Government of the District of Columbia
Vincent C. Gray, Mayor
Department of Insurance, Securities and Banking

William P. White
Commissioner

BEFORE THE INSURANCE COMMISSIONER OF THE DISTRICT OF COLUMBIA

Re: Report on Examination – **National Council on Compensation Insurance, Inc.**

ORDER

A target Market Conduct Examination of **National Council on Compensation Insurance, Inc.** as of December 31, 2010 has been conducted by the District of Columbia Department of Insurance, Securities and Banking ("the Department").

It is hereby ordered on this 20th day of April, 2012, that the attached target market conduct examination report be adopted and filed as an official record of this Department.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, this Order is considered a final administrative decision and may be appealed pursuant to Section 31-4332 of the D.C. Official Code.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the issuance of the adopted report, the company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related order.

Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the Department will continue to hold the content of the report as private and confidential information for a period of 10 days from the date of this Order.

William P. White
Commissioner

REPORT OF EXAMINATION

As of December 31, 2010

NATIONAL COUNCIL ON COMPENSATION INSURANCE, INC.

901 Peninsula Corporate Circle
Boca Raton, Florida 33444

TABLE OF CONTENTS

SALUTATION 1
PURPOSE AND SCOPE OF EXAMINATION 2
COMPANY PROFILE 2
EXECUTIVE SUMMARY 3
PRIOR EXAMINATION RECOMMENDATIONS 5
a. Prior Examination Recommendations – Oregon 2001 Examination 5
b. Prior Examination Recommendations – New Hampshire 2005 Examination ... 11
OPERATIONS/MANAGEMENT/GOVERNANCE 15
STATISTICAL PLANS 38
DATA COLLECTION AND HANDLING 41
CORRESPONDENCE WITH INSURERS AND STATE REGULATORS 48
REPORTS, REPORT SYSTEMS AND OTHER DATA REQUESTS 51
RATEMAKING 54
CLASSIFICATION AND APPEAL HANDLING 55
FORM DEVELOPMENT REVIEW 56
INSPECTION SERVICES 58
RESIDUAL MARKET FUNCTIONS – PLAN ADMINISTRATION 58
RESIDUAL MARKET FUNCTIONS – REINSURANCE ADMINISTRATION 64
INFORMATION TECHNOLOGY CONTROLS 71
COMPLETENESS AND ACCURACY TESTING 73
OTHER PROCEDURES 75
a. Physical Security 75
b. Efficiency 76
c. Rule Development 78
d. Medical Data Call Program 79
SUMMARIZATION 79
EXAMINATION REPORT SUBMISSION 82

January 5, 2012

Kevin M. McCarty
Commissioner
Office of Insurance Regulation
State of Florida
Tallahassee, Florida 32399-0326

Eric A. Cioppa
Superintendent
Maine Bureau of Insurance
Street Address
76 Northern Avenue
Gardiner, Maine 04345

Michael D. Riley
Acting Commissioner
West Virginia Offices of the Insurance Commissioner
Street Address:
1124 Smith Street
Charleston, West Virginia 25301

Dear Commissioners:

Pursuant to your instructions, an examination has been conducted of the

NATIONAL COUNCIL ON COMPENSATION INSURANCE, INC.
901 Peninsula Corporate Circle
Boca Raton, Florida 33444

hereinafter referred to as "NCCI" or "Company." The following report of the findings of this examination is herewith respectfully submitted.

PURPOSE AND SCOPE OF EXAMINATION

The Advisory Organization Examination Oversight (C) Working Group of the National Association of Insurance Commissioners ("NAIC") initiated a multi-state examination of the business practices of NCCI. The examination focused on processes and procedures currently in place including but not limited to the preparation of loss cost filings, rules, forms, operations/management, statistical plans, licensing or authorization, data receipt and controls, processing, editing and compilation procedures, error handling, correspondence with reporting insurers, report submissions to regulators, as well as compliance with the applicable standards set forth in Chapter 16 and Chapter 25 of the 2010 NAIC Market Regulation Handbook. Compliance with previous examination recommendations was also reviewed.

COMPANY PROFILE

NCCI maintains the nation's largest database of workers' compensation insurance information. NCCI collects data, analyzes industry trends, prepares workers' compensation insurance rate recommendations, determines the cost of proposed legislation, and provides data products to maintain a workers' compensation system and reduce the frequency of employee injuries. Insurance companies that sell workers' compensation insurance coverage rely on NCCI to provide data upon which their premium rates are based.

NCCI was established in 1922 to coordinate the interests of insurers with those of regulators and other public policy makers. NCCI is guided by regulatory agencies in 36 jurisdictions where it is licensed or designated as a statistical agent or an advisory organization. NCCI operates as a not-for-profit corporation and is guided by a board of directors that consists largely of representatives of insurance companies that write workers' compensation business. NCCI collects workers' compensation data from insurers about their policies, claims, and financial results and then assembles that data into a data repository. NCCI's stakeholders include public policy makers, employers, employees, independent bureaus, insurers, regulators, legislators, agents/ brokers, trade associations and communities.

NCCI's core services include:

- Rate and advisory loss cost filings
- Cost analyses of proposed and enacted legislation
- Residual market management
- Production of experience ratings
- Statistical and compliance services
- Maintenance of the workers' compensation infrastructure of classifications, rules, plans, and forms

EXECUTIVE SUMMARY

The Advisory Organization Examination Oversight (C) Working Group of the National Association of Insurance Commissioners ("NAIC") initiated a multi-state examination of the business practices of NCCI.

The following states participated in this examination:

Lead States:

Florida
Maine
West Virginia

Participating States:

Alabama	Illinois	Nebraska	South Dakota
Alaska	Indiana	Nevada	Tennessee
Arkansas	Iowa	New Hampshire	Texas
Arizona	Kansas	New Mexico	Utah
Colorado	Kentucky	New York	Vermont
Connecticut	Louisiana	North Carolina	Virginia
District of Columbia	Maryland	Oklahoma	Wisconsin
Georgia	Mississippi	Oregon	
Hawaii	Missouri	Rhode Island	
Idaho	Montana	South Carolina	

This examination encompasses the period from January 1, 2006 through December 31, 2009. However, the scope of the examination was extended to include the review of operations through December 31, 2010.

An introductory meeting was held at NCCI's offices in Boca Raton, Florida, on April 14, 2010. Field work began on July 6, 2010, and was completed on November 4, 2011.

The examination included a review of NCCI's compliance with applicable Handbook standards of the following subject areas:

- Prior Examination Recommendations
- Operations/Management/Governance
- Statistical Plans
- Data Collection and Handling
- Correspondence with Insurers and State Regulators
- Report Systems and Data Requests
- Ratemaking

- Classification Appeal Handling
- Form Development Review
- Inspection Services
- Residual Market Functions – Plan Administration
- Residual Market Functions – Reinsurance Administration
- Information Technology General Controls Review
- Completeness and Accuracy Testing of the Data
- Other Procedures:
    a. Physical Security
    b. Efficiency
    c. Rule Development
    d. Medical Data Call Program

The Medical Data Call, which targets the actual costs based on specific codes used in reporting medical diagnoses and procedures, was implemented in late 2010. Given the recent implementation of this call, testing of this database was excluded from the scope of this examination.

Forty-eight standards were reviewed, including a review of the information technology control environment, and testing for completeness and accuracy was performed. Of these standards, 45 involved a procedural review, 33 involved detailed testing of which 30 included sampling.

NCCI's procedures and processes were reviewed in conjunction with each standard, as applicable. NCCI uses the same procedures and processes for each NCCI state. However, it does modify the procedures and processes to comply with any state statutes, regulations or other exceptions.

The sampling methodology set forth in Chapter 14 of the NAIC Market Regulation Handbook was used. However, judgmental sampling, which is a non-probability sampling technique, was used for certain areas in which the examination team subjectively selected the sample based on its knowledge of the subject area and its professional judgment and experience. These areas generally encompassed those with small populations or areas relating to the actuarial analysis of ratemaking and related topics wherein NCCI's processes and methodologies were reviewed for compliance with applicable statutes, actuarial standards, reasonableness and consistency.

The overall results of the review showed that NCCI's processes and procedures are adequate. The following recommendations, however, are made by the examination team:

Quality Assurance Processes to Review Forms:

See Page 57 of this Report - NCCI does not use the Flesch test or other readability tests/tools as required by statutes in various states. It uses what it describes as the "plain language" approach to promote the readability of its forms and rules.

Recommendation: It is recommended that NCCI comply with the readability requirements as set forth in state statutes.

Information Technology General Controls:

Please refer to page 71 of this report. The review of information technology general controls resulted in various observations. These observations do not materially impact the adequacy/effectiveness of NCCI's information systems control environment and as such, are suggestions for best practice purposes.

PRIOR EXAMINATION RECOMMENDATIONS

a. Prior Examination Recommendations – Oregon 2001 Examination

Oregon Examination Follow up

Follow up of the findings and recommendations associated with the Oregon Examination of NCCI in 2000.

Results: **Pass**

Observations: A procedural review was performed to verify that NCCI has addressed recommendations made as a result of the Oregon Market Conduct Examination of 2000.

The procedures introduced were found to be effective during the extensive review of policies and procedures, as well at the testing of the greatly enhanced number of data edits, reports, data reporting and analytical tools currently in place at NCCI. The addition of the Anomaly Testing process greatly improved the analysis of potentially emerging data issues.

DQ3

Recommendation: The NCCI Internal Audit Department should include comprehensive and targeted data quality audits in their annual audit plan.

NCCI's Response: The NCCI Internal Audit Plan includes data quality audits on unit reports, policies, and experience ratings. NCCI's Internal Audit Department is to continue performing data quality focused audits as part of their annual audit plan.

Status of Compliance: Procedures and processes are effective. A review of the audit plans for the examination period and selected audits indicate that NCCI has developed and implemented a successful internal audit program. The audits adequately target NCCI's risk areas and significant operational processes including data quality. The risk areas identified by internal audit cover all critical processes related to the services and

products that NCCI provides to the states. The more significant areas include ratemaking, experience rating, residual market activities, classification inspections, data quality, data processing, as well as general information systems processes.

DQ4

Recommendation: NCCI should develop procedures for the performance of trending, profiling and advanced analytical procedures of URS, experience rating and other related data, to identify anomalies, outliers or differences in the data by risk, by classification, by carrier, etc.

NCCI's Response: NCCI developed the following three new data quality reports to monitor data reporting trends and anomalies: Summary Error Rates Report; Field Outliers Report; and the Ratios Report. NCCI is to continue to follow-up and address emerging data reporting issues and to enhance and develop new trending reports as needed.

Status of Compliance: The examiners reviewed recent copies of the Summary Error Rates Report. This report is a countrywide review and includes follow-up research into both high and low error rates. High error rates indicate areas where clarification of reporting instructions or carrier training may be needed. In these instances, an error-specific run is made to identify the specific carriers involved. Low error rates are also reviewed to ensure that the edits are working correctly and are tested periodically to ensure failure. In addition, a review of significant changes in error rates over time provides evidence of an emerging problem. Also, reviewed was the Field Outliers Report created by the field outlier program which performs a series of range checks on statistical plan fields, highlighting reported values by Carrier Group that are not within the expected distribution range. This analysis is done annually and findings are communicated to data providers for research and resolution via the Unit Notification System under tests A601 (Header fields), E601 (Exposure fields) and L601 (Loss fields). These reports have been run continuously since implementation by the Data Quality & Compliance Group within the Data Resources Division. The final report - The Ratios Report was prototyped in March of 2003, but has since evolved into a more targeted Countrywide validation test, which provides exposure and claim level detail. The Countrywide validation tests have been run continuously. In addition to these analytical reports, anomaly testing has been developed to identify any data reporting issues that were not flagged by the traditional edits. The frequency of occurrence dictates the potential need for changing edit criteria or developing new edits. Procedures and processes are effective.

DQ8

Recommendation: NCCI should evaluate the errors noted during the employer site visits and address each type of error to determine whether additional actions should be developed (e.g., additional employer test audits, additional analytical and detection procedures and tools).

NCCI's Response: Since the examination, NCCI filed a revision to the Basic Manual for Workers' Compensation and Employers Liability Insurance and created a User's Guide to simplify and clarify the determination of premium and assignment of classifications. As part of the Test Audit process, NCCI is to proactively request any corrective action to be submitted via unit statistical correction reports.

Status of Compliance: In 2001, the Basic Manual for Workers' Compensation and Employers Liability Insurance was filed and approved in NCCI states along with the complementary companion reference guide, the Basic Manual User's Guide. NCCI represents that the 2001 Edition of NCCI's Basic Manual was revised with particular emphasis on increasing the ability of users to quickly find the information they need in an electronic environment, and revised using simplified language to describe the subject matter. The examination team's use of the Basic Manual and User's guide supports NCCI's representation. In addition, NCCI developed test audit procedures for Alaska, Florida, and Oregon that describe the guidelines and steps required to perform test audits. Based on thresholds established for the various types of errors identified via these audits, carriers are required to submit a revised unit statistical report or billing invoice based on the types of errors identified by these audits. Procedures and processes are effective.

UR1A

Recommendation: The examination team recommends that NCCI develop and implement a program to ensure that unit reports with estimated exposures are corrected with audited exposures in a timely manner.

NCCI's Response: The NCCI Data Quality Incentive Program includes the evaluation of carrier performance concerning the timeliness of audited exposure amounts on first unit reports. NCCI also implemented new editing to prompt carriers to report correction reports.

Status of Compliance: The Data Quality Incentive Program (DQIP) is designed to improve the availability of data for use in NCCI's products and services through monetary incentives. This incentive program is based on the timeliness and data quality performance of a carrier's combined policy and unit statistical data reporting, as well as the carrier's responses to notifications concerning the results of edits applied to policy and unit data submissions. This program is described in detail under Standard 3 of the Correspondence with Insurers and State Regulators. Please refer to page 48. Procedures and processes are effective.

In addition, in 2000, NCCI developed and implemented new edits to address this recommendation.

- Unit Edits 0068-02 (URE) and 0271-02 (pre-URE) on the Estimated Exposure Flag will flag on First Reports, First Report Replacements and Corrections to the First Report when the Estimated Exposure Flag is reported as a 'Y', indicating that a Correction Report with Audited Exposure is required.

- Unit Edit 0078-02 (URE and pre-URE) on the Standard Exposure Amount or Nonstandard Exposure Amount fields will flag on First Reports, First Report Replacements and Corrections to the First Report when the Estimated Exposure Flag is reported as a 'N' and the Audited Exposure appears rounded (contains six or more trailing zeros).

A detailed discussion of the edit process and associated testing results can be found under the Data Collection and Handling section of this report beginning on page 41. The edit process was found to be effectively designed and controls are in place to ensure that all submissions are subject to the edits.

UR2B

Recommendation: NCCI should analyze the change between estimated and audited exposures by carrier and in total to identify trends in under/over reporting of exposures. NCCI should utilize its database(s) for performing exposure and premium comparisons and detecting unusual variations.

NCCI's Response: Three new tests look for carrier patterns that could identify inaccurate reporting of audited amounts. These tests include: the proportion of exposure records with trailing 0's; the proportion that match the risk's exposure from the prior policy period; and the proportion that matches the policy. Additionally, NCCI is implementing new estimated exposure analytical reports and is to contact carriers with unusual volumes to resolve reporting issues.

Status of Compliance: The following specific tests are currently performed.

