loss was used for medical benefits. While the DCRB's measure of claim frequency uses only indemnity claims, the vast majority of medical benefits are attributable to indemnity cases. This approach is consistent with prior filings.

Consistent with last year's filing, the DCRB used a split trend when trending periods before and after January 31, 2018, due to the impact from the medical reforms. This date was selected as it was the date when the fee schedule began to increase after the reform period fee schedule decreases that occurred in 2015 to 2017. Based on this, a 7-point exponential trend fit was used for the periods prior to January 31, 2018. An average of the 10-point fit and the results from the CPI-U 6-point fit was used for trending periods after January 31, 2018. This resulted in an annual trend rate of -1.2% for the period prior to January 31, 2018, and 1.9% for the period after January

31, 2018. When combined with frequency trend, the resulting medical loss ratio trends are -6.5% and -3.6% per year for each period, respectively.

As discussed above, the CPI-U trend was added as an additional method. The changes being used in this method started in 2017 when this index began to be used as the basis for the change in the medical fee schedule (rolling 12-month average from December to November). Fee schedule changes, including more recent higher levels related to the pandemic, are not fully contemplated in the data. Since the filing relates to a prospective period starting 12/1/2022, these changes in costs need to be considered. The selection also recognizes that only about 50% of the medical payments are driven by the fee schedule, while the other 50% are from individually negotiated contracts making an average of the two methods appropriate.

Medical loss ratios for this filing were then trended to December 1, 2023, the midpoint of the prospective rating period, by applying the claim frequency and claim severity trends to each of the most recent four policy year loss and loss adjustment expense ratios. The final projected medical loss and loss adjustment expense ratio, 0.3193, is based on the selected Policy Year weights of 10% placed on 2020 and 30% on each of the years 2017 to 2019 as discussed above.

#### **Determination of the Permissible Loss Ratio for Proposed Residual Market Rates, Exhibit 9**

It is common in preparing workers compensation rate filings to use methods that explicitly recognize investment income in concert with anticipated cash flows, benefit costs and expense needs. The actual methods used differ from jurisdiction to jurisdiction. The DCRB's approach has been to directly compute a permissible loss and loss adjustment expense ratio consistent with an independently established target rate of return. This is the same approach as has been used in previous annual filings.

The prospective determination of an appropriate overall rate of return, which workers compensation insurers should be entitled to earn given the risk they assume in underwriting this line of business, is accomplished by a variety of economic analyses which are generally based on expected returns for businesses subject to risk levels comparable to that of underwriting workers compensation insurance. These methodologies next proceed by establishing a set of total cash flows representing the various transactions related to the underwriting of workers compensation insurance. These cash flows include the expected patterns for the receipt of premiums, payment of losses and expenses, use of tax credits and/or payment of tax obligations, use of debt and maintenance of surplus funds in support of the business. Expense levels to which expense cash flows apply are determined based on historical experience.

Estimates of the probable investment results that an insurer underwriting workers compensation insurance may expect to achieve were made by reviewing existing insurer investment portfolios and prevailing investment returns on various forms of investments. Applying these estimates to the cash flows previously established allows an explicit presentation of the effects of investment income throughout the life of a book of workers compensation policies and an estimate of the value of that income to the insurer.

Based on the set of cash flows determined to apply to prospective policies and the estimated parameters of investment yields, federal tax laws, etc., these methods model all expected cash flows over the entire period during which payments attributable to a given policy period are expected to continue. For any given loss provision in rates, the present value of these cash flows can then be consolidated and compared to the target rate of return. The loss provision accomplishing a balance between the expected and target rates of return then becomes the basis

for the permissible loss ratio. Within the concept of the Internal Rate of Return (IRR) Model used by the DCRB, the loss provision includes provision for amounts generally related to losses such as loss adjustment expense and loss-based assessments.

This filing recognizes investment income on reserve and surplus funds as well as the cost of debt capital in determining the overall expected return for carriers from writing workers compensation business in Delaware.

As mentioned above, the inclusion of debt capital as part of the weighted average cost of capital was a change in this year's filing. The primary reasons supporting this change were:

1. Debt capital is part of statutory surplus.
2. Insurance company debt/capital ratios have risen over the past 20 years.
3. Inclusion of debt capital brings the model into compliance with industry best practices.

The analysis supporting this filing uses a similar IRR model as used in last year's filing. This filing indicates a needed underwriting profit provision of +0.49% compared to last year's underwriting profit provision of +3.79%. This difference is primarily driven by the addition of debt capital (2.3-point impact) as previously mentioned and the increase in investment yields (1.0-point impact) compared to last year.

For this filing, the DCRB again retained an independent economic consultant to perform the above-described analyses. Results of this work are presented in complete detail in Exhibit 9.

Additional expense provisions are shown in Exhibit 8 and the expense loading is shown in Exhibit 11.

