



AMERICAN ACADEMY *of* ACTUARIES

January 16, 2004

Alan Wickman, ACAS
Administrator, Actuarial Division
Nebraska Department of Insurance
941 O St., Suite 400
Lincoln, NE 68508

Re: NAIC/IAIABC Joint Working Group (JWG) Large Deductible Study

Dear Alan:

At your request, I distributed the November 6 version of the captioned study to the American Academy of Actuaries Workers' Compensation Subcommittee (WCS) and held a conference call on November 21 to discuss the paper. Participating on the call was a cross section of actuaries with significant workers' compensation expertise employed by commercial insurers, state funds, insurance regulators, rating bureaus and consulting firms. As can be expected, these actuaries had a variety of opinions on the draft paper and we were not always in agreement. Therefore, this document seeks to share our expertise with your working group. I presented a summary of these comments at your meeting on Sunday, December 7 in Anaheim. The WCS remains available to answer any questions that your group may have regarding these comments.

Scope & Size - First and foremost, the greatest area of consensus among the WCS members on the call was that the sections related to claims handling issues should be removed and included in a separate paper that needs further development. While we acknowledge that these issues exist on some large deductible policies, the same issues exist on retrospectively rated policies and fronted captive programs. It is clear that the JWG does not explicitly condone insurers that allow employers to self-administer their own claims, yet many self-insured employers are permitted to self-administer their claims. This is a separate and legitimate topic and we ask that a separate paper be written on it. The paper is very long, and we are concerned that too many valid issues related to these policies will be lost to the reader in its current form. We think that JWG will be more effective in influencing public policy debate by issuing five-to-ten one page papers rather than one fifty page document.

Tone & Perspective – Several members of the WCS representing insurers that write large deductible policies were concerned about the tone and perceived bias of the paper against large deductible policies. Clearly, most of the “horror stories” cited in the paper resulted from insurers who used these policies irresponsibly and experienced financial difficulties as a result. These members of the WCS with large primary company background are concerned that the reputation of large deductible policies in general, and the responsible insurers that continue to issue them, are being unfairly tarnished due to the actions of a few bad actors that paid the price (insolvency) for their actions. While the JWG conducted a survey of regulators related to large deductible problems, we are concerned the JWG did not also survey underwriters at current and former insurers that have written or still write these policies to confirm or rebut perceptions of abuses and to offer suggestions on how they could be prevented. The WCS would

be willing to work with the JWG in drafting such a survey and developing an appropriate list of contacts at the various insurers. We would also appreciate it if you could send us a copy of the survey that was distributed to regulators.

Evolution of Large Employer Rating/Payment Plans – One member commented that the paper talks about retrospective rating plans as if they no longer exist. The same member noted that there is very little mention of paid loss retro plans, from which large deductibles evolved. The JWG needs to understand that there a number of rating/payment plans available to large employers that grow in complexity and availability as the size of an employer’s premium and willingness to take on risk increases. These range from small deductibles (under \$25K) to retention dividend plans, incurred loss retro plans or large deductibles, paid loss retro plans or large deductibles, fronted captive programs and ultimately self-insurance.

The WCS members with large primary insurer background are inclined to preserve and protect large deductibles as a viable competitive tool needed to reverse the flight of large employers from insured retro plans (the traditional vehicle) to self-insurance. Structurally, there is very little difference between traditional retrospective rating plans (filed by the National Council on Compensation Insurance (NCCI)) and the large deductible policies (filed by insurers independently starting in the early 1990s) other than the amount of premium booked by insurers in their financial statements. These premiums are typically used to determine premium taxes, residual market “burdens” and other premium based assessments. Some WCS members believe that employers feel more “at risk” psychologically under a large deductible policy over a retrospective rating plan, while others believe the primary reason that insurers have pushed these programs, even after the virtual elimination of residual market burdens in the last half of the 1990s, is to compete more effectively with self-insurance by reducing their tax and assessment liabilities. In many states, the use of these policies by some insurers increases the tax and assessment liabilities paid by self-insurers or other insurers writing guaranteed cost or retrospectively rated policies.