- E941 – Audited Exposure = Exposure Reported on Policy Description: The Audited Exposure on the Unit is equal to the Estimated Exposure on the Policy.
- E942 – Audited Exposure Same as Prior Years Unit ----- Description: The current Audited Exposure is equal to the Audited Exposure from the prior year.
- E943 – Audited Exposure Divisible by Large Powers of Ten ----- Description: The Audited Exposure Amount is evenly divisible by a large power of ten.

These tests are applied annually against unit statistical data in the IDB. This process was verified by the examiners as being in place and effective. It is also noted that the new edits that resulted from the conversion of the Ratios Report examine the exposure fields. Procedures and processes are effective.

UR4B

Recommendation: NCCI record retention and record retrieval policies and procedures should be reviewed, and enhanced to ensure appropriate audit trails exist to support its processes.

NCCI's Response: NCCI utilizes data retention programs to ensure that all historical data is retained and stored. At the request of the working group, documentation of these NCCI policies and procedures be provided by exhibit.

Status of Compliance: NCCI does not maintain a separate retention schedule for each state in which it is licensed. Instead, it maintains records in connection with its rating and statistical agent responsibilities for at least seven years, which is more conservative than the most expansive state requirements. A more detailed description of NCCI's record retention policies can be found under standard 16 of the Operations/Management/ Governance section of this report. Please refer to page 34. Procedures and processes are effective.

UR5

Recommendation: It is recommended that NCCI review the current process for data entry of information from carriers and determine if enhancements to the system are necessary.

NCCI's Response: NCCI currently receives greater than 99% of its unit statistical data electronically. The NCCI focus has been on the reduction of hard copy by providing flexible tools and solutions to customers to make data reporting convenient, accessible, and cost-effective. NCCI has also been improving the keying vendor process by adding daily audits, edit and validation routines, and timeliness controls.

Status of Compliance: A review, of the controls related to hard copy submissions, was performed by the examination team. Hard Copy submissions were included in the Accuracy and Completeness testing performed on the IDB (Integrated Data Base) submissions. The percentage of hard copy filings was verified to be less than 1%. As such, this recommendation is no longer relevant.

ER2C

Recommendation: NCCI should develop procedures to strengthen the documentation trail for ERM-14 and comparable documents, as well as for the NCCI Ruling Letter and notification documentation.

NCCI's Response: The NCCI ERM-14 retention schedule was increased from five to seven years and enhancements were implemented.

Status of Compliance: NCCI increased the retention schedule for ERM-14 (Change in Ownership) and related documents from five to seven years, and then more recently to 15 years as evidenced by the retention schedule provided to the examination team. Procedures and processes are effective.

ER6B

Recommendation: NCCI should periodically perform internal audits of experience rating "bypasses" or overrides of automated edits to assess that the edits and controls are operating effectively.

NCCI's Response: The NCCI experience rating internal audit began February 2003 and was completed July 2003. Audit results were summarized to the working group. All audit components received the highest internal audit rating "Good").

Status of Compliance: Procedures and processes are effective. The examiners reviewed the existence of overrides and bypasses of edits. These occur only following research into the reason for an edit failure.

When an experience rating is not released systematically due to edits invoking, it is reviewed by Experience Rating Analysts. During this review, the Analyst will determine if the rating is correct as produced, or if changes are required. For those that are determined to be correct as produced, the experience rating is marked to be released systematically.

As part of the Experience Rating Quality Program, a sample of all ratings produced is reviewed by Technical Analysts in the Experience Rating Quality Team.

Internal Audit performs audits of the experience rating processes and procedures during which a review of edit procedures is performed.

ER7

Recommendation: NCCI should implement more effective procedures to identify non-experience rated risks that qualify for experience rating.

NCCI's Response: NCCI provided new documentation on the automatic experience rating for newly qualified businesses.

Status of Compliance: The current procedures for identifying newly qualified risks include a review of the exception reports that are generated via the experience rating automated system. These procedures were reviewed by the examination team along with the documentation of the Automatic Experience Rating for newly qualified businesses including Business Requirements Documentation, Detailed Design, Test Cases. Results and Software Specifications were also reviewed and found to adequately detect and process newly qualified businesses. Procedures and processes are effective.

b. Prior Examination Recommendations – New Hampshire 2005 Examination

New Hampshire Examination Follow up

Follow up of the findings and recommendations associated with the New Hampshire Examination of NCCI in 2005.

Results: **Pass**

Observations: A procedural review, as well as detailed testing was performed to verify that mitigating controls which have been put in place in response to the specified recommendations made as a result of the New Hampshire Market Conduct Examination of 2005.

Duplicate prevention in the IDB - The examination team reviewed the controls and testing performed by NCCI to assure that there are no duplicate records in the database. The first stage of preventing duplicates is the editing for duplicate submissions. This would consist of a resubmission of the same data that has previously been submitted. During the testing of the edits, the examiners intentionally caused a duplicate submission to occur on six occasions and each time the issue was detected. The duplicate issue discovered during the NH Exam of 2005 was in part caused by the fact that multiple records were allowed at that time as a part of a submission. This was due to an issue with the length of an exposure field. In order to allow a large exposure (larger than would fit into the current field size) to be reported, the carrier could submit multiple records. NCCI now has a rule of never allowing two exposure rows for any one policy. This duplicate situation is now being checked from several angles. Edit 9904-01 specifically checks for duplicate exposure records. Testing was done with dummy data to trigger this edit and the test results were all positive – each duplicate exposure was detected and the appropriate notification sent. Additional tests are performed on the IDB periodically (some weekly and some monthly) to detect any erroneous data that was not detected by the edits. These are called anomaly tests and there are several that specifically look for duplicates in the data. The results of the anomaly testing for the years of the period under review were reviewed and it was noted that the occurrence of any duplicates being detected has greatly decreased. There are still unit reports in NCCI's unit statistical collection database (IDB) for NCCI states with the multiple rows of exposure condition for data with effective years prior to 2000. There are also a small number of exceptions for data with 2001 effective dates. NCCI's class ratemaking datasets (P&Ls) use data for policy effective years 2000 and forward. The data amount is immaterial and the duplicate records are known.

The control review as well as the testing results provides adequate verification that sufficient editing and review are being performed to prevent duplicate information from being imported into the IDB - Integrated Data Base at NCCI.

Verification of utilization and correctness of "A" Sheets - The A sheet Interrogatory database was created in 2005. Apparent inconsistencies are flagged and researched. If an acceptable explanation is provided, the data will still be flagged but will not be researched. Otherwise, the research will continue and the data will be evaluated considering the inconsistencies. The information is stored in the "A" Sheet Interrogatory Database, which is currently in MS Access. This database is on the schedule to be re-platformed to SQL in the future. Specific state actuaries are involved in this process along with Actuarial and Economic Sciences (AES). A specific individual is responsible for the procedures and making sure they are followed. The actuaries asked the questions and the Senior Data Analysts assist in the research. The examiners selected a sample of 22 filings and went onto the website to review the "A" sheets as completed for each filing. The results were provided to NCCI for explanation of any filings not found. Each instance was a filing type that does not require an "A" Sheet and therefore there were no exceptions. Additionally an "A" Sheet stability report was reviewed whereby the Payroll and Claims information for the current year compares to that of the previous year for all classes for a selected state. Finally a sample report was run from the "A" Sheet Interrogatory Database, which shows the status of the interrogatory such as who is being waited on and the due date as well as description of the issue.

The "A" Sheet process was found to be adequately monitored for compliance with the procedures and corrections are made in a timely manner.

NCCI Impact Analysis Review – A meeting was held with NCCI to review the processes followed in determining the impact of the issues noted in 2005. The impact analysis was completed at that time. Subsequent to the analysis of the issues and the impact on the states, mitigating controls have been developed and put into place. The current edits, anomaly edits, independent "curr" (the pointer that indicates the most current record for each record type within the (IDB) Integrated Database) testing and reconciliations are strong and should ensure that the issues with the databases reported in the 2005 audit will not occur again. The exam team performed extensive review and testing of the mitigating controls within the review of appropriate standards. At the time of the data issues, a complete and thorough impact analysis was performed. Each state affected was provided with a detailed list of all policies and classes affected in the order of impact. Each state determined the action to be taken with regard to the rate corrections needed or to use the new rates only on a going forward basis. The decisions of each state were documented in a circular and orders from the state to comply with the circular were issued. Samples of the reports to the states and associated circulars were reviewed. Additionally, NCCI has implemented more aggressive impact analysis of any data issues immediately on discovery of the problem. Two such incidents and the subsequent impact analyses were reviewed as a part of this examination. Both were performed timely and verified that no impact resulted on the rating processes.

The control review provides adequate verification that sufficient impact analysis is now documented and performed at the first indication of a problem.

Validate System Corrections – System corrections for the following were reviewed and tested as part of the testing of edits, anomalies, duplicates and verification of the continuous monitoring of "Curr." The Netfix process, which netted the amounts where multiple exposure records were submitted, is no longer needed, as multiple exposure records are no longer allowed. Both edits and anomaly testing monitor for duplicate records received.

The control review provides adequate verification that sufficient monitoring of system corrections is in place and effective.

Validate "Curr" Audit Program – Exposure and Loss Data – "Curr" is the pointer that indicates the most current record for each record type within the IDB (Integrated Data Base). Edits are in place to prevent the existence of duplicate records in the IDB. Testing was performed on various types of duplicate records being submitted as test data. In each case, the appropriate edit provided the appropriate error message and email to the carrier. The seven specific edits that check for duplicates were tested outside of the overall edit testing. In order to continuously verify that the current view accurately reflects the appropriate data records as the most current, anomaly testing is performed both weekly and monthly to check for the conditions being present that caused the findings in the New Hampshire Exam. Anomaly #18 recalculates the current view pointers independently of the production process and compares the results flagging any differences. This test is completed on a weekly basis and the results researched. The results reports for all anomalies were reviewed by the examiners and higher occurrences of those related to duplicate testing and "Curr" testing were discussed with NCCI who were able to explain and provide evidence of the research. In no instance was "Curr" affected by the issues found.

The control review and testing provide adequate verification that sufficient monitoring of system corrections is in place and effective to assure that "Curr" is adequately monitored.

Internal Audit and Systems Development - The Internal Audit Department has been greatly enhanced following the 2005 New Hampshire Market Conduct examination including the addition of qualified IT Auditors. This also includes the interaction of external auditors and the examination of database quality, completeness and accuracy, as well as the involvement of Internal Audit (and external Audit) in the development and modification of systems processes at NCCI. The testing performed on the seven projects selected for review verified that internal audit is included in the development of the specification documents for all major projects at NCCI.

The control review and testing provided adequate verification that Internal Audit is sufficiently involved in IT Reviews and project development.

The following two control tests were added due to the extreme importance of appropriate processing of the Data Purges as well as Add, Change and Deletes. The

inappropriate handling of these functions could have a negative impact on the accuracy of "Curr".

Validate the Purge Process – At the time of the 2005 NH examination, it was recommended that a formal documented procedure be implemented with regard to allowing a submission to be purged as if it never existed. Inappropriate reloading of purged data contributed to the out of order issues of 2005. The current procedure was reviewed. The process is discouraged and is only utilized in cases where no other solution is possible. A formal contract is required to be signed by the requesting carrier. This contract was reviewed. Only eight purges have occurred from January 1, 2006 to present. In order to make sure that all related records are purged from the file, for all purges, all report levels higher than the requested report level must also be purged. For example, if the request is to purge the second report, all corrections associated with the second report as well as all third and higher reports and all associated corrections must also be purged. All avenues are explored by the Data Analysts at NCCI with the carrier and the reason for purging the data must conform to the reasons stated for that state in the document included above. The purge process is verified by the Data Quality Assurance Team (QA) prior to the process being executed into production. The data is re-submitted by the data provider through the normal procedures, all edits are run and all data integrity checks are performed. The new submission has a new submission date and no relation to the purged submission, which is actually deleted from the database.

The control review provides adequate verification that the purge process currently in place is adequately controlled and documented and is utilized only as a last resort.

Validate Processing of Adds, Changes and Deletes to Submissions – During the NH review of 2005, it was noted that the processing of adds, changes and deletes contributed to the sort order issues. Therefore, a review and testing of the current process was performed by the examiners. Different scenarios were designed by the examiners and the resulting actions that would be taken in the processing were tracked. One of the scenarios did allow for inappropriate action to occur, however NCCI demonstrated that mitigating controls are now in place to discover the issue and make the appropriate corrections.

The control review and testing provide adequate verification that the procedures associated with adds, changes and deletes are appropriately designed and implemented and that mitigating controls are in place to catch any discrepancies that may occur.

Based on NCCI's policies and procedures, as well as testing performed, NCCI has satisfactorily mitigated the issues that led to the findings in the New Hampshire Market Conduct Exam of 2005.

OPERATIONS/MANAGEMENT/GOVERNANCE

The advisory organization examination is designed to verify that the advisory organization maintains procedures for providing regulated services that are in accordance with applicable statutes, rules and regulations.

Standard 1 - Operations/Management/Governance

The advisory organization has implemented written policies and procedures to prevent NCCI from engaging in anti-competitive practices in the insurance marketplace, as related to the advisory organization's services and communications.

Results: **Pass**

Observations: A procedural review was performed to address this standard. NCCI has written policies and procedures that document its efforts to prohibit anti-competitive practices. As a statistical agent and rating organization, NCCI receives confidential data from its subscribers and then uses this data to provide various products and services to its subscribers. NCCI also provides regulators with information that is used to monitor the workers' compensation industry. As such, it is essential that NCCI have effective controls in place to prohibit anticompetitive practices that might limit or prevent competition.

NCCI's code of business conduct and ethics prohibits the violation of antitrust laws and requires that employees annually acknowledge receipt of the antitrust compliance guide and agree to comply. Formal training programs incorporate this topic into the curriculum. The anti-trust compliance training programs were reviewed for content and adequately address the requirement. At each board meeting and committee meeting of the board, NCCI's counsel reads an antitrust statement that is entered into the formal minutes. NCCI's chief legal officer and/or its outside antitrust counsel attends all board meetings and committee meetings of the board and reviews documents and presentations for compliance with antitrust policies and laws. The board and committee minutes reviewed for the examination period, confirmed that counsel attended each meeting and read the antitrust statement.

Standard 2 - Operations/Management/Governance

The advisory organization uses sound actuarial principles for the development of prospective loss costs.

Results: **Pass**

Observations: A procedural review and testing were performed to address this

standard. A review of a sample of rate filings was performed to address this standard, following guidelines set forth in Actuarial Standards of Practice 12, 13, 23, 25, 29, 30, 38, 39, and 41. A sample of seven separate experience/loss cost rate filings was reviewed by the examiners:

Rate Filing	Effective Date
Illinois	January 1, 2009
Iowa	January 1, 2007
Kansas	January 1, 2007
Maryland	January 1, 2011
Missouri	January 1, 2011
Montana	July 1, 2007

As part of this review, a sample of calculations supporting the derivation of certain loss costs was verified, including:

- On-level factors
- Factors to adjust for loss-based expenses
- Trend factors
- Factors to adjust limited losses to an unlimited basis
- Factors to develop policy year premiums to ultimate
- Loss development factors

The agendas and minutes for all Actuarial Committee meetings held between January 25, 2007 and May 19, 2010 were reviewed to focus on those meetings where methods used in the development of prospective loss costs and/or rates were discussed. The Actuarial Committee was found to act in only an advisory capacity. There are no votes taken, so the Committee does not act to adopt or not adopt recommendations. NCCI staff prepares a work plan at the beginning of each year that summarizes activities to be addressed during the year. The Actuarial Committee meets at least four times per year (normally in January, May, August, and October/November). Occasionally, additional meetings have been held outside of this timeframe (e.g. June 24, 2009 and May 19, 2010). Agendas are distributed prior to the meetings and minutes are distributed subsequently.

