AMERICAN ACADEMY of ACTUARIES

January 15, 2007

Ms. Sarah McNair-Grove, Chair
Workers' Compensation Large Deductible Subgroup
Casualty Actuarial (C) Task Force
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108-2604

Re: Comments re: Large Deductible Subgroup Proposal for State Page Reporting

Dear Ms. McNair-Grove:

The Workers' Compensation Subcommittee of the American Academy of Actuaries (hereinafter WC Subcommittee) respectfully offers the following observations, comments, and suggestions regarding the Workers' Compensation Large Deductible Subgroup Proposal for State Page Reporting.

The WC Subcommittee's understanding is that the NAIC is trying to accomplish two things with this new form: 1) to make available a consistent source to use when assessing the various state-operated funds that support state workers' compensation systems and, 2) to provide regulators with a more holistic view of the workers' compensation marketplace in their respective states.

In response to item 1), making available a consistent source to use when levying taxes and assessments, we note that:

- States have a variety of tax and assessment bases in place today and a variety of mechanisms for collecting the data needed to levy them. A single reporting form is not likely to replace sources already used for these purposes. Thus, the proposal may not deliver the desired benefits.
- Large deductibles have been in place for over fifteen years, and a number of states already have mechanisms in place for supplemental reporting of large deductible information. The definitions used in states' reports are not consistent with what is requested here, creating potential duplication and conflicts.

In response to item 2), providing regulators with a more holistic view of the workers' compensation marketplace in their respective states, we note that:

- Information measuring the size of the workers' compensation marketplace already exists at the National Council on Compensation Insurance (NCCI) and independent bureaus. Hence, a new reporting mechanism may not be needed. For example, exposures, premiums prior to the application of deductible credits, and losses on a first dollar basis are already required to be reported on unit statistical reports in most states.
- The definitions used in the statistical reporting of data to rating bureaus is not consistent with definitions proposed here, which may lead to reliability issues and confusion in the marketplace as to what is being reported.

While the proposed state reporting page for deductibles may have merit, information to meet the needs for which it was designed already exists elsewhere in many states. Also, the information may not meet states' needs for levying taxes and assessments, and the information being requested conflicts with data reporting requirements that already exist in some states. See below for a state-specific example of data already being collected. Therefore, the WC Subcommittee believes that the costs associated with adding the proposed form to the Annual Statement and the added expense to insurers of providing such data may far outweigh the potential benefits.

Before expanding the Annual Statement to insert additional detail pertaining to large deductible workers' compensation business, the WC Subcommittee would encourage a meaningful inventory of information pertaining to large deductible business currently being reported by insurers on an individual, state-by-state basis, covering both what information is collected and the purpose(s) for which it is collected. The bases for existing taxes and assessments by state should also be inventoried. We expect that such a review would identify existing sources for much or all of the information sought in the suggested proposal. Such a review might also reveal more cost-effective and focused alternatives to expansion of the Annual Statement that could be considered if a jurisdiction(s) were to decide to impose additional reporting requirements in this area. This inventory of current bases for existing taxes and assessments would also highlight the varied data reporting requirements of individual states. This inventory may show that, due to the variability in data requirements, this schedule will not meet individual states' needs.

<u>State-Specific Example of Existing Data Reporting Requirements:</u>
In Pennsylvania, large deductible workers' compensation business (defined as coverage under which the employer agrees to reimburse the carrier for an initial amount of $100,000 or more per claim or per accident) is already reported much more extensively than what is proposed for inclusion in the Annual Statement in both Special Schedule W required by the Insurance Department and Financial Calls issued annually by the Pennsylvania Compensation Rating Bureau (PCRB, the state rating bureau licensed in Pennsylvania). Premiums and losses for deductible coverages in which the policyholder's agreement to reimburse losses stops at less than $100,000 (called "small deductible" policies) are already required to be reported in financial data on a gross basis, i.e., before the effects of premium credits and/or policyholder reimbursements.

Policy information collected by the PCRB already includes accounting for the effects of deductible coverage provisions on premiums, and unit statistical reports must show total exposures, gross premiums and deductible premium credits, and losses for deductible coverages on a gross (first-dollar) basis. The PCRB posts exposure and premium data including the effect of deductible credits on its website by policy-effective quarter under the heading "Market Profile Reports," using policy information for early reports and then migrating to unit statistical data (which has the benefit of final premium audits) when the policies involved become sufficiently mature.