Large Deductibles vs. Self-Insurance - We identified a number of reasons why large deductibles are presently an increasingly popular alternative to self-insurance:

- Regulation – A large, multi-state insurer need only deal with the requirements of one insurance underwriter rather than the multiple self-insurance requirements and regulations that can vary considerably from state to state.
- Security Requirements – Many states require independent actuarial opinions on the accrued liabilities of their self-insured employers, and the amount and type of security that must be posted varies by state. While large account underwriters will have similar requirements, the risk manager only has to deal with one underwriter who performs an actuarial analysis at the insurer’s cost. It can often be difficult for self-insurers to get their security deposits back from, or reduced by, self-insurance regulators, but this is also true of some insurers writing large deductibles, and the risk manager may have to hire an actuary to assist in negotiations with the insurance underwriter.
- Privacy – Many self-insurance regulators require the filing of confidential financial, payroll, loss and other information that may not be protected by state privacy laws. This is generally not a problem with large deductibles, making them particularly appealing to privately held employers.

- Statutory Excess Coverage – Post 9/11/2001, statutory excess coverage for self-insured employers is available but increasingly difficult to find. Insurers writing large deductibles have no choice but to offer statutory coverage.

While these are legitimate competitive advantages of large deductibles over self-insurance, the concern among regulators, self-insured employers and small employers written on guaranteed cost policies or retrospective rating plans is that the insurers issuing them have an “unfair” competitive advantage, and that employers are attracted to them because do they not have to pay their “fair share” of taxes and assessments in states where these taxes and assessments are based on net premiums without adjustment to remove deductible credits. For states considering changes to the basis for taxes and assessments, WCS members expressed concerns about the use of standard premium for premium-based taxes and assessments due to the lack of consistency in how this term is defined. In previous presentations to the JWG, I have discussed similar concerns about the use of manual, net or forms of premium as reporting bases. However, because of AICPA’s SOP 97-3 and the need to improve predictability in the ratemaking process, some insurer trade organizations have been advocating conversion from loss based to premium-based assessments.

Lump Sum Settlements – Conclusion 17 seems to come out of nowhere and is unsupported by any other discussion in the document.

Deductible Reimbursement Policies – A member of the WCS involved in developing the first large deductible policies agrees that these policies should not exist. He added that large deductible policies were not created with the use of the reimbursement policies in mind.

Claims Handling – WCS members with large primary insurance background (including those that work with large deductible policies) insist that they do not handle claims from these policies any differently than those arising from other policies.

Experience Rating Data – One member expressed concern about the underreporting of claims for experience rating purposes on employers coming out of large deductible policies.

Statistical Reporting & Bureau Ratemaking Considerations – One member suggested that data from large deductible policies (or preferably from all large employers that are loss rated and/or have premiums over some threshold, possibly \$250K) be segregated and/or excluded from the data used to develop advisory loss costs and experience modifiers for small-to-medium sized employers typically written on a guaranteed cost basis. Another member expressed concern about the accuracy of exposure data by class reported for these accounts; since they are generally loss rated based on aggregate payroll and do not rely on manual rates or experience rating mods.

Guaranty Fund Issues – Several WCS members were particularly concerned that the JWG took no position on the problems created in recent major insolvencies, where large deductible reimbursements paid by insured employers were credited to the estate of the insolvent insurer rather than the Guaranty Funds which bear responsibility for paying the claims that these reimbursements were designed to fund. The same is apparently true of second injury fund reimbursements and salvage/subrogation recoveries. This problem is a major concern to the members of the WCS with large primary insurance backgrounds.

Thank you for the opportunity to review and comment on your paper. Please contact myself or Greg Vass, Senior P/C Analyst at the American Academy of Actuaries.

Sincerely,

A handwritten signature in cursive script, appearing to read "Richard A. Hofmann".

Richard A. Hofmann, ACAS, MAAA
Chair, Workers' Compensation Subcommittee