Specific methods used in the development of prospective loss costs that were reviewed in meetings held during this time period include:

- A statistical trend model for forecasting frequency, severity, and loss ratio
- Tail factor calculation methodology
- Class ratemaking. This area received the most attention by the Committee since it represented the most significant change undertaken in the period under review.

Two items specifically related only to rates that were reviewed were:

- The cost of capital
- Expense provisions

NCCI staff work together collaboratively with the Actuarial Committee providing input and feedback. A clear example of this is the implementation of the new class ratemaking methodology. The Committee reviewed this methodology from October 2006 through its implementation in 2009, with an analysis presented in May 2010 on the initial year's results. Throughout this process, the Actuarial Committee's questions and suggestions appear to be fully considered.

In addition to reviewing the minutes and agendas of the Actuarial Committee meetings, several papers detailing methods used were reviewed. These include:

- Class Ratemaking for Workers' Compensation: NCCI's New Methodology
- Workers' Compensation Ratemaking
- Statistical Trend Estimation with Application to Workers' Compensation Ratemaking
- Catastrophes and Workers' Compensation Ratemaking

Additional methods used by NCCI in trending, on-level calculations, credibility, etc. are widely documented standard actuarial methods.

The unit statistical and aggregate financial data that are used to develop aggregate rates and class rates are subject to a validation processes to ensure completeness and accuracy. Testing indicated that the data used in rate making are complete and accurate. Data for which the completeness and accuracy is in question are not used in ratemaking until it has been corrected. The specific results of the testing and related discussions are set forth in the Data Collection and Handling section of this report. Please refer to page 41.

Based on the above review and the finding that NCCI develops rates and risk classifications in accordance with applicable Standards of Practice, it was concluded that NCCI has implemented policies and procedures to ensure the development of prospective loss costs and/or rates in accordance with sound actuarial principles.

Standard 3 - Operations/Management/Governance

The advisory organization prepares, submits filings as necessary, adheres to applicable state filing and/or approval requirements and written procedures prior to distribution of prospective loss costs, policy forms, endorsements, factors, classifications or rating rule manuals.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. NCCI makes filings on the System for Electronic Rate and Form Filing (SERFF) in all NCCI states except Florida and Illinois. Florida has an electronic filing system that is referred to as I-File. During the examination, Illinois required that paper filings be made. It is noted that earlier filings with the state of Kansas were also in paper form. However, Illinois and Kansas now require that current filings be made via SERFF.

The effective date of a filing may be based on statutory requirements, regulatory request/input, potential impact to the industry, and/or time required for implementation. Typically, NCCI uses the following business rules to establish the effective dates on rule and form filings:

Business Rules for Effective Dates:

- For state item filings, at least 60 days in the future.
- For national rule item filings, at least 6 to 18 months in the future
- For national form item filings, at least 18 months in the future

Typically, the effective date of rate/loss cost filings (except law-only filings) occurs on the same date each year. The actual filing is made in advance of the effective date to accommodate the amount of time it takes to process and approve a rate filing. Generally, the timing of this process remains the same from year to year for each respective state. However, if a rate or loss cost is revised to reflect the impact of a change in the statutory benefit structure, the effective date is established via the underlying legislation. Other types of filings such as rule, form, class and statistical may be prompted by law and rule changes initiated by a regulator for which the effective date for use is set by that jurisdiction. In instances where such filings are initiated by NCCI based on its research, NCCI establishes an effective date based on the business rules noted above.

A sample of 94 item filings was reviewed to determine if filings are made using an approved filing system; if mandated time requirements are followed; if answers to regulator's questions are responsive; if materials distributed relative to a filing are the same as those filed with the applicable state regulator; and if accurate information is provided to subscribers relating to the states' approval status and approved usage date of prospective loss costs, policy forms, endorsements, factors, classifications or rating rules in a timely manner.

The sample size was determined in accordance with the sampling procedures set forth in Chapter 14, of the NAIC Market Regulation Handbook. The population of filings during the examination period was estimated to be 500 filings. Based on the Acceptance Samples Table (AST) in Chapter 14, a sample size of 86 is required. However, since the total population was based on an estimate, the examination team determined that a more conservative sample size of 94 should be selected. Filings for the following states were included in the review: Alabama, Alaska, Arkansas, Arizona, Colorado, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas,

Kentucky, Louisiana, Maryland, Maine, Missouri, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, Oregon, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia and West Virginia.

Based on the filings sampled, NCCI makes filings using (SERFF) in all states except Florida and Illinois. Florida has an electronic filing system that is referred to as I-File, which NCCI uses, and paper filings were required by Illinois during the examination period. Of the 94 filings reviewed, 36 involved questions/interrogatories from state regulators for which all answers were responsive to the questions posed. For all filings reviewed, the materials distributed are the same as those filed with the applicable state insurance departments and notifications to subscribers announcing filings, subsequent approvals and effective dates were timely.

With the exception of one filing, all were filed within the appropriate time requirements. The exception was noted when the impact of the 2008 amendments made to Iowa code 515A, which were effective on April 25, 2008, was not reflected by NCCI as a rule change to the Basic Manual until April 24, 2009. However, since the acceptable error rate for the sample equates to five (5) exceptions, and only one exception was noted, it is concluded that based on this sample, NCCI's filing are timely.

During the review of rate filings, we did not note any concentration of warnings, fines, or other negative actions from state regulators regarding late or incomplete filings. NCCI represents that it has not been fined by any state regulator for not meeting filing/approval documents and has not received any warnings, communications or other negative actions from regulators in rate, rule, form filings, factors, classifications or technical manuals.

Standard 4 - Operations/Management/Governance

Experience-rating factors are developed in a correct and timely manner.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. NCCI has adopted a metric for the timeliness of experience modification factors. For 2010, 83% of ratings are to be completed 90 days prior to the rating effective date, 96% completed 60 days prior to the rating effective and 99% completed 30 days prior to the rating effective date. Additionally, there are timeliness targets for the completion of revised ratings. For 2010, this target was one day. NCCI has developed an application - Experience Rating Management Reporting System (ERMR) to manage and track the processing of experience modification factors. Since the calculation of the experience factors is automated, managing and tracking the timeliness of the process lends itself to automation. The examiner reviewed the extraction methodology and processes with Company personnel. A summary of the service level agreements (SLAs)

or expectations for timeliness of reporting and processing was provided. The reports provided by ERMR are utilized by management to assure compliance with the SLAs. NCCI is currently running within 99% compliance with the stated SLAs. The security around the ERMR system is consistent with NCCI's basic access controls for IT, which have been reviewed and found to be effective. As such, reliance was placed on the reports this application produced.

Customer expectations and the availability of data are the basis for the metrics. Management monitors the actual performance against the metrics and has the flexibility to direct resources as needed to achieve the targets. Performance for 2008 and 2009 was reviewed and NCCI met or exceeded its targets for 2008 and 2009.

Inquiries regarding individual experience rating modification factors are addressed by NCCI's customer service center, which is typically able to resolve the inquiry at the time of the initial call. However, if the inquiry remains unresolved, it is forwarded to regulatory assurance for resolution. Such disputes are documented and maintained in the Regulatory Assurance Information System Correspondence (RAISC). The disputes resolution process and related procedures are set forth in the Basic Manual (2001) and its companion users guide. NCCI's log of disputes reflected 136 disputes for the period of 2006 through September 2010. A judgmental sample of 31 disputes (23% of the total population) was randomly selected for review. The sample included 21 voluntary accounts and 10 residual market accounts. Disputes originated from the following states were included in the review: Florida, Georgia, Illinois, Iowa, Kansas, Kentucky, Nebraska, Nevada, New Hampshire, Oregon, South Carolina, Tennessee, Utah, Virginia and West Virginia. The majority of the disputes pertained to the ownership or combinability of companies and the subsequent effect of those issues on the experience modification factor. All grievances were assigned to regulatory service managers who processed the cases to conclusion. A measurement was taken of the number of days between the date the dispute was entered into the system and the date the first acknowledgement letter was sent to the party filing the grievance, as well as the number of days from the first significant contact with the other party and the date of the file closure.

The review showed that in every instance a detailed acknowledgement letter was sent on the same day the file was opened. The acknowledgement letter provided a detailed description of the grievance procedure. The first significant contact averaged 18 calendar days. This was usually a letter explaining the reason for the initial decision, or requesting additional information from the other party. In 19 of the 31 cases, the issue was resolved at this first level. Ten cases were taken to a second level, which involved the scheduling of a dispute hearing. Of the 10 cases taken to the second level, six cases concluded with the NCCI position being upheld, and in four cases, either the officer ruled in the insured's favor or NCCI reversed its position prior to the hearing. Two cases were appealed in court. The average time to conclude a dispute was determined to be 150 days, however it should be noted that a small number of cases were open for a lengthy period of time, which significantly impacted the average and the majority of the cases were closed in less than 60 days.

The exposure, claim and policy data used in the experience modification calculation are obtained from the policy and unit statistical submissions. The validation processes to ensure completeness and accuracy of this data were tested under the Data Collection and Handling section of this report. Please refer to page 41 for the specific discussions and results of the testing performed. The testing indicated that the data used in the experience modification calculations was complete and accurate. Data for which the completeness and accuracy is in question is not used in the calculation until it has been corrected by the carrier.

The calculation of the experience modification factors is a highly automated process. The Experience Rating System was built in the 1990's. Since then, NCCI has implemented many improvements that have increased the quality, automation and modernization of the system. The Experience Rating System is made up of several applications that provide specific functions (e.g. Distribution for producing and sending out the ratings, E-notes online viewing and corrections to Ratings, ERQAT - Experience Rating Quality Automation Tool, etc. The examiners reviewed the specifications, testing and implementation of the Experience Rating System and the changes made from its inception to date including enhancements of edits, distribution enhancements, expansion of the E-Notes process, additional management reports, improvement of the Contractor's Classification Premium Adjustment Program (CCPAP) and some general improvements in the Experience Rating Systems. The consistency of the experience rating calculation is verified on a monthly basis. This verification process is a proactive step and is accomplished through the processing of 491 test ratings. The ratings are reproduced using the full experience rating calculation and editing programs. Once produced, detailed values of the test ratings are compared to baseline values for the same ratings. If any discrepancies are identified, further research is conducted. The expectation is that all revised values should match the baseline values with the exception of two ratings. Those differences are consistent with expectations for the two test ratings, as the test cases they represent require additional manual intervention.

The test ratings fall into two general categories:

- Standard test ratings for each jurisdiction
- Specialized test ratings for individual jurisdictions

In each jurisdiction test, ratings are created to validate all aspects of the experience rating calculation. This includes validating ELR & D-Ratios for all class codes, weight and ballast values, claim limitations (e.g. single claim, multiple-claim, medical-only, Federal) and premium qualification. A test rating is created for each rating year within the given jurisdiction's revision time period (ER Plan Manual Rule 4.B.2). Each year, a new test rating is created to coincide with the new rating's effective year. Additional test ratings are created for individual jurisdictions where state specific calculation rules exist. As necessary, new test ratings are created whenever changes have been approved to the Experience Rating Plan Manual rules for a given jurisdiction.

The examination team observed a demonstration and tracing of the modification, online viewing and corrections to Ratings through the E-Notes process. This process is referred to as Rate Tape Maintenance. The process was traced for a sample rate tape, the application of the updated values, verification of the values (two persons manually verify each entry) and notifications regarding the process and results. The process was found to have effective controls in place.

As with all processes performed in relation to rate making, there are specific deadlines for the completion of each step.

The security around the Experience Rating System is consistent with NCCI's basic access controls for IT, which have been reviewed and found to be effective.

The examiners reviewed the filed experience-rating plan and user's guide. Based on this plan, experience-rating factor calculations were verified for a sample of policies. This review included verification of the values and factors from the experience-rating plan, as well as the correct application of those factors in the calculation of experience modification factors.

Each state may have special rules (exceptions) that apply to this calculation that are referred to as the business/formula rules. As such, compliance with these rules is mandated by statute. To ensure compliance, NCCI has developed 61 edits that are designed to ensure that exceptions/rules are reviewed and applied to each calculation, as applicable.

Based on the assessment noted above, a modified sample size of 50 calculations was selected to determine if the process extracted/used the correct discount ratios, weighting values and ballast values. In all items sampled, the values used in the calculations were those values contained in the respective experience rating plans. Calculations for the following states were included in the review: Alabama, Alaska, Arkansas, Arizona, Colorado, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Missouri, Mississippi, Oklahoma, Utah, Vermont, Virginia and West Virginia.

The minutes for the Actuarial Committee meetings indicate that the Committee reviewed an update on the experience-rating plan, as well as research performed on the plan. NCCI considers input provided by the Committee as reflected in the minutes. However, the Committee serves in advisory capacity and does not act to approve or disapprove the materials presented to it.

Standard 5 - Operations/Management/Governance

The advisory organization performs thorough and meaningful inspections and research when required for individual insured rating classification.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. Comprehensive inspections of job classifications help ensure that insurers use the proper classification assignments when reporting data to NCCI. This promotes accurate classification assignments and payroll reporting, which are necessary to ensure the accuracy of the data used in class rate making and experience rating.

NCCI's inspection program initiates inspections to monitor, maintain and improve the overall classification system, as well as to help ensure that each business inspected has correctly classified its operations. NCCI also performs special inspections at the request of an employer, agent, insurance carrier or insurance regulator, which are used primarily to resolve disputes regarding classification code assignments.

The inspection program was evaluated to determine if inspection reports are adequately documented, if the results are communicated in a timely manner, if the classifications are consistent with the classification system, if the inspectors are qualified and if adequate resources are devoted to the inspection program.

A random sample of 116 inspections reports was selected from a population of 44,425 inspections performed from January 2006 through June 2010. The sample size of 116 was determined using the sampling methodology set forth in the NAIC Market Regulation Handbook Acceptance Samples Table (AST). Inspections reports from the following states were included in the review: Alabama, Arkansas, Arizona, Colorado, Connecticut, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maryland, Maine, Missouri, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Mexico, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia and West Virginia. It was determined that one inspection report incorrectly applied a classification that was not consistent with the classification system manual rules. In addition, four of the inspections were not communicated to the insured and/or insurance carrier within NCCI's internal metric for inspections (i.e. 50 days for inspections initiated by NCCI or within 75 days for special inspections requested by the employer, agent, insurance carrier or insurance regulator). The error rate is below the tolerable threshold of six exceptions for the sample size. Based upon the review, the inspection reports are adequately documented.

The job and training requirements for inspectors were reviewed to determine if inspectors are qualified. Inspectors are required to have at least eight years of experience in workers' compensation in the areas of field auditing, classification inspections, audit review, underwriting or loss prevention, and preferably hold a bachelor's degree. New inspectors complete a training program instructing them on NCCI inspection policies and procedures.

From 2005 through 2009, NCCI expanded its inspection program resulting in a substantial year over year increase in the number of inspections completed. NCCI's goal was to inspect a statistically credible sample of the classification data related to experience rated risks. The following chart reflects the increase in resources devoted to

the inspection program from 2006 through 2009. NCCI used commonly accepted sampling methodology to determine sample sizes and met its performance goals.

Year	Number of Staff Inspectors	Number of Inspections	Annual Inspections per Staff Inspector	NCCI Inspection Actual Expenses ($)	Cost per Inspection
2006	12	5,011	418	2,300,902	$459
2007	16	8,554	535	3,155,668	$369
2008	20	11,757	588	3,891,041	$331
2009	21	12,598	600	4,088,984	$325

Based on this review, NCCI's classification inspection program satisfies this standard.