<u>Additional Comments and Observations:</u>
The WC Subcommittee also offers the following comments and observations about the substance of the proposed additional data report, with comments grouped into those pertaining to overall scope, premiums, losses, and general items.

Scope:

- The exhibit needs to clearly define what deductibles are to be included. While this proposal appears to apply to <u>all</u> deductible workers' compensation business, only "large" deductible coverages have appreciable effects on premium and loss transactions in this market, and although this proposal emerged from the large deductible subgroup, nothing in the definitions provided for this form limits the reporting to large deductibles. If the intent is to apply this state reporting page to large deductibles only, this should be stated explicitly. In addition, if the proposal is intended to apply only to large deductibles, the term "large deductible" then needs to be defined. As a point of reference, workers' compensation rating bureaus, like the PCRB described above, have generally defined large deductibles as those with a deductible limit of $100,000 or more.

- The exhibit should make clear what policies are to be included in the report – i.e., are these policies with inception dates during the calendar year for which the Annual Statement is being prepared, all policies with earned exposures within that year, all premium transactions taking place in the calendar year irrespective of policy effective date, or something else? Note that premium reporting in the Annual Statement is typically done on a calendar year basis, reflecting all transactions that took place in the calendar year, irrespective of the effective dates of the policies to which those transactions applied.

Premiums:

- The exhibit does not clearly specify whether the premiums being reported are to be written or earned. This should be clarified. (Given that the form provides no guidance for how partial policy periods are to be accounted for and seems to prescribe calculations embracing complete policy terms, and considering the definition for net premium is presented in terms of "written" premium, it would appear that <u>written</u> premiums are the intended data.)

- Are the (potentially significant) effects of premium audits upon policy expiration to be included in this report? Similarly, if deductible policies have a retrospective rating component, are those corresponding premiums to be included in the report? Instructions for the premium fields do not address these points. The written premium reported elsewhere in the Annual Statement does include audit and retrospective rating transactions.

- The Direct Gross Premium in Column (2) is based on "standard premium." Column (3) is defined to be "net premium." The differences between these figures will necessarily include many things not related to the effects of deductible coverages, including but not limited to schedule rating credits or debits, safety program credits, premium adjustment program credits, and retrospective rating adjustments, if any. It is unclear what the intent of column (4), "Premium Credits," is, but if the intent is to show the impact of deductible coverages, column (4) will misstate this.

- The definition of standard premium can vary even within a state. Thus, what is intended to be reported is ambiguous. For example, the definition of "standard premium" differs between what the NCCI requires on its policy year aggregate calls for Large Deductible Experience and what it requires on unit statistical reports.

    - In NCCI's statistical plan, the total standard premium to be reported is "the total premium charged for the policy, excluding the approved expense constant, premium discount, and any special payments to the states that are assessed on total premium writings or total losses incurred," and hence is after deductible credits, schedule rating, and certain other adjustments have been applied.

- NCCI's policy year aggregate call for Large Deductible Experience includes the following in standard premium at company level:
    - Expense constant premium using the company's selected expense constants
    - Application of NCCI-published Experience Rating Plan modifications

- NCCI's policy year aggregate call for Large Deductible Experience excludes the following from standard premium at the company level:
    - Premium Discounts
    - Schedule Rating Adjustments
    - Nebraska Flexible Rating Adjustments
    - Retrospective Rating Adjustments/Loss Sensitive Rating Plan Adjustments
    - Large Deductible Credits
    - Dividends
    - Certain Other Adjustments

- The Direct Gross Premium data to be reported in Column (1) is not likely to be an amount readily available in company systems currently in use for Annual Statement reporting. Annual Statement reporting systems are generally designed to capture calendar period transactions. In addition, some of the required components of this data field may not even exist today. For example, carriers may not capture premium discounts on large deductible policies today when they rate the policy. Premium discounts also vary by size of policy. Thus applying the proposed formula to compute gross premiums may require carriers to go back and "re-price" large deductible policies as if no large deductible existed so that an appropriate premium discount can be applied. Hence, providing the requested data will be complicated, burdensome, and costly.