### **Considerations Regarding the Experience Rating Plan, Exhibits 13, 20, 21 and 27**

The DCRB reviews the performance of the Experience Rating Plan as part of its analysis supporting each annual rating value filing submitted to the Department of Insurance. Fluctuations in results of the plan, in particular movement in the average experience modification produced by the plan, are measured and accounted for in the derivation of proposed changes in manual rates and loss costs. This allows the Experience Rating Plan to reallocate premium obligations among insureds based on the merits of their past experience, but not either increase or reduce the total amount of premium indicated by the DCRB's benchmark filings of residual market rates and voluntary market loss costs.

The DCRB based the Collectible Premium Ratios used to derive manual rating values for purposes of this filing on the most recent three completed available years of Market Profile data as shown in Exhibit 20. This approach is used to support the proposed collectible rate and loss cost changes and to provide more current recognition of the probable impact of experience rating for the upcoming rating period.

Exhibit 32 calculates temporary staffing rates based on the methodology presented in DCRB Filing No. 2012. Exhibit 33 calculates expected loss factors for certain temporary staffing classes that were discontinued effective December 1, 2021.

## **CLOSING COMMENTS AND QUALIFICATIONS**

DCRB Filing No. 2202 fully and fairly reflects the most recent available experience indications in Delaware. Together with all initial and continuing effects of SB1, SB238, HB175 and HB373, the methods and selections balance overall stability and responsiveness of the workers compensation system. The DCRB respectfully requests a timely review of this filing, allowing implementation on a new and renewal basis **effective December 1, 2022**. A timely review will allow adequate advance notice of final residual market rates and voluntary market loss costs and related rating values to all participants in the Delaware marketplace. Toward that objective, the DCRB will be pleased to answer any questions or provide any available supplementary information which you, your staff and consultants reviewing this filing on your behalf may require.

This filing has been developed by and under the direction of Brent Otto, FCAS, MAAA and Ken Creighton, ACAS, MAAA. They both meet the Qualification Standards of the American Academy of Actuaries to provide the actuarial opinion contained within this filing.

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## **APPENDIX – LEGISLATIVE CHANGES**

Here is a brief summary of the recent major legislative changes in Delaware.

### **Senate Bill 1, 144<sup>th</sup> GA**

SB1 was signed into law on January 17, 2007. This was a landmark piece of legislation, creating several features of the health care payment system in Delaware. It included the following notable components:

- Established a Health Care Advisory Panel
- Provided for a health care payment system intended to control health care costs in connection with workers compensation
- Provided for the establishment of health care practice guidelines
- Provided for the development of certification standards for health care providers treating employees in the workers compensation system
- Provided for the adoption of forms and a consistent and uniform reporting system among employees, employers, insurance carriers and health care providers
- Adopted standards for billing and payment of health care services
- Required contractors and other parties doing substantial work within Delaware to adequately insure their employees for workers compensation under the laws of Delaware
- Authorized payment of indemnity benefits or health care benefits without prejudice against the right to later contest the employer's obligation to pay the expense in question
- Established new procedures for attorney fees in workers compensation matters
- Clarified the obligations of independent contractors and subcontractors with respect to maintaining workers compensation insurance
- Clarified the calculation of wage rates, especially in cases where employees had limited work histories
- Implemented procedures for the collection of data relevant to workers compensation including injury reports, mandatory insurance requirements and health care treatments and costs

### **Senate Bill 238, 146<sup>th</sup> GA**

SB238 was signed into law on August 7, 2012, and revised procedures used to determine payments to hospitals and ambulatory surgery centers for services provided to workers compensation claimants. SB238 made technical improvements to the changes in SB1.

### **House Bill 175, 147<sup>th</sup> GA**

HB175 was signed into law on June 27, 2013, arising from work done by the Workers' Compensation Task Force created by House Joint Resolution 3.

### **House Bill 373, 148<sup>th</sup> GA**

HB373 was signed into law on July 15, 2014, and included the following notable components:

- A 33% reduction in medical expenditures phased in over a three-year period (20%, 5% and 8%) effective 1/31/2015, 1/31/2016, and 1/31/2017 respectively.
- Imposed caps expressed as percentages of Medicare per-procedure reimbursements beginning on January 31, 2017

- Revised certain procedures pertaining to the position of Ratepayer Advocate

**House Bill 166, 148<sup>th</sup> GA**

HB166 was signed into law on July 27, 2015, and included the following provisions:

- Defined “health care provider” for purposes of §2301
- Allowed recognition of savings other than fee schedule changes in accomplishing the reductions in medical expenditures required by HB373
- Modified procedures applicable to the reimbursement for medical treatment and procedures performed outside Delaware
- Authorized the Workers Compensation Oversight Panel to adopt rules requiring electronic medical billing and payment processes and to standardize documentation required for billing adjudication
- Provided for the certification of healthcare providers not licensed by Delaware
- Made the utilization review program applicable to health care providers regardless of whether such providers are certified under §2322D

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