Standard 6 - Operations/Management/Governance

The advisory organization has processes and procedures in place to develop sound, understandable and appropriate risk classifications.

Results: **Pass**

Observations: A procedural review and testing were performed to address this standard. NCCI develops and maintains the workers' compensation classification system utilized in most states. The NCCI class code system of national codes is comprised of approximately 500 unique classification codes, and is the basis for underwriting and pricing workers' compensation coverage. In addition, there are over 800 state specific codes, which are mostly duplicates of the national codes. Each code represents very specific and different workplace risk exposures. In most states, NCCI is also responsible for providing guidance on the correct use of workers' compensation class codes, and performs inspections of employers operations to determine if the proper workers' compensation codes are being used.

NCCI maintains the Basic Manual, which is comprised of classification codes, rules, and the rates or loss costs to be used for writing workers' compensation and employers' liability insurance coverage. NCCI also maintains the Scopes Manual, which is a more detailed guide for understanding and assigning workers' compensation classifications. The Scopes Manual is a codebook containing four-digit numerical classification codes and the classification definitions/phraseology for each code used in classifying workers' compensation risks. NCCI provides online access to the classification in the Basic Manual; by clicking on the code, it links the reader to the same class code in the Scopes Manual for a more complete, and detailed description of the classification including all of the inclusions and exclusions. The Scopes Manual provides guidance to better clarify proper application of the classification. State exceptions are also listed to further clarify

the proper application of the classification.

The examination team obtained a list of all risk classifications and randomly selected a sample of 90 classifications for review (7% of the total population) in lieu of the sample size of 86 required by the AST Table of the handbook due to the additional state codes. The sample included four state specific codes. The definitions for the 90 classifications were reviewed to determine if they provided clear guidance when classifying business operations and risk exposures. Based on the class codes reviewed, the definitions provided clear guidance to classify risks.

Although the review of the manuals showed that the definitions provide clear guidance to classify risks, there are occasions when questions regarding the applications of class codes arise. These questions are most often resolved at the Customer Service level and do not evolve into formal disputes. However when they cannot be resolved, most states mandate that rating organizations, such as NCCI, provide a means for policyholders to dispute the interpretation or application of the rating organization's rules to the policyholder's workers' compensation insurance policy. NCCI fulfills this obligation through a variety of dispute resolution mechanisms depending upon each state's particular statutory or administrative rule requirements. NCCI's dispute resolution services begin when NCCI receives a request from an employer for dispute resolution assistance. In states for which NCCI is the Plan Administrator, carriers and producers are also eligible for NCCI's dispute resolution services in accordance with rules found in the Workers' Compensation Insurance Plan (WCIP). The process employed by NCCI is the same that is applied to disputes of any kind such as experience modification factors or ownership rules. A review of disputed classifications was made under Standard 1 of the Classification Appeal Handling section of this report. Please refer to page 55 of this report.

Detailed and complex processes followed by NCCI are maintained to assure consistent handling of risk classifications, which also may include a review of existing industries. The process includes gathering information, determining how changes affect the rate, evaluating the change, and ordering other data reports and research that generate internal discussions. NCCI also reviews existing class codes to maintain a consistent handling of risk classifications. This process includes ordering statistical data, identifying external sources, identifying and documenting all known issues, preparing preliminary discussion papers, releasing the discussion papers for feedback and further discussions. When considering a new class code, three primary factors are generally considered:

1. The operations must be readily identifiable and the characteristics that make it identifiable must be defined.
2. The operations must be relatively homogeneous throughout the industry and the characteristics that make it homogeneous must be defined.
3. The industry must be of sufficient size to develop a statistically credible rate. The rate classification is essentially based on a statistical method of predicting future results on the basis of past experience. Therefore, the larger the database of past experience, the more credible is the experience underlying the rate.

During the examination period, NCCI initiated reviews of 36 industries. The examination team selected five industries (13.8%) to evaluate NCCI's process by which classification codes are analyzed and revised if determined necessary.

- Banking
- Insurance Operations
- Oil or Gas Lease, Well & Drilling
- Property and Building Management
- Country Clubs

The class codes for each function were identified, and their Basic Manual and Scopes Manual descriptions were reviewed. The reviews involve identifying and describing the different functions in the industry. The class codes and descriptions of other available classification systems were also used in the analysis.

Functions were grouped into class codes after evaluating similarity of job duties, work conditions, and exposures to injuries. Along with an inspection of job duties and work environment, the similarity or dissimilarity of claim frequencies among class codes help support the decision to modify, or not to modify, class codes. Information obtained from internal and external sources helped identify which codes needed to be revised as part of the analysis.

The procedures and data from NCCI support the examination finding that NCCI's methods for evaluating similarities and dissimilarities of exposures for class codes satisfy this standard.

On an annual basis, NCCI prepares a schedule of codes or industries to be reviewed the following year. Some sources of input for priority research may include some or all of the following:

- Analysis of internal data to identify confusing codes and problematic codes
- Identification of emerging industries (from NAIC's data or other external input)
- External and internal requests for research of codes
- Trends and conclusions attributed to appeals board decisions
- Requests by insurance departments
- Inspection program results

Annually, based on the sources of information/feedback noted above, NCCI identifies industries selected for review/research. NCCI completed the following reviews:

Year	National	State Special	Industries
2003	36	7	15
2004	113	45	53
2005	90	36	31
2006	113	74	47
2007	144	47	47
2008	83	91	42
Total	579*	300**	235

*100% of all national classifications reviewed
**100% of all state special classifications reviewed

Updates to the classification system are communicated to the industry through:

- Regulatory filings
- Circulars
- Publications
- Manuals – updates

A review of countywide classification filings was made to determine if they were approved and if the results of NCCI's classification research were reflected in actual filings. Based on this review, the filings were approved and the results of NCCI's classification research are reflected in actual filings.

The examiners reviewed the Actuarial Committee meetings spanning more than three years. The risk classification system was discussed at a high level in some meetings. However, the agenda is set by NCCI, which considers input by the Committee, and risk classification was not selected as an agenda item during the period under review. Given the limited role of the actuaries in the review of risk classifications, it seems reasonable that the Committee did not consider this area a priority.

Standard 7 - Operations/Management/Governance

Loss Control services are effective and based on valid risk management, engineering and scientific evidence.

Standard 7 does not apply to NCCI.

Standard 8 - Operations/Management/Governance

The advisory organization conducts ongoing research and review of state insurance laws and insurance-related case law in order to be responsive to necessary changes in prospective loss costs, policy forms, endorsements, factors, classifications or manuals, as applicable.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. Compliance with state laws, regulations and new legislation is maintained through direct communications with state regulators by monitoring the relevant legislative activities of each state. NCCI uses state relations executives (SREs) to monitor changes in laws and regulations. SREs are the primary contact with state regulatory authorities and are responsible for establishing relationships with the regulatory community, legislators, insurance trade associations, and employer and agent groups at the state level. This allows the SRE to identify and monitor regulatory changes that impact the statistical plans, forms, rules, rates/loss costs and relevant manuals for each state, and to then initiate changes, as applicable. NCCI has twelve SREs. Each is assigned a group of states for which each is responsible for monitoring the workers' compensation environment.

Through this process, once changes to laws and regulations are identified, the SRE initiates and monitors the appropriate filings with state regulators to make revisions accordingly. NCCI staff, with the appropriate subject matter expertise, assists the SRE in the filing process, and notifying members/subscribers of these changes.

NCCI uses circulars and informational releases to keep subscribers, members, agents and regulators informed of filings and subsequent approval/disapproval, as well as issues affecting the workers' compensation marketplace. These communications are similar to bulletins, press releases, notices, etc. that are used to communicate information to interested persons. These notifications are available both electronically via NCCI's website and in paper form.

A search for changes in laws and/or regulations that pertain to workers' compensation was conducted using NILS Insource. A judgmental sample of 20 new or revised laws that became effective since 2006 were selected for review. The review included statutes/regulations from fourteen (14) states: - Alabama, Arkansas, Colorado, Kansas, Kentucky, Louisiana, Maine, Montana, New Hampshire, Oklahoma, Oregon, Utah, Vermont and West Virginia. For all items sampled, NCCI identified and adequately addressed the change in law/regulation. The appropriate modifications, additions, deletions or withdrawals to the statistical plan, forms rules, rates/loss costs and/or relevant manuals as necessitated by the underlying law/regulation were changed in a timely manner. In addition, members/subscribers were notified of these changes in a timely manner. NCCI is proactive in informing member/subscriber of changes in forms, rules rates/loss costs, classifications, or manuals that have been made as a result of legislative action.

Standard 9 - Operations/Management/Governance

The advisory organization uses objective and established procedures when administering residual market or pool assessments.

Results: **Pass**

Observations: The processes and activities related to the reinsurance pooling mechanisms administered by NCCI are also addressed under Standard 1 of the Residual Market Functions – Reinsurance Administration section of this report. A review of the methodology used to determine the allocations indicates that it is an objective approach and is consistently applied. For a description of the pooling mechanisms and the allocations, please refer to page 64 of this report.

Standard 10 - Operations/Management/Governance

The advisory organization uses objective and established procedures when administering assigned risks.

Results: **Pass**

Observations: The processes and activities related to the administration of the assigned risk plans administered by NCCI are also addressed under Standard 1 of the Residual Market – Plan Administration section of this report. A review of the administrative activities performed by NCCI indicates that objective procedures and processes are established. For a description of administration activities, please refer to page 58 of this report.

Standard 11 - Operations/Management/Governance

When performing analysis and impact studies of proposed legislation, the advisory organization presents thorough and objective information.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. A sample of five separate impact/benefit change studies were reviewed by the examiners - Iowa (2010), Kansas (2010), Maryland (2008), Missouri (2008) and Montana (2010).

The samples reviewed related to studies triggered by either an action by a government entity such as the State Senate or State House of Representatives or an update of fee schedules. The final presentation of each impact study is the Impact Study Circular distributed to the state government entities and NCCI members. The process begins with a pricing documentation form driving the analysis process, providing guidelines for the

analysis, and providing spreadsheets comprising the actual calculations of the analysis. This form requires that the following be disclosed for each impact study: quantified impact, data sources, methodology used, peer review, and identification of the impacted components of the rate filing. NCCI also researched external resources and used them as necessary for each study.

Impact studies are each unique because the approach taken is dependent on the proposed changes. Even when simply updating medical fee schedules, there could be differences in application, exceptions, etc. between states or between current and prior updates. Therefore, studies were primarily reviewed for consistency of approach and procedures. Spreadsheets were reviewed for overall reasonableness and consistency with Impact Study Circulars and some calculations were also spot checked.

The underlying analyses provided by NCCI reconcile with the impact study circulars with the exception of the Missouri study. NCCI explained that this circular was based on the results of an earlier analysis/study, whereas the analysis/study provided to the examiners was based on updated experience. The update was performed to evaluate whether the original overall impact was still reasonable. The updated overall impact indicated in the spreadsheet was 0.3%, compared to the original estimate in the circular of 0.2%. Therefore, NCCI determined that the original estimate was still reasonable and did not update the circular.

Based on the examination review of the five sample studies provided, NCCI presents information in an objective manner, using reasonable assumptions, research, and data. More specifically, NCCI has a consistent process to:

1. Research and acquire the necessary available data;
2. Identify and state the significant assumptions; and
3. Present the current and proposed conditions and the analysis driving the cost changes in an objective manner.

There are various teams and positions in place to internally vet analyses and impact studies of proposed legislation. One of these positions is a state team mentor/peer reviewer and another is a management peer reviewer. Peer review of a draft-pricing memo begins after the quality review. At least one person performs this peer review. This review ensures that all material concerns are addressed in the memo and checks that the approach and results are reasonable. If any material changes are later made to the pricing memo, it must undergo another peer review. After the peer review, the memo is sent to several teams for final review, where at least two parties must sign off.

The LEAP process flow defines the responsibilities of various personnel in determination of the cost impact of proposed or enacted legislation. The individuals and teams involved in this are: the State Relations Executive (SRE), the LEAP State Team Leader and team members, the State Actuary, Mentors/peer reviewers, the Management Team, Legal Representatives, and the LEAP Pricing Focus Leads.

The LEAP process does not strictly specify the education and experience of these personnel, though the State Actuary is likely a credentialed actuary. The extensive use of peer review and supervisory approval in each step implies that the impact studies are properly vetted by personnel having the appropriate education and experience.

For changes that are actually enacted, the LEAP State Team determines whether a further technical peer review should be conducted. This decision involves the SRE, State Actuary, Management Team, and LEAP Process Focus Leads for their final review. Procedures for conducting a technical peer review are also documented.

Based on the examination review, it was concluded that the advisory organization presents thorough and objective information when performing analyses and impact studies of proposed legislation.

Standard 12 - Operations/Management/Governance

The advisory organization has an up-to-date, valid internal or external audit program.

Results: **Pass**

Observations: A procedural review was performed to address this standard. This standard pertains to the statistical agent's ability to identify weaknesses in its operations and implement corrective actions to mitigate the risk of material errors in the data that is used to calculate rates/loss cost and experience modification factors, as well as to provide complete and accurate information to regulators and its subscribers.

A review of the audit plans for the examination period and selected audits indicate that NCCI has developed and implemented a successful internal audit program. The audits adequately target NCCI's risk areas and significant operational processes. As evidenced by the audit committee minutes, internal audit reports the results of its audits directly to the committee. All material exceptions are presented to the committee and management's success in addressing each exception is tracked by the committee until each exception is fully resolved or mitigated. Meaningful information is provided to management and the board of directors. Management uses the audit reports as a mechanism to identify exceptions/weaknesses in its processes/procedures that pose significant operational risk. Management formally responds to audit findings and recommendations and takes action to correct/mitigate risks by implementing changes to its policies and procedures. The accuracy of statistical data is among the areas tested by the internal audit function.

Periodically, NCCI will use the services of an independent auditor to perform special reviews of operational and system processes.

Standard 13 - Operations/Management/Governance

The advisory organization has appropriate controls, safeguards and procedures for protecting the integrity of computer information.

Results: **Pass**

Observations: A procedural review was performed to address this standard. Testing was performed to evaluate the safeguards and procedures for protecting the integrity of computer information.

An inspection of the computer facility was performed by the examiners. The security items tested included logical (application/system access) and physical access to the computer facility, monitoring of access rights and traffic in the facility including badge management and firewall settings. A review of Network access was performed to assure the adequacy of Active Directory (AD) settings and controls. All controls were found to be adequate. Additional testing was performed on building management, which was also determined to be adequate.

Email security was reviewed during the Information Technology General Control review (ITGC). NCCI utilizes appropriate virus control technology on servers, desktops and laptops. Secure and encrypted email software is utilized for transmission of all sensitive information. Inbound emails are scanned for potentially dangerous attachments, keywords and spam content. Email security was found to be adequate.

NCCI uses Secure File Transfer Protocol (SFTP) for all data being transferred over public connections. It was also verified that no personal data is collected by NCCI, which eliminates the risk of identity theft. Laptop encryption is being implemented throughout the company and removable devices containing data are also encrypted.

Logical access to applications was reviewed as a part of the ITGC review. Testing was performed on appropriate processing of 10 new hires, five terminations and 19 modifications to assure appropriate access is maintained. The sample sizes were based on the population of each process that occurred during the period under review. No exceptions were noted. Additionally, the company performs periodic review of all access during which business unit management verifies that the access for each employee is appropriate. This testing performed by NCCI was reviewed to verify completeness and effectiveness.