- The Direct Gross Premium column is presumably intended to get to the first dollar equivalent premium for deductible policies. However, the formula does not give a true "premium equivalent." In all likelihood, many of these customers would have either been self insured or written on retrospective rating plans had they not elected deductible coverage. If the customer was written on a guaranteed cost plan, other credits might also have applied (e.g., schedule rating credits).

- The WC Subcommittee does not understand how the circumstance cited in which a computed direct gross premium is exceeded by the actual net premium for a policy could occur. However, if this did happen, it seems inappropriate to default to the actual net premium.

Losses

- As defined, "incurred losses" are calendar year values. Unless another column is added to reflect the prior year unpaid loss, the incurred losses reported on this form will not balance to the combination of paid and unpaid losses on the exhibit itself, a point that might generate confusion. In addition, the definition of incurred losses should be clarified to address whether losses that are incurred but not reported (IBNR) are to be included.

- While we expect that paid losses within the deductible are likely captured and retained by most companies, at least for statistical reporting purposes, with respect to loss reserves and calendar year incurred losses, there is likely considerable variation among carriers regarding the level of detail maintained and their ability to report amounts by state in the Annual Statement. For example, many carriers do not currently establish IBNR for amounts below the deductible by state and line in the systems used for Annual Statement reporting.

- The need for reporting calendar year incurred losses gross of deductibles is unclear. It is doubtful that calendar year incurred losses are used in computing any taxes or assessments. These amounts also would not reflect company liabilities, since they ignore collateral. Typically, large deductible customers have letters of credit or other instruments backing up their promises to reimburse carriers for the amounts below the deductible. (Note: we are not advocating the reporting of collateral. Collateral is typically applied at a policy or account level, not at the individual state level.) Also note that the Annual Statement Note 31, High Dollar Deductible Policies, discloses the amount of reserve credits taken on high dollar deductible reserves and the amount billed and collectible on paid claims. While not line or state specific, this does give regulators an indication of likely future payments associated with amounts below the deductible in the aggregate.

General

- The proposal seems to be inviting a mismatch between premiums and losses. It appears to show a written premium, where development of premiums from policy inception to final audit is not recognized, in combination with a calendar year incurred loss amount. Typically, incurred losses are compared to earned premiums, with both values stated on a calendar basis.

- Regardless of the approach taken and/or definitions applied, it seems to the WC Subcommittee that the proposed data reports will result in an additional set of data reports that will not balance or readily reconcile with other existing sources such as Statutory Page 14, for a variety of reasons. This “free-standing” aspect of the proposal seems troublesome, as it invites data quality concerns not susceptible to simple resolution.

- The “alternate proposal” would provide uniform assumptions about carrier pricing programs and premium discounts in lieu of actual carrier results. However, these assumptions are inconsistent with how a policy would be priced if it were written on a first-dollar basis. The WC Subcommittee is not aware of the reason(s) for, or value anticipated, from this approach.

In addition to the comments offered above, we refer the Casualty Actuarial Task Force to the American Academy of Actuaries’ Committee on Property and Liability Financial Reporting (COPFLR) letter of July 7, 2006 regarding the Workers’ Compensation Large Deductible Study. In the opinion of the WC Subcommittee, many of the points mentioned in that letter apply to the proposed Large Deductible State Reporting Page as well.

In summary, the WC Subcommittee does not see a compelling reason for the proposed Annual Statement Deductible State Reporting Page, as it is not clear that the form will meet its intended purposes, information to meet these needs may already be available elsewhere, and the cost of compliance is likely to be significant. There are numerous technical issues associated with attempting to get to a calendar year "first dollar premium equivalent" amount for deductible business that would be consistent by state. We have articulated many of these above.

We suggest the NAIC inventory existing tax and assessment bases and existing data being collected on deductible business. We expect the NAIC will find that the proposed reporting form will not meet the varied needs of all the states or replace the need for information already being provided in at least some states. It is also likely that information that measures the size of the deductible workers' compensation insurance market already exists at NCCI and independent bureaus. Hence, the benefit from reporting such information in the Annual Statement is likely to be far outweighed by the cost of providing the information. The WC Subcommittee would be happy to assist in gathering the above-recommended inventories.

Thank you for the opportunity to comment.

Sincerely,

Timothy L. Wisecarver

Tim Wisecarver, Chair
Workers' Compensation Subcommittee
American Academy of Actuaries