



AMERICAN ACADEMY *of* ACTUARIES

Objective. Independent. Effective.™

March 16, 2018

Lori K. Wing-Heier, Chair
Workers' Compensation (C) Task Force
National Association of Insurance Commissioners

Sent via srobben@naic.org

Re: Considerations in Comparing State Workers' Compensation Rates

Dear Director Wing-Heier:

The Workers' Compensation Committee of the American Academy of Actuaries¹ is pleased to provide comments to the NAIC's Workers' Compensation Task Force on the challenges of comparing workers' compensation rates by state. Our comments are in response to a request made on the Feb. 20, 2018, call of the task force during which the Oregon Workers' Compensation Premium Rate Ranking Report was discussed.

The task of comparing workers' compensation rates among the states is a significant undertaking, as evidenced by the ratemaking processes that give rise to each state's rates. To develop a proper comparison, consideration must be given to the ratemaking process that ultimately results in the rates paid by employers. Each element included in the ratemaking process must be analyzed in developing such a comparison. In addition, the purpose of the comparison must be considered. A comprehensive analysis of costs across the country involves complex and extensive efforts. A study that focuses on the predominant types of employment in one state may not be useful for other states.

A partial list of elements to consider includes the benefits provided, the interpretation and administration of the law, wage levels, the distribution of workers by industry, economic conditions and demographics, treatment outcomes for injured workers, and adjustments made to the final premium rate based on an employer's claim experience and unique characteristics. Additionally, for the majority of states where rating bureaus are limited to pure premium filings, the expense provisions applied to produce final rates must be evaluated.

¹ The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Benefit Levels

Indemnity: Each state has different indemnity (wage loss) benefit levels, statutes, and rules that affect the amount and timing of indemnity benefits. These statutes and rules specify the categorization of benefits, the minimum and maximum weekly indemnity benefits, waiting periods, the duration of benefits, the existence of cost-of-living adjustments, and other practices, all of which vary by state. Thus, it is important to measure the relationship between the rate and the benefit level when evaluating a particular state's rates. A key question to be answered is whether the rates reflect the benefits being provided. In a comparison across states, does the percentage difference in rates reflect a difference in benefit levels, or is there something else involved?

Medical: Workers' compensation laws provide for unlimited medical payments. In recent years this has caused total medical benefits in most states to be larger than total indemnity benefits. There are several elements to consider in regard to medical benefits. For example, medical system and provider costs, the use of mandated fee schedules, the ability of the injured worker to select a medical provider, the extent to which medical services are provided on a fee-for-service basis versus a contractual basis, and cost shifting between workers' compensation systems and health insurance systems all vary by state. As a result, treatment for identical injuries results in different medical costs by state. In comparing rates among states, caution must be exercised in order to avoid distortion caused by these structural factors, which vary from state to state.

Administration of the Law

Similar and sometimes identical state workers' compensation laws have been implemented differently from state to state. The application of the law by administrative law judges and decisions in each state's courts can result in far different results for similar or identical language in the law. As a result, not only must the benefit provisions within a state be evaluated, an evaluation must be made of the ultimate application of laws.

Wage Levels

The level of wages in a state, usually measured by the statewide average weekly wage, is a fundamental ingredient in the rates employers pay. This is one of the most important elements to consider. Two states that appear to be otherwise identical—the same hours worked, the same injury rate, the same type of injury, identical benefits, and the same administration—can have very different rates because the wage levels differ. Because rates are based on costs per unit of payroll for the majority of classifications, and the premium generated is based on payroll, the different wage levels among the states should be a major consideration in developing a comparison of rates.

Industry Distribution

In developing a meaningful comparison of rates, it is necessary to reflect the distribution of industries by state. Using one state's distribution as a guide can lead to a comparison of premiums that superimposes another state's rates on a given payroll distribution. This is a

challenging aspect when developing a comparison and may involve subjective decisions regarding the effect that volume can have on frequency and other variables.

General Economic Conditions and Demographics

General economic conditions within individual states and across the country can affect rate levels. This is a particular concern when a change in economic conditions affects certain industries over others. When a particular industry experiences declines, the profile of the workforce can change. Younger, less senior workers may need to seek other types of employment while longer-term workers remain. Conversely, when an industry experiences significant growth, newer, less experienced people enter the workforce. These conditions can influence the frequency of accidents and the severity of the injuries associated with those accidents.

The distribution of workers by age and education level varies between states, impacting the cost of providing workers' compensation. Older workers who are injured on the job may require more medical treatment and recovery time before being able to return to work. Less-educated workers may need additional vocational training if they are unable to return to their former job.

Treatment Outcomes

A comparison of rates involves a comparison of workers' compensation systems. It is important to consider how each system treats the injured worker. What are the outcomes? Is the system providing the worker with the appropriate benefits? For instance how well does the system function in ultimately returning those injured to work. These outcomes for each state's system should be considered.

Pricing Practices

The published rate is not the final price paid by most insureds. The application of experience rating plans, schedule rating plans, and dividend plans plays a significant role in the ultimate price paid. The prevalence of large-deductible policies and retrospective rating plans also has a significant impact on the final amount paid by employers, whether through costs retained by the employer or through premiums paid to insurers. Consideration should be given to these various elements that affect the final price.

Pure Premium and Expenses

In most states, rating bureaus file pure premiums rather than final rates. When including those states in a comparison, it is important to carefully consider the need to add on provisions for the additional costs of providing coverage. These additional costs include commission and brokerage expense; other acquisition and general expenses; taxes, licenses, and fees; and a provision for profit and contingencies; and differ by insurer. Consideration should be given to the variation in these additional costs.

We appreciate the opportunity to provide input on this topic and would be happy to provide additional input as necessary. For more information, contact Marc Rosenberg, senior casualty policy analyst, at 202-785-7865 or rosenberg@actuary.org.

Sincerely,

John R. Pedrick, MAAA, FCAS
Chairperson, Workers' Compensation Committee
American Academy of Actuaries