Change management was reviewed as a part of the ITGC review. Changes to existing applications and development of new applications were reviewed and testing performed on samples of application changes and new development. The sample was judgmentally selected to include those major changes that were most significant to the processing of edits and data to be utilized for ratemaking and experience-rating. The test sample consisted of the review of seven of the 13 major projects (modifications to

existing functionality and new functionality were included) completed during the exam period. This testing included tracking the selected changes for appropriate request forms, design documents (both functional and technical), test plans (adequacy and results) and implementation (including approvals and signoffs). There were no exceptions noted. The controls in place were found to be adequate.

Based on NCCI's policies and procedures as well as testing performed, NCCI satisfied this standard.

Standard 14 - Operations, Management and Governance

The advisory organization has a valid Disaster Recovery Plan.

Results: **Pass**

Observations: A procedural review was performed to address this standard. The Disaster Recovery and Business Continuity plans were reviewed in detail to assure all aspects such as key business functions, Recovery Time Objectives (RTOs) and Business Impact Analysis (BIA) were appropriately covered. NCCI replicates all data to a remote IBM hot site in Boulder, Colorado. This allows complete recovery of all systems well within the specified RTO.

The results of the most recent test were reviewed and the last two sets of test results were overall positive and recovery of all systems was performed adequately. Follow up was performed on the small issues that were encountered and resolutions have been put into place. The examiners reviewed these with NCCI.

Based on NCCI's Disaster Recovery and Business Continuity Plans, NCCI satisfied this standard.

Standard 15 - Operations/Management/Governance

The advisory organization is adequately monitoring the activities of any entity that contractually assumes a business function or is acting on behalf of the advisory organization.

Results: **Pass**

Observations: A procedural review was performed to address this standard. NCCI does not use outside vendors to perform a significant number of functions related to its advisory and statistical agent activities. The inspections of classification codes are the only significant activity for which NCCI routinely uses outside vendors to supplement its internal inspection staff. Inspections are performed in 35 states and vendors are

utilized to perform some inspections where more local or specialized expertise is required.

The policies and procedures in place were reviewed to determine if NCCI audits the activities of vendors at least annually to assess compliance with the contractual terms and the quality of the work performed.

NCCI's policy requires a written contract for all outside services regardless of the dollar amount or length of service. Compliance with the contract and an assessment of the quality of work performed is monitored directly by the area responsible for the vendor relationship.

To determine compliance with the contractual terms and quality of the inspections performed by vendors, all classification code inspections are subject to a quality review by NCCI's staff of specialists. The reviews determine if the inspections contain the information necessary to ascertain if the classification code assignment is correct and adequately documented. Of the 116 inspection reports reviewed for Standard 5, 30 were performed by vendors, and all inspection reports were reviewed by NCCI for the quality of the work performed.

Based on NCCI's policies and procedures, which include a review of one-hundred percent (100%) of the inspections performed by vendors, NCCI satisfied this standard by adequately monitoring the activities of outside vendors.

Standard 16 - Operations/Management/Governance

Records are adequate, accessible, consistent and orderly and comply with state record retention requirements.

Results: **Pass**

Observations: A procedural review was performed to address this standard. NCCI does not maintain a separate retention schedule for each state in which it is licensed. Instead, it maintains records in connection with its rating and statistical agent responsibilities for at least seven years, which is more conservative than the most expansive state requirements.

Based on a review of applicable state record retention laws, none required that records be maintained for more than seven years. NCCI has adopted a formal records management program. The Records and Information Management Department and the Internal Audit Department are responsible for monitoring overall compliance with the program. The retention schedule was obtained and reviewed to verify the retention requirements for each record type/category. The retention period for policy, unit statistical, financial and detailed claim information is 50 years. All employees are required to sign an Annual Employee Acknowledgment, Code of Business Conduct and Conflict of Interest

Certificate, which specifically requires that all employees acknowledge compliance with NCCI's records management program. The 2010 acknowledgments for senior management and the board of directors were reviewed with no exceptions noted.

Throughout the course of the examination, all data requested was provided without exception, thus indicating adherence to the retention policy. Based on the examination team's review of the information provided throughout the course of the examination, the structure of files and data was organized, orderly and legible.

Standard 17 - Operations/Management/Governance

The advisory organization is appropriately licensed.

Results: **Pass**

Observations: Detailed testing was performed to address this standard. For each NCCI state, a current license was reviewed without exception.

States	License Type	Filing Frequency
Alabama	Rating Organization	Annual
Alaska	Rating Organization	Triennial
Arizona	Rating Organization	Perpetual
Arkansas	Advisory Organization	Annual
Colorado	Rating Organization	Triennial
Connecticut	Rating Organization	Perpetual
District of Columbia	Rating Organization	Perpetual
Florida	Rating Organization	Annual
Georgia	Rating Organization	Annual
Hawaii	Rating Organization	Triennial
Idaho	Rating Organization	Annual
Illinois	Advisory Organization	Annual
Illinois	Rating Organization	Biennial
Iowa	Rating Organization	Annual
Kansas	Rating Organization	Annual
Kentucky	Advisory Organization	Perpetual
Louisiana	Rating Organization	Triennial
Maine	Advisory Organization	Biennial
Maryland	Rating Organization	Triennial
Mississippi	Rate Service Organization	Perpetual

Missouri	Advisory Organization	Perpetual
Montana	Rating Organization	Annual
Nebraska	Advisory Organization	Annual
Nevada	Rate Service Organization	Annual
New Hampshire	Advisory Organization	Annual
New Mexico	Advisory Organization	Annual
Oklahoma	Advisory Organization	Annual
Oregon	Rating Organization	Perpetual
Rhode Island	Rating Organization	Triennial
South Carolina	Rating Organization	Perpetual
South Dakota	Rating Organization	Triennial
Tennessee	Rate Service Organization	Perpetual
Texas (independent bureau state)	Advisory Organization	Perpetual
Utah	Rate Service Organization	Annual
Vermont	Advisory Organization	Perpetual
Virginia	Rate Service Organization	Perpetual
West Virginia	Rating Organization	Triennial

NCCI maintained a rating, advisory and/or rate service organization license in certain independent bureau and monopolistic states

States	
California	Independent Bureau
Delaware	Independent Bureau
Indiana	Independent Bureau
Michigan	Independent Bureau
Minnesota	Independent Bureau
North Carolina	Independent Bureau
New Jersey	Independent Bureau
New York	Independent Bureau
Pennsylvania	Independent Bureau
Texas	Independent Bureau
Wisconsin	Independent Bureau
Ohio	Monopolistic State
North Dakota	Monopolistic State
Washington	Monopolistic State
Wyoming	Monopolistic State

Standard 18 - Operations/Management/Governance

The advisory organization cooperates on a timely basis with examiners performing the examinations.

Results: **Pass**

Observations: To assist in evaluating NCCI's cooperation throughout the examination, a request log was maintained that documented the date each request was made, the date a response was due and the date on which the response was ultimately received. Additionally, status meetings were held weekly, providing a means to discuss outstanding requests, examination progress and immediate needs of the examination.

On occasion, NCCI requested additional time to provide the information/documentation based upon the assessment of the time needed to complete the request and all requests for extensions were considered reasonable. With respect to the examination in its entirety, NCCI's responses to requests were timely and its cooperation during the extensive testwork of system databases contributed to an efficient examination process.

Standard 19 - Operations/Management/Governance

The advisory organization has developed and implemented written policies, standards and procedures for the management of confidential or proprietary information.

Results: **Pass**

Observations: A procedural review was performed to address this standard. NCCI maintains policies and procedures related to confidential and proprietary information and data. Board members and employees may not disclose any confidential information or material received in confidence from third parties. NCCI's policies related to confidential information and corporate information security are referenced in the Code of Business Conduct and acknowledged in writing by board members and employees annually. The 2010 acknowledgments for senior management and the board of directors were reviewed with no exceptions noted.

Employees receive specific training regarding NCCI's confidentiality policy and procedures. As part of NCCI's 2010 annual compliance training requirement, all employees are required to complete an online Information Security compliance training course. NCCI uses an online Learning and Event Management System (LEMS) for registering and tracking employees' completion of the annual compliance training

courses, such as the Information Security training course. A sample of test results produced through LEMS was reviewed and documents the testing process.

STATISTICAL PLANS

The statistical plans portion of the examination is designed to verify that NCCI maintained adequate statistical plans in accordance with applicable statutes, rules and regulations, and that the data are reported in accordance with the statistical plans. This test is also intended to measure NCCI's compliance regarding the filing and approval of statistical plans.

Standard 1 - Statistical Plans

The statistical agent has filed its statistical plans in accordance with applicable statutes, rules and regulations.

Standard 2 - Statistical Plans

The statistical plans are reviewed and updated in accordance with applicable statutes, rules and regulations.

Results: **Pass**

Observations: Detailed testing was performed to address these two standards. In 2007, NCCI began the process of identifying enhancements to the statistical plan that would make it easier to use and modifying the plan to better conform to the format, outline and state exception pages of existing regulatory manuals. This process was completed in 2008, and the new statistical plan was filed for approval by the various states. NCCI produced documentation, which evidences each state's receipt and/or approval of the 2008 Statistical Plan Manual. Most of the filings were made via the NAIC's System for Electronic Rate and Form Filing (SERFF). However, manual filings were made in some states. The new manual was effective September 1, 2008.

Compliance with state laws, regulations and new legislation is maintained through direct communications with state regulators and by monitoring the relevant legislative activities of each state. NCCI uses state relations executives (SREs) to monitor changes in laws and regulations that impact the statistical plan. SREs are the primary contact with state regulatory authorities and are responsible for establishing relationships with the regulatory community, legislators, insurance trade associations, and employer and agent groups at the state level. This allows the SRE to identify and monitor regulatory changes that impact the statistical plans of each state and to initiate changes in the statistical plans,

as applicable. NCCI has twelve SREs. Each is the assigned a group of states for which each is responsible for monitoring the workers' compensation environment.

Through this process, once changes to laws and regulations that impact the statistical plan are identified, the SRE initiates and monitors the appropriate filings with state regulators to revise the plan accordingly. NCCI staff with the appropriate subject matter expertise assists the SRE in the filing process.

Since September 1, 2008, changes relative to a particular state's requirements were filed with the respective state as an exception (revision/modification) to the 2008 Statistical Plan Manual. Six states adopted minor revisions/modifications subsequent to the filing of the 2008 Statistical Plan Manual (National version). These revisions/modifications were filed with and approved by the respective states. From September 1, 2008 through early 2011, 11 were selected for review to determine if the statistical plan was timely updated in accordance with applicable state laws and regulations of 27 new state exceptions. All of the filings were approved by the regulatory authority and were timely.

The IT examination team reviewed the procedures in place to assure that all changes to the statistical plan are reviewed to determine what modifications are needed to the systems and that those changes are timely and correctly tested and implemented. Impact analysis is performed to determine what programming changes are needed. Three types of analysis are done: Impact Analysis, Side-by-side analysis and business requirements analysis. These documents were reviewed for the 2008 Plan change. Edits affected by updates to the statistical plan were documented in the edit matrix. Edits affected in the 2008 changes were the addition of three new statistical codes, a new Managed Care Organization code and a new Cause of Injury Code. The examination team reviewed the documentation to assure that the changes were tested and approved prior to implementation.

During the examination, the IT Team learned that there were not many examples available for verification that included any state exceptions for the analysis, modification and testing of programs due to changes in the Statistical Plan. However, since the process to research and implement such programming changes would be identical for NCCI and non-NCCI states, a review of one example involving programming changes for non-NCCI states was made. Documentation for all three types of analysis was reviewed: Impact Analysis, Side-by-side analysis and Business Requirements analysis. Testing results were verified and the process was found to be well controlled.

Based on the documentation and process review and testing, NCCI satisfies these standards.

Standard 3 – Statistical Plans

The statistical agent verifies that companies submit data in accordance with the appropriate statistical plan.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address each aspect of this standard.

Tracking the receipt and flow of the data through the system is critical. For Unit and Policy data, this flow of data submissions to NCCI is tracked through a system referred to as Submission Tracking System (STS). STS includes dates that submissions are due and whether they are received in a timely manner. Interaction with the carriers is automatic to notify them of pending dates. Timely completion and correct filing is related to the incentive plans as described below. Additionally, each submission is tracked through the pre-edits and edits of critical data elements. At each stage, STS displays the status of the all submissions currently being processed. Data edit failures are produced. STS was verified during each of the edit tests performed by the examination team.

The Financial Data Base also has an expected call list and reminders in place to contact carriers of pending deadlines for submission of financial call data. The Financial Call system also tracks the submissions through the various stages including pre-edits and edits until the data is acceptable to be included in the production database. The requirements for the submission of data are developed to assure that the data received from the carriers is in compliance with applicable statutes, rules and regulations.

The use of edits is also a key component in determining if data is submitted in accordance with the statistical plan. The use of edits is discussed in Standard 1 of Data Collection and Handling. Please refer to page 41 of this report.

The reconciliation process of financial data to the State Exhibit of Premiums and Losses, Statutory Page 14 of the carrier's annual statement is performed as part of the overall Financial Data Call system validation and notification processes. A demonstration of this process was provided and testing was performed. During the demonstration of test submissions, errors were created that would cause the reconciliation to fail. In every case, the appropriate notifications were generated and the status of the submission was appropriately put in "Failed" mode. Additionally, corrections were applied to the data and the edits were repeated. In each test case, the data was then allowed to pass to the production database. For both units and policies, a balancing edit is executed to check for a balancing error, which occurs when the reported record submission control count does not match NCCI's derived record count. The primary review of unit and policy data for completeness and accuracy occurs following the first extract of the data from the Integrated Data Base (IDB) to the Actuarial and Economic Services (AES) team where "A" Sheets are completed for each submission. "A" Sheets compare Payroll and Claim data for reasonableness checks. Additionally, the data for different years are compared to check for omitted data or extra data being erroneously reported in a submission. These are used in addition to the edits that are completed at this stage of the process. The due date for carrier resolution

is typically set at 60 days after date of notification. Unresolved validation items are subject to NCCI's phased escalation program.

NCCI's uses Pre-edits to verify that submissions from carriers are complete and in the appropriate format. Carriers may submit unit and policy data via Data Transfer Via Internet (DTVI) or other file transfer processes. Files submitted through DTVI may be rejected for several reasons including invalid record length of data records. Tests were run through the system to verify that files submitted with invalid record lengths would generate this error. In every test case performed, the appropriate error was triggered and the appropriate notification was sent.

This standard also addresses incentives designed to encourage carriers to report timely and error-free data, programs designed to monitor and provide guidance to those carriers with significant reporting issues and effectiveness of procedures to collect complete and accurate statistical information. These areas are described under Correspondence with Insurers and State Regulators, Standards 1, 2 and 3. Please refer to page 48 of this report.

DATA COLLECTION AND HANDLING

The data collection and handling portion of the examination is designed to verify that NCCI adequately tests reported data for validity, completeness and reasonableness. The areas to be considered in this type of review include data quality, data checking procedures and edit programs.

Standard 1 - Data Collection and Handling - Data Editing Process

Edits are sufficient to catch material error in data submitted by a company.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. NCCI's data quality processes evaluate data submissions for accuracy, validity, completeness, reasonability and timeliness. Edits are used to validate incoming data to ensure that data submitted by carriers is consistent with reporting requirements and quality standards. Data that may not be correct is identified and communicated to carriers for further review and/or correction and resubmission.

Edits are designed to test the format and values of specific data fields, the relationship among data fields in a single submission, as well as the relationship between a field in an incoming transaction with previously submitted data. Data that contains no errors is available for use in ratemaking, experience modification calculations and other NCCI products. However, data with errors may not be used depending upon the nature of the questionable data and how critical it is to ratemaking, experience modification

calculations and/or other products. Certain data failures result in a rejection of the entire transaction and require correction and resubmission.

The examination team evaluated the data fields for the policy, unit statistical and financial call submissions to identify the edits that are applied to each data field, as well as those fields that are not subject to edits. Each edit was also reviewed to determine if it was effectively designed to adequately test the nature and type of data being submitted. An analysis was also performed to identify instances in which additional edits were needed to sufficiently test the data. All of the edits for each data type were reviewed.

Data Type	Number of Edits
Policy	397
Unit Statistical	505
Financial	534
Total	1,436

Based on the results of this review, edits are applied to all critical data fields. Those data fields that are subjected to edits do not contain data that is critical to ratemaking, experience modification calculations or other NCCI products that are within the scope of this examination. All edits were effectively designed and no additional edits were deemed necessary.

The examination team performed testing to determine the effectiveness of the edits. A sample was chosen to represent different types of edits with varying severity to allow the examiners to verify the results of each edit detecting erroneous data. The testing was performed on the test databases to avoid creating any issues with production data.

For each database (Integrated Data Base and the Financial Call Database), the examiners in conjunction with the data management team from NCCI first performed a "dry run" on three edits to evaluate the testing approach. Dummy submissions were developed for each edit being tested. The dummy submission included a Pass record where the control data was acceptable and a Fail record where the data was unacceptable and the edit would be triggered. During the testing, other edits were also verified such as duplicate records, invalid record length and duplicate submissions. The dummy data was submitted and tracked through STS (Submission Tracking System) as a further verification that all data passes through all stages of editing. There were no issues with either "dry run" performed. It was verified that the records with severe errors or errors on critical fields were flagged and not to be used in the databases. The records with no errors were accepted. Appropriate email notifications and reports were generated for all edit failures.

For Unit Statistical and Policy data, testing was performed on the IDB. Dummy submissions for each data type were developed. Based on the overall effectiveness of NCCI's information systems control environment, a modified sample size of 20 to 23 edits was selected for each database to ensure that the different edits types were included (field, logical and relational edits) in the testing.

A sample of 22 edits was selected for testing unit data edits. As in the "dry run", submissions were tracked in STS during the entire testing phase. No exceptions occurred. In every case, the edit caught the erroneous data and the appropriate error report and data grade resulted. The appropriate data was accepted (if the error was not severe or the data element was not critical) and the appropriate data was flagged and not accepted. The examiners queried the database and determined that the data in the database was accurate.

A sample of 20 edits was selected for testing policy data edits. As in the "dry run", submissions were tracked in STS during the entire testing phase. No exceptions occurred. In every case, the edit caught the erroneous data and the appropriate error report and data grade resulted. The appropriate data was accepted (if the error was not severe or the data element was not critical) and the appropriate data was flagged and not accepted. The examiners queried the database and determined that the data in the database was accurate.

Financial Call data was tested in the Financial Call database. A sample of 23 edits was selected for testing financial call data edits. This database is set up differently than the IDB in that the data remains in a staging database where the carrier has the ability to work with the data until it is ready to submit. A "dry run" was also performed prior to the final testing of financial call data. The approach was also different since we were not creating a submission file but rather a data call that was loaded into the staging database. For this testing procedure, the erroneous data was loaded and then run through the editing process. In every case, the appropriate error was triggered by the targeted edit. The erroneous data was then corrected and the editing process repeated to verify that data was processed appropriately for both erroneous data and correct data. The Financial Call Database has its own tracking facility and between each phase of the testing, the status of the call being tested was checked. The flow process was found to be appropriate in every case.

The sample of 23 edits included one edit that was effective in 2007. Therefore, a specific call was set up to make sure that this edit fired for 2007 data and did not fire for subsequent year's data. No exceptions occurred. In every case, the edit caught the erroneous data and the appropriate error report and data grade resulted. The data was then fixed and appropriate data was accepted (if the error was not severe or the data element was not critical) and the appropriate data was flagged and not accepted. The examiners queried the database and determined that the data in the database was accurate.

A Production Edit Matrix and Future Edits Enhancements Matrix are maintained as edit maintenance is a high priority at NCCI. The need for new edits arises from many sources. Changes to statutes and regulations, which are filed and for which filing meetings are held, are evaluated by Data Services for applicability and impact to data reporting. Once the filing is announced and communicated, Data Services and Data Quality assess whether or not new edits are warranted to help carriers properly report the data. When a new edit is proposed, the edit is reviewed internally by the Edit Action

Committee (EAC), and then externally by the Edit Task Group (ETG). New edits also may be needed when data reporting layouts change or an application used to collect, process or store the data is modified. These edits are proposed in much the same way: in collaboration with Data Quality and Data Services, but through an annual project in which the application is changing. For one-off changes, these are accomplished through the HEAT system as part of standard edit maintenance. Annual projects exist for Financial data, Units and Policies in which edits are involved. Internal stakeholders or users of the data may also bring forward data quality concerns that may warrant implementing a new edit. Once their concern is communicated to Data Quality, the issue is evaluated and researched. If a new edit or change to an existing edit is needed, it is included in an annual project, or if time sensitive, is implemented via the HEAT system. High occurrence of specific anomalies (issues detected in the data that were not caught by the edits) can also result in the modification of an existing edit or addition of a new edit. Edits are adequately tested prior to release into production. This was verified in the review of the seven major projects tested during the change control testing. The projects selected were related to edit changes. Training manuals are updated and published as changes to edits are required and they are communicated to the user population. A quarterly edit review is available for external customers to monitor performance of edit process on their submitted data. This process helps to ensure that edits are functioning as expected and alert customers to trends in data format/submission problems.

Based on NCCI's policies and procedures as well as testing performed, NCCI satisfied this standard.

Standard 2 - Data Collection and Handling - Data Editing Process

All data that is collected pursuant to the statistical plan is run through the editing process.

Standard 3 - Data Collection and Handling

Determine that all databases are updated as needed with all accepted company data.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address these two related standards. The flow of data submissions to NCCI is tracked through a system referred to as Submission Tracking System (STS). The STS system has been in effect since 2004 and an upgrade was implemented in 2010. The upgrade enabled new functionality and enhancements. The examiners reviewed the functional and technical specifications for the upgrade of this system. In order to review the online functionality of STS, a demonstration was provided wherein the tracking of a submission was observed in STS from its original submission through the stages of the data being

received, pre-edits, edits and the loading of the data into the production database. At each stage, STS displays the status of all submissions currently being processed. Reports are generated to indicate submissions that remain in one status longer than expected. Reports are generated that reconcile the number of submission received to those still in progress, rejected or added to the production databases. This process assures that all submissions that are accepted are added to the appropriate production database.

Additionally, trouble tickets (called Heat Tickets) are created if a failure occurs and an exception is noted during the process. NCCI personnel work the Heat Tickets to discover the issue and the root cause of the error. They work with the carrier if necessary to determine and implement the solution that will allow the submission to be accepted. There were 46 heat tickets addressing STS failures during the examination period. A sample of ten unit and ten policy submissions error tickets was judgmentally selected to incorporate all failure types in the review (which represents 43% of the total population). This verified that the any issues with the flow of the submissions through the process were being flagged and that no data got through the system without fulfilling all requirements at each level. All Heat Tickets were addressed in a timely manner and appropriately handled with no relevant exceptions were noted.

As part of the edit testing performed in Standard 1 of the Data Collection and Handling section of this report the test submissions were tracked using STS and the flow through of the edits was observed. Errors were simulated on each test submission to verify the completeness and accuracy of the tracking, as well as to verify that all submissions were required to run through the edit process and that all accepted submissions were included in the database. No exceptions were noted.

As a final verification of the completeness and accuracy of the production databases, the exam team performed completeness and accuracy testing on all in scope databases. A sample of submissions was selected for each database. The data in the original submission file was compared to the data in the production database to ensure that all data was present and that the data in the production database accurately represented the data as it was submitted. The testing is detailed in the Completeness and Accuracy section of this report. Refer to page 73. The results of this process verified that all accepted data is being appropriately and completely processed.

Based on the testing and review of NCCI's Policies and Procedures, NCCI satisfied both of these standards.

Standard 4 - Data Collection and Handling

Determine that statistical data is reconciled to the State Rate Exhibit of Premiums and Losses, Statutory Page 14, of the NAIC annual statement on an annual basis.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. Most states do not have specific statutes, rules or regulations that relate directly to the reconciliation of the statistical data to the State Exhibit of Premiums and Losses, Statutory Page 14, of the NAIC annual statement. However, Nebraska has a statute that addresses the reconciliation process. Financial Call #8 is the automated report that reconciles the earned premium, direct losses paid and incurred and the direct defense and cost containment expenses to the State Exhibit of Premiums and Losses, Statutory Page 14, of the annual statement. Through Call #8, NCCI complies with the reconciliation requirement set forth in the Nebraska statute.

Section 23 of the NAIC Statistical Handbook applies specifically to statistical agents that collect workers' compensation data. Section 23A, which addresses unit statistical data, sets forth the required data elements that the statistical agent must collect. It also identifies the following reports that the statistical agent is required to compile.

- Total Experience Annual Report for All Industries
- Total Experience Annual Report by Industry Group
- Total Experience Annual Report by Class

Section 23B addresses financial calls for aggregate experience and sets forth the required data elements that the statistical agent must collect. It also identifies the following reports that the statistical agent is required to compile:

- Workers' Compensation Calendar/Accident Year Experience Annual Report
- Workers' Compensation Policy Year Experience Annual Report

While the examination team has determined that NCCI collects all material data elements noted in Section 23, 23A and 23B of the NAIC Statistical Handbook, it cannot document that NCCI complies with the specific reporting requirements of subsections 23A.5, 23A.6, 23B.4 and 23B.5.

NCCI represents that it has not routinely compiled these reports with the exception of similar reports that have been produced at the request of Florida and Texas. NCCI annually summarizes both calendar/accident year and policy year data in similar detail on a state-by-state basis, and these summaries are available to affiliates and regulators on NCCI's website. However, for the purposes of this examination this subject will be referred to the appropriate committee of the NAIC for further review and clarification.

NCCI obtains the Statutory Page 14 information directly from the NAIC. Carriers are required to submit this call by April 1 of each year. NCCI applies a series of automated edits that are designed to test the arithmetic of the reconciliation and compare the annual statement amounts reported on the call to the actual amounts reported to the NAIC. Explanations and/or corrections are obtained from carriers if these amounts do not reconcile within certain thresholds. Only data that passes the edit process is used in aggregate ratemaking.

The reconciliation process of financial data to page 14 of carrier's annual statement is performed as part of the overall Financial Data Call system validation and notification processes. A demonstration of this process was provided and testing was performed. During the demo of test submissions, errors were created that would cause the reconciliation to fail. In every case, the appropriate notifications were generated and the status of the submission was appropriately put in failed mode. Edits 821, 822, 823, 824 and 825 were tested. The generation of appropriate error reports was confirmed. Subsequently, corrections were applied to the data and the edits were repeated. In each test case, the data was then allowed to pass to the production database. Additionally, production error summary reports were reviewed to verify notification, corrective action and utilization of corrected data.

NCCI passed this standard based on the results of the testing.

Standard 5 - Data Collection and Handling

Determine that all calculations associated with the database have been accurately applied.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. The examiners reviewed a list of all calculations performed in the development of and within the Integrated Data Base (IDB) and the Financial Database involving Unit, Policy and Financial Call data. NCCI performs very few calculations within or in development of the database. It was verified that none of the calculations performed would have an impact on the data utilized for ratemaking or experience rating. The actual code behind each calculation listed was provided and reviewed by the examiners to determine that the code performed the calculations described in the related functional specifications. The code was found to be appropriate and well written in all cases.

Based on testing and review of the calculations for the in-scope databases, NCCI satisfied this standard.

Standard 6 - Data Collection and Handling

Where applicable, determine that the statistical agent employs use of data completeness tests as outlined in the NAIC Statistical Handbook of Data Available to Insurance Regulators.

Results: Not Applicable

Observations: A procedural review was performed to address this standard. Subsection 2.3 of the NAIC Statistical Handbook addresses the completeness tests that statistical agents are required to perform on data submitted by carriers. However, the requirements set forth in subsection 2.3 of the NAIC Statistical Handbook do not apply to workers' compensation. While NCCI is still required to apply "substantial data quality checking" to data submissions, those completeness tests set forth in subsection 2 of the NAIC Statistical Handbook are not specifically required.

NCCI does employ a series of automated tests and processes to help ensure that the data it collects and utilizes in its products and services is complete and accurate. The examination team has performed work related to the completeness and accuracy of NCCI data pursuant to other standards as set forth in this report.

CORRESPONDENCE WITH INSURERS AND STATE REGULATORS

Statistical agents frequently need to contact or correspond with companies regarding the quality and timeliness of the company's data. The purpose of this section of the examination is to verify that NCCI promptly notifies the carriers (and regulators, as requested or required) when a problem with or question about the data is found, and then follows up, if the carrier does not respond within the appropriate time frame.

Standard 1 - Correspondence with Insurers and State Regulators

The statistical agent keeps track of companies that fail to meet deadlines.

Standard 2 - Correspondence with Insurers and State Regulators

The statistical agent has established procedures for notifying companies (and regulators, as requested or required) of material data reporting errors and for correcting those errors.

Standard 3 - Correspondence with Insurers and State Regulators

Statistical agent maintains a follow-up procedure with companies that have reporting errors.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address these related standards. NCCI uses automated processes to identify data exceptions and to track carriers that fail to meet deadlines.

Unit and policy submissions are tracked electronically from the time they are received, through processing and ultimately to the production database. The policy information maintained is used to monitor the due dates of all corresponding unit reports. If a unit report is due but not received, the carrier is notified. Financial calls that are not submitted are identified by an automated comparison of calls received from carriers against a corresponding table of calls that are earmarked as due.

The process to monitor the submission of detailed claim information is also automated. Based on the qualifying claims reported on new units, the automated process estimates the appropriate sample size. If the actual sample size submitted by the carrier is materially different, the carrier may be required to reconcile the difference. The first submission for each claim is used to track and determine if the subsequent updates to the claim are filed in a timely manner.

Data submissions are subjected to a series of edits to verify the accuracy and completeness of the data. These processes incorporate various reports that are used to notify carriers of the data exceptions and if carriers fail to submit certain data types.

These reports are designed to notify carriers of the exceptions as each submission is processed, and for certain data types, to also periodically summarize outstanding exceptions across individual submissions. Standard formatted reports are prepared and communicated to carriers via email notifications with internet portals that are used by carriers for viewing the reports and accessing the report contents. Carriers also have the ability to request standard reports at any time and to tailor the format of some reports to better meet their specific needs.

To help ensure the accuracy and completeness of data, NCCI has developed data quality compliance programs designed to provide carriers with incentives to submit clean data. The Data Quality Incentive Program (DQIP) applies to policy and unit statistical data. This program is designed to improve the availability of data for use in NCCI's products and services through monetary incentives based upon the performance of data providers' combined policy and unit statistical data. Reporting performance is evaluated against thresholds as defined in the program criteria. Based on this evaluation, the data provider may receive an incentive through a credit or a debit that modifies the statistical agent and/or data management fees.

The Aggregate Data Quality Incentive Program (ADQIP) applies to financial call data with an incentive to accurately submit financial data in a timely manner by applying credits to carriers with accurate early reporting of call data, and reallocating the impact of late and/or inaccurate reporting back to the appropriate carriers via monetary assessments.

A remediation program that applies to all data types is also used. Under this program, NCCI works with carriers to resolve significant data reporting issues. However, when a carrier fails to correct data quality reporting deficiencies, the deficiencies are escalated to the appropriate regulator(s) in an attempt to involve the regulator(s) in the remediation process to add pressure on the carrier to improve the quality of its data submissions. In March each year, a report, which identifies those carrier groups that have received failing scores in reporting data to NCCI is provided to regulators.

In addition, the Regulator Exception Program is designed to support the timely delivery of complete experience ratings. If a carrier's late or uncorrected unit statistical data meets or surpasses the escalation thresholds defined in the program, the information is made available to the applicable state regulator via the Regulator Exception Report.

The data tracking and exception reporting processes, as well as the data quality compliance programs were documented. These processes are automated and the testing performed under the standards related to Statistical Plans and Data Collection and Handling indicate that the processes are operating as designed. As such, the sample sizes were selected taking into account the results of the information systems reviews of the automated processes. A judgmental sample of 120 exception reports was reviewed, and a sample of 39 individual data exceptions was traced to final resolution. This documentation confirmed that NCCI identifies carriers that fail to make submissions, that it performs follow-up reviews/reporting of outstanding data quality issues, and that it identifies material data reporting exceptions and notifies carriers of these exceptions, as well as regulators in instances when the reporting issues are considered material.

Standard 4 - Correspondence with Insurers and State Regulators

Review any additional data quality programs maintained by the statistical agent pertaining to data collected pursuant to the statistical plan.

Results: **Pass**

Observations: A procedural review was performed to address this standard. NCCI is the nation's largest database of workers' compensation information. NCCI collects and maintains millions of data records on virtually every aspect of workers' compensation insurance. NCCI's data quality processes evaluate incoming data for accuracy, validity, completeness, reasonability, and timeliness.

NCCI's uses system checks/edits and validation tests to help ensure that the data submitted is consistent with the reporting requirements and that it meets quality standards. These system checks/edits and validation tests were reviewed pursuant to the standards set forth in the NAIC Market Regulation Handbook Chapter 25, Data Collection and Handling. Please refer to page 41 of this report.

NCCI has also developed data compliance programs designed to provide carriers with financial incentives for good data quality and timeliness performance, as well financial penalties for carriers that do not meet data quality and timeliness standards. These programs also include communications with regulators, which are designed to place additional pressure on carriers with poor data quality and timeliness issues. These programs were reviewed pursuant to the standards set forth in the NAIC Market Regulation Handbook Chapter 25, Correspondence with Insurers and State Regulators. Please refer to page 48 of this report.

NCCI performs other data quality tests on its unit statistical and policy databases that it refers to as anomaly testing. These tests are designed to identify possible problems with these databases. Unlike the results of system checks/edits and validation tests, the result of the anomaly testing is not communicated to carriers. The nature of the anomaly testing is more at a database level.

NCCI uses an application (DATAAUDIT), which executes structured query language queries against the production databases. Reports are generated that summarize the results of these queries. NCCI's IT and Data Resources areas research potential "anomalies," and design solutions to address any issues as deemed appropriate.

Standard 5 - Correspondence with Insurers and State Regulators

With each standard premium and loss report to the states, the statistical agent provides a listing of insurers whose data is included in the compilations and a historical report listing those insurers whose data for the state was excluded from the compilation as set forth in subsection 2.4 of the NAIC Statistical Handbook.

Results: Not Applicable

Observations: Based on communications with existing and former NAIC staff and regulator committee members, history seems to indicate that the intent was to exclude workers' compensation from the requirements of Section 2 of the NAIC Statistical Handbook. As such, for the purposes of this examination, it was determined that NCCI is not subject to the reporting requirements of Subsection 2.4 of the NAIC Statistical Handbook, and that this subject will be referred to the appropriate committee of the NAIC for further review and clarification.

REPORTS, REPORT SYSTEMS AND OTHER DATA REQUESTS

The purpose of this portion of the examination is to review NCCI's reports and other statistical compilations prepared for the states, as well as NCCI's internal procedures for preparing reports and responding to data requests, including the timeliness and quality of the response.

Standard 1 - Report Systems and Data Requests

All calculations used to develop the database have been performed accurately.

Results: **Pass**

Observations: The calculations used to develop the databases are also addressed under Standard 5 of the Data Collection and Handling section of this report. Based on testing and review of the calculations for the in-scope databases, NCCI satisfied this standard. For a full description of the testing performed, please refer to page 47 of this report.

Standard 2 - Reporting Systems and Data Requests

The statistical agent has accurately extracted the appropriate information from the statistical database.

Results: **Pass**

Observations: Procedural reviews and detailed testing were performed to address this standard. The initial focus for this standard was on the generation of reports utilized for reporting issues to the carriers evaluating submissions and summarizing edit failures. For each step of the edit testing, duplicate testing and submission testing conditions were created to cause specific reports to be generated. In every case, the appropriate report was generated and the information on the report was determined to be correct. Examples of reports generated were duplicate submission, duplicate policy, and data failed specific edit (also verified that the report reflected when the edit was fixed and the data resubmitted). In each of these cases, the examiners emulated a carrier. The reports were sent via email, and were made available to carriers on NCCI's website.

Additionally reports utilized for management of NCCI operations, quality assurance and timeliness of processing data were tested and verified.

For additional verification of extract accuracy and monitoring, the following major extract procedures were reviewed and testing performed.

Class Rate Making Data Extract Process

The examiners conducted a review of the process utilized in extracting information from the IDB (Integrated Data Base) to be utilized by the actuaries for the Class Rate Making process. The extraction is done in three phases. When expected data has been

collected from the carriers and the schedule indicates that the entire submission is ready, the first data set is created for utilization by the Actuarial and Economic Services Division team (AES) for Class Rate Making. The data is reviewed by the AES team. Reconciliations are performed (this process was reviewed) to assure that the data provided to the AES team includes all submissions that have passed all edits and do not include any Data Grade 9 errors (which would exclude the data from processing). The actuaries review the data to determine any issues. One methodology was the use of a tool called "A" sheets. This analytical tool looks at Payroll and Loss Data along with Premium data across years to determine inconsistencies. Testing was performed on the consistency of the utilization of "A" sheets, as well as the accuracy of the data in the "A" sheets. The "A" Sheet process along with various other analytical tools is utilized by the actuaries to determine potential issues with the data provided from the IDB. Issues are reported to the analysts who research the issue and work with the carrier to either determine an acceptable explanation of the issue or determine the action needed to correct the error. When most of the issues have been addressed and additional data has been refined to become useable (carriers are constantly working to correct data errors) a second extract is performed and new data is provided to the AES team. The actuaries again review and evaluate the data and repeat the analysis and issue identification. There is a deadline for the final extraction to be performed. The entire process from the initial extraction to the final extraction takes between 60-90 days and the data is thoroughly reviewed. Once the final extraction is completed, the data is set or "frozen" and the AES team uses the data to develop the Class Rates to be filed. The reconciliation and data quality processes were examined in detail. Reports were reviewed and verified that illustrated the satisfactory reconciliation between data in the IDB (Integrated Data Base) and in the final extract.

Aggregate Rate Making Data/Financial Call Dataset Selection Process

For the Aggregate Rate Making process, the data comes from the Financial Call Database. The data is not extracted for this process; however, a dataset is created by the actuaries utilizing a front-end process. The aggregate ratemaking is done by state. A detailed demo of the process was performed for the examiners whereby the parameters are entered for the data to be selected. The specified data is selected and run through the data edits. Reports are generated to reflect any errors or inconsistencies in the data. The examiners created situations to cause failures and verified that the appropriate reports were generated. The dataset is held in specific statuses as it moves through the process and is finally released for utilization in Aggregate Rate Making. The tool utilized for this process is called Aggregate Ratemaking Tool (ART). In every case, the expected errors were generated. Likewise, when the error was corrected in the data, the error condition was no longer present.

Experience Rating Data Set Selection Process

Experience rating data comes from the Unit reports in the IDB (Integrated Data Base). There are a separate set of edits associated with the evaluation of the data to be utilized for Experience rating. The examiners reviewed the programming for each of these nine

edits and found the logic to be appropriate to accomplish the edit as described in the documentation.

Based on the documentation and process review and testing, NCCI satisfies this Standard.

Standard 3 - Report Systems and Data Requests

Data for reporting is correctly extracted from database and combined with other information.

Standard 4 - Report Systems and Data Requests

Data collected, in addition to the data collected under the statistical plan, was adequately reviewed for quality and compiled according to applicable statutes, rules and regulations.

Results: Not Evaluated

Observations: These two standards were discussed with NCCI personnel and an information request was submitted for all inquiries for data from external sources requiring data from the statistical plan, as well as additional data from carriers.

NCCI's response indicated that the last such inquiry was made in the 1990's, which is outside the scope of this examination. NCCI indicated that no data quality procedures are in place to provide for the processing of such inquiries.

It is not anticipated that the need will arise for a data request from NCCI due to the availability of the data on the NCCI website for authorized users.

The NAIC Market Regulation Handbook indicates that these Standards are "Recommended." Therefore, the Standards were not evaluated. Based on the response to the data request, these Standards are verified as being not applicable for NCCI.

RATEMAKING

The purpose of this portion of the examination is to review NCCI's ratemaking, reports and reporting systems, if any, as well as its internal procedures for preparing related reports and responding to data requests, including the timeliness and quality of the response.

Standard 1- Ratemaking

The advisory organization submits filings and/or submissions to the state within the established time frame.

Observations: NCCI submits filings to states within established time frames. The activities and processes surrounding ratemaking including the timeliness of filings are also addressed under Standard 3 of the Operations/Management/Governance section of this report. Therefore, the description and results of the testing are summarized under that standard. Please refer page 17 of this report.

CLASSIFICATION AND APPEAL HANDLING

The purpose of this portion of the examination is to review NCCI's classification and appeal processes, where applicable.

Standard 1 - Classification Appeal Handling

The advisory organization takes adequate steps to finalize and dispose of the classification appeal in accordance with applicable statutes, rules and regulations, and written manuals and procedures.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. NCCI has sufficient procedures in place to require satisfactory handling of appeals received, as well as internal procedures for analysis of classification codes that commonly cause appeals. Disputes are assigned to a Regulatory Services Managers (RSM), who handles the case to conclusion. When the RSM receives a request to appeal a class code determination, the RSM checks the inspections database to determine if NCCI has performed an inspection. If the inspection was performed by a NCCI inspector (not a vendor), the RSM notifies the inspector's Team Leader via email with a carbon copy to the Manager, Classification Quality Assurance. The Team Leader is the inspection team liaison for the case. If the inspection was performed by a vendor, the RSM contacts the Manager, Classification Quality Assurance (CQA). The CQA Manager assigns the appropriate person from the inspection team (the CQA representative) to be the inspection team liaison for the case. The RSM reviews the inspection to determine if there is appropriate documentation for the decision. If necessary, the RSM can request the inspection be placed on the Class Review agenda. If the classification in question has not yet been reviewed at a Class Review meeting, the Team Leader or CQA representative schedules the matter for review at the next scheduled meeting. If either the RSM or the Team Leader or CQA representative is not satisfied with the conclusions of the Class Review, the matter is referred to management. Management confers to make a final decision on behalf of NCCI.

If all efforts to resolve the dispute fail, the RSM offers to take the dispute to the next available Dispute Resolution Hearing Board. At the hearing the disputing party (usually the insured or agent), and the carrier would state their case and the Board would make an immediate ruling.

NCCI maintains a dispute resolution log of classification appeals. The log showed 875 entries for the period of January 2006 through September 2010. Sample sizes were

determined by the NAIC Market Regulation Handbook Acceptance Samples Table (AST). Per the table, the sample size was determined to be 106. Of the 106 disputes, 49 were identified as residual market accounts, 13 as voluntary accounts and 44 as "not applicable". According to NCCI "not applicable" is intended to be used when the issue in dispute doesn't concern a specific market type. The review indicated that the category was used also when the market type was not identified. The review indicated that both residual market and voluntary policy disputes were handled in an identical manner. The sample included appeals from the following states: Alaska, Arkansas, Arizona, Colorado, Connecticut, Florida, Georgia, Illinois, Iowa, Kansas, Louisiana, Massachusetts, Maryland, Missouri, Montana, Nebraska, Nevada, New Hampshire, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Utah, Virginia, Vermont and West Virginia.

The review indicated that no one single process was used, but instead it was tailored to the best approach, given the circumstances of the dispute. The vast majority of the disputes were from insured's or their agents who were disputing the classification of one or more employees to one or more different class codes. The general process used was that upon receipt of the dispute, notification via an acknowledgement letter was sent to the party filing the dispute. This letter explains the dispute resolution process and what the next steps will be.

The most common process was to obtain as much documentation as possible to support their position from the party filing the dispute. The carrier would then be contacted to ascertain the carrier's position. In many instances with this exchange of information, the insured and carrier would reach an agreement and the case would be closed quickly. Depending on the circumstances, the RSM might offer the disputing party an NCCI re-inspection. These re-inspections would involve a fee; however, they also could reveal additional information, which would result in a resolution of the issue without resorting to a hearing.

In 85 out of 106 files reviewed, the case was resolved without the need for a hearing. These are considered to be resolved at the first level. Of the 19 cases taken to a hearing, eight were ruled in the insured's favor, seven in the carrier's favor, and four involved a compromise ruling. These cases are considered second level resolutions. Two cases taken to a hearing were appealed. These cases are considered third level disputes and are handled through the court system.

FORM DEVELOPMENT REVIEW

The purpose of this portion of the examination is to review NCCI's processes for development, maintenance and filing of forms for insurance programs.

Standard 1- Form Development Review

The advisory organization has processes in place to identify and provide subscribers with necessary changes (by virtue of changes in state laws or case law) to advisory forms, rules or loss costs.

Observations: A procedural review and detailed testing were performed to address this standard. NCCI has processes in place to identify changes in state laws and regulations, to make such changes to forms, rules and manuals, and to notify its members and subscribers of changes. These processes are also addressed under Standard 8 of Operations/ Management/Governance section of this report. For the related discussions and testing, please refer to page 27.

Standard 2 - Form Development Review

The advisory organization has quality assurance processes in place to review submissions of forms, rates, loss costs or other submissions prior to filing or submitting to the applicable state.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. NCCI does not use the Flesch test or other readability tests/tools. However, it uses what it describes as the "plain language" approach to promote the readability of its forms and rules. Approximately ten years ago, NCCI began a program to implement the use of plain language in all communications. The plain language approach prescribes that the material be presented in a way that best serves the reader. Accordingly, the goal of the program was to enhance the understanding of its communications, by using simplified text and shorter sentences and paragraphs where necessary. NCCI developed a style reference guide that describes the various rules and writing styles/theories that define the "plain language" concept. This manual is shared with NCCI's employees. To help ensure that the plain language approach is incorporated into its forms and manual rules, NCCI's Information Publishing Department performs a quality assurance review of filings prior to submission to state regulators. The review process for filings is subject to a series of peer reviews, which also encompasses a review by NCCI's legal team prior to submission to state regulators.

Based on a review of state statutes, some states require the use of the Flesch test or some comparable test. The states of Florida and Vermont require that the Flesch test be used. The state of Montana requires that the Flesch test be used or a comparable test be used. As such, NCCI does not comply with the statutory requirements of these particular states.

Recommendation It is recommended that NCCI comply with the readability requirements as set forth in applicable state statutes.

A sample of 22 filings was traced to the edited version of the filing or the workflow history of the filing to determine if the filing was reviewed by the Information Publishing Department, and to determine if the filing was subjected to an internal peer review process. The sample size was determined based upon professional judgment. Based on the review, all filings are subjected to internal peer reviews and a formal editing process.

INSPECTION SERVICES

The purpose of this portion of the examination is to review NCCI's processes for ensuring proper classification of risks that are subject to inspection, and to report the results of this review to carriers and policyholders.

Standard 1 - Inspection Services

The advisory organization conducts inspection services in accordance with applicable statutes, rules and regulations, and written procedures.

This standard is addressed under Standard 5 of the Operations/Management/Governance section of this report. Please refer to page 22.

RESIDUAL MARKET FUNCTIONS – PLAN ADMINISTRATION

The purpose of this portion of the examination is to review NCCI's actions as a residual market plan administrator in regard to the implementation of rules, procedures, manuals, policy forms, endorsements, pricing programs, application processing procedures, carrier selection, compensation and oversight.

Standard 1 - Residual Market Functions – Plan Administration

The advisory organization uses objective and established procedures when administering assigned risk plans.

Results: **Pass**

Observations: A procedural review and detailed testing were performed to address this standard. As of June 1, 2010, NCCI was the appointed administrator for the assigned risk plans in 21 states. Generally, each state has a statute and/or regulation authorizing the state's Commissioner/Director of insurance to develop an assigned risk plan and to appoint an administrator. The plans for each state are referred to as the Workers' Compensation Insurance Plan (WCIP). NCCI developed a national plan that is used as the basis for each state's respective WCIP. If a particular state has specific statutes or regulations that conflict with the basic (National) plan, these statutes/regulations prevail, and the basic plan for that particular state is modified accordingly to comply with all state exceptions.

NCCI makes filings for the residual market on the System for Electronic Rate and Form Filing (SERFF) in all states in which NCCI is the WCIP administrator except for Illinois, which during the examination period asked that paper filings be made. The

same procedures are used to process filings for both the voluntary and residual markets. As such, testing was performed under Standard 3 of the Operations/ Management/Governance section of this report. Please refer to page 17 for the details related to this testing. The results of this testing indicate that filings are made within the appropriate time requirements mandated by applicable statutes.

NCCI receives inquiries concerning individual assigned risk policies via phone, e-mail, facsimile, and regular mail in various departments based on departmental functions. The inquiries concern a range of topics, such as application processing procedures, assigned carrier performance standards, classification codes, experience modifications, ownership, policy audits, and manual rules. The most frequently used research tools for responding to customer inquiries are NCCI's underwriting manuals – specifically the Basic Manual, Assigned Risk Supplement and the Assigned Carrier Performance Standards. In that NCCI did not maintain a single log for the examination period (2006 to date), and for the vast majority of the inquiries, supporting documentation was not maintained, the examination team could not determine the accuracy of the information entered on these logs or NCCI's responsiveness to the inquiries. However, disputes are documented and the dispute resolution process was reviewed. NCCI represents that the vast majority of customer service inquiries are related to routine subjects such as validating user ID's and passwords. It is not necessary to tack inquiries of this or similar nature.

NCCI works with carriers, producers and policyholders to resolve disputes or concerns prior to the filing of a formal dispute. NCCI's Regulatory Assurance and/or Plan Administration departments work with all parties to ensure the appropriate rules and/or procedures have been followed by the parties. In addition, many times the issue is a matter of communication and education and NCCI informs the parties of the rules in a manner that ensures clarification and understanding. NCCI generally is successful in resolving these matters before a dispute is formalized.

The Basic Manual sets forth the dispute process in Rule 4-A-10, and requires that policyholders' seek resolution to disputes with the carriers before the state-specific dispute resolution process applies. NCCI administers the dispute resolution process until the dispute requires intervention at the state level. Disputes are documented and maintained in the Regulatory Assurance Information System – Correspondence (RAISC) application. This system assigns each dispute record a separate identification number. The plan administration staff works with the regulatory services staff to resolve issues or consult on specific matters during all phases of the appeal process.

In addition, NCCI's legal department is involved in the resolution of disputes that cannot be resolved at the applicable appeals board or internal review panel level. Should the employer or carrier choose to proceed to the state's administrative proceeding process or through litigation, NCCI's legal department will coordinate this level of the appeal.

The basic dispute resolution process is the same for voluntary policies as it is for residual market policies, and is maintained in the same database. Based on a total population of 875 entries for the period of January 2006 through September 2010, a sample size of 106

disputes was randomly selected using the methodology set forth in the Acceptance Samples Table (AST) of the NAIC Market Regulation Handbook. To supplement this sample an additional 31 disputes specifically related to experience modification calculations were selected for a total sample size of 137 disputes of which 59 were related to the assigned risk market.

The review showed that in every instance a detailed acknowledgement letter was sent within one day of when the dispute file was opened. The acknowledgement letter provided a detailed description of the grievance procedure. The first significant contact in almost every case was less than 30 days and in most cases less than seven days. Those rare instances when the time to make the first contact took longer, the reason for the delay was explained and was found to be reasonable. In 45 of the 59 assigned risk cases, the issue was resolved at this first level, which is a resolution prior to a hearing. Twelve cases were taken to a second level, which involved the holding of a formal dispute hearing. Two cases went to the third level, which involved litigation. Based on a review of these files, it was concluded that NCCI fully implemented the dispute resolution process set forth in the Basic Manual.

NCCI has developed a process for selecting carriers to provide services to residual market policyholders. These carriers must maintain the necessary staff, facilities and expertise to comply with the procedures, performance standards, financial reporting requirements, and statutory and other regulatory requirements that relate to the residual market. NCCI uses a scoring methodology that scores three components:

- Plan of Operation 40% - Commitment to the Assigned Carrier Performance Standards and other requirements
- Price/Compensation at Risk 40% - Carriers' pricing at different quota ranges
- Historical Audit 20% - results of historical audits conducted by NCCI

The scoring process is not designed to produce results on an individual carrier basis, but instead generates various weighted average scenarios based on the mix of carriers, their unique qualifications and respective quotas. With few exceptions, the results of the scoring are presented to the respective state regulator who makes the final selection.

Proposals are traditionally solicited every three years. There are approximately 12 carriers that specialize in providing these services. The examination team randomly selected recent proposals for the states of Kansas, Iowa and Illinois. The documents showed a complex point value system is used to create the rankings and the scenarios as set forth in NCCI's selection procedures manual. The final selection documents show that the regulators selected one of the top scenarios in all three instances. Based on a review of these proposals, NCCI has an unbiased selection process to which it adheres.

Carriers are compensated in accordance with the bid price presented in their respective applications and corresponding market quota. Compensation can be based on a percentage of the final net premium collected or a combination of a percentage of the final net premium and a flat per policy fee. In addition, compensation may be adjusted

through either NCCI's Pay for Performance Program or Paid Loss Ratio Incentive Program, which provide monetary incentives and disincentives based upon a servicing carrier's paid loss performance relative to other servicing carriers in a state. The compensation generally includes premium taxes, other premium based assessments, acquisitions costs, and allocated and unallocated loss adjustment expenses/cost containment expenses. Compensation excludes commissions, subrogation expenses, indemnifiable legal expenses and reimbursable collection expenses.

NCCI developed performance standards establishing the minimum level of performance for servicing carriers writing coverage on behalf of the residual market plans. The purpose of the assigned carrier performance standards is to provide policy issuance and service level requirements that servicing carriers must adhere to in order to provide assigned risk market policyholders with uniform service while reducing the overall loss ratio.

Each servicing carrier is responsible for complying with the performance standards, as well as all statutes, regulations, and plan rules. Should the performance standards conflict with state laws or regulations, the more stringent standard applies. Where these performance standards conflict with carrier-enhanced standards through a bid process and/or contract, the more stringent applies.

Performance standards address the following areas:

- Data Reporting
- Customer Service
- Underwriting
- Loss Prevention
- Claims
- Audits
- Billing and Collection of Premium
- Billing and Collection of Deductibles

As the administrator, NCCI ensures that servicing carriers fulfill their obligations to the residual market plan, by utilizing an oversight program comprised of four components. This program is designed to ensure that the assigned carriers meet performance standards/expectations. The four primary components of the oversight plan are:

- Visitations - A visitation is conducted early in the process. Carriers new to writing and managing policies and claims as a servicing carrier are provided with a high-level synopsis of how it is handling the residual market business according to the performance standards.
- Servicing Carrier Operations Reporting (SCOR) – SCOR is a program in which the servicing carriers submit aggregate data in key areas of performance on a quarterly or semiannual basis. The program ensures that servicing carriers are continuously meeting the performance standards and immediately address any deficient areas of performance instead of waiting for an annual self-audit or an

on-site audit to take place. These are performed quarterly until the results are satisfactory and the performed in accordance with state requirements, which may be annually, semi-annually or quarterly.

- Self-Audits – The self-audit process is a web-based application in which selected policies and claims are sent to the assigned carrier. The carrier is required to respond to a series of standardized questions for each of the selected policies and/or claims. Carrier ratings are then determined for key attributes, which are specific areas of performance linked to individual performance standards. These are performed in conjunction with the On-site Audits in three cycles. These audits are performed each year for two consecutive years and an On-site audit is performed the third year.
- On-Site Audits - On-site audits encompass a full-scope review of policies and claims handled by servicing carriers for various attributes outlined in the performance standards. NCCI auditors review a sampling of policies and claims, along with a walk-through of edits and company controls. Ratings are provided and utilized as part of the scoring of subsequent servicing carrier bids. These audits are performed in conjunction with the Self-Audits in three year cycles. This audit is performed one year and then the Self-Audit is performed for two consecutive years.

A sample of audits was reviewed to determine if NCCI actually performs audits and if the audits are designed to test/determine the carrier's compliance with the performance standards. Based on the relatively small population of audits, a judgmental sample of 11 audits was selected. The review of these audits indicates that NCCI adhered to its established procedures for conducting servicing carrier audits and these audits were adequately designed to determine if the carriers satisfy the performance standards.

As the plan administrator, NCCI assigns residual market policies to the servicing carriers. The mechanism used to provide for the random and equitable distribution of assignments is based upon the quotas for each of the servicing carriers. Plan Pool Membership (PPM) is an automated application designed to make these assignments and to ensure that the carriers attain their appropriate quota percentage during the contract term. The policyholder's prior plan coverage, special requirements (e.g., federal coverage), premium size and the carrier's proximity to its quota are considered. Generally, the automated process is programmed to keep employers with the prior carriers for continuity and efficiency. Multistate assignments to a single servicing carrier are also made for efficiencies in underwriting, loss prevention services, audits, and claims handling. In addition, increased limits of employers' liability are considered.

The Plan and Pool Membership (PPM) system is a subsystem of Residual Market Application Processing System (RMAPS® Online Application Service) managed by NCCI's plan administration department. Its primary functions are to maintain every carriers plan/pool membership by year and state and to calculate the quotas for all assigned carriers based on their bid award quota percentages.

NCCI's PPM system documents the carrier's premiums and daily assignments to ensure

the most up-to-date assignments volume (daily, weekly, monthly, and annually). The goal of the PPM system is to ensure that all carriers are participating in the plan with appropriate requirements. As practicable, PPM ensures that the carriers attain their appropriate quota percentage during the contract term.

The PPM System - Plan Pool Membership System (PPM) also provides the tool utilized by NCCI to manage the participation and quota information regarding the carriers. PPM is the single source for all Plan/Pool, Membership/Participation information (by state, year and pool). It provides a list by state of all carriers licensed to write workers' compensation insurance in a given state and the carrier's status in a state (direct assignment, servicing carrier, Pool member).

The Premium Load process, for Residual Markets Plan Administration, includes Direct Assignment carriers Premium Preload run in PPM to find and correct errors. Once all errors are found the actual Premium Load is performed. Quotas are adjusted and communicated to internal stakeholders and Direct Assignment carriers.

PPM is interfaced with the Reinsurance Pool Financial System (RPFS) where the ratio management portion of the system is synched with data in the PPM tables.

The functional and design specifications were reviewed by the examiners to confirm that the design/testing of the PPM applications include the execution of the business rules and state exceptions to ensure that the servicing carriers attain their quota percentage.

With the RMAPS© system, producers may submit applications at any time. Confirmation of coverage is possible within minutes, if all information is provided. The system is also an online communication tool that enables the analysts to make requests for additional information and allows online response to those requests. This application allows NCCI to monitor the timeliness of the application process with a reporting feature that produces reports used by management to monitor the entire application process. Reports are generated and reviewed to reflect the timeliness of processing of applications for Residual Market Applications.

From the Business Requirements document, the stated purpose of the RMAPS® project is to provide an integrated set of automated decision support tools that would provide customers with risk evaluation, premium calculation and payment. RMAPS® should provide flexibility for either a novice or expert user to easily enter and assess the information needed to submit and thoroughly evaluate a risk. RMAPS® will incorporate current products, enhancements and new offerings to strategically provide a one-stop, seamless tool for processing and tracking assigned risk applications with minimal to no assistance or review. RMAPS® processing includes the business rules associated with the complete Residual Market application, binding, premium collection and assignment to an appropriate carrier. Test cases and results were reviewed and found to be well designed and to have the results appropriately documented.

Much of the tracking of the process of the flow through the system is supported by the

RMAPS® eFax system, which tracks faxes from Signature Letter and ACORD forms, Binder Letters, Underwriting, Additional Payment Letters, Refund Letters and Cancellations, from beginning to end. Any discrepancies in the process are noted in the RMAPS® event system.

Timeliness reports for the months of February, May and August for each year were obtained. These reports show an average processing time of less than two days. Overall, the review indicates that NCCI is processing applications consistently and in a timely manner.

Based on the documentation and process review and testing, NCCI satisfies these combined Standards.

The rate filings for the residual market were reviewed in conjunction with the voluntary market filings pursuant to Standard 2 of the Operations Management/ Governance section of this report. The review concluded that NCCI develops rates and risk classifications in accordance with applicable Standards of Practice, and that the resulting rates do not contribute to premiums that are inadequate, excessive, or unfairly discriminatory. For the discussion related to the testing performed, please refer to page 15 of this report.

RESIDUAL MARKET FUNCTIONS – REINSURANCE ADMINISTRATION

The purpose of this portion of the examination is to review NCCI's processes for preparing and publishing manuals, procedures and/or information for such reinsurance administration.

Standard 1 - Residual Market Functions – Reinsurance Administration

The advisory organization uses established procedures when administering residual market pool assessments or reinsurance pooling mechanisms.

Results: **Pass**

Observations: A procedural review was performed to address this standard. Insurance companies authorized to write workers' compensation insurance in the voluntary market, in those states that have approved NCCI's Workers' Compensation Insurance Plan, are required to also participate in the involuntary market (residual market) designed to provide coverage to those employers who cannot obtain coverage through the voluntary market. A separate and distinct pooling mechanism for the residual market risks is created for each policy year for each state.

The operating results (surpluses/deficits) of these pooling mechanisms are distributed to the member insurance carriers through quota share reinsurance arrangements. NCCI has contracted to provide administrative services for these pooling mechanisms, which

include accounting services, actuarial services, collection services, staff support services and other services related to the general administration of the financial credit policy, premium fraud activities and litigation, as well as other services required to administer the pooling mechanisms.

There have been no significant fluctuations in staffing from year to year. There are approximately 20 individuals that perform functions related to the administration of the pooling mechanism: from supervisory roles to the detailed execution of the various administrative functions. The actual number of dedicated staff varies depending upon the time of the year and workflow related to pool activities. Staffing levels are adjusted accordingly as necessary. Staff members working on various residual market processes come from a variety of departments within NCCI, including residual markets, finance, actuarial and legal. The written premium for the residual markets serviced by NCCI has steadily declined from a high of $1.2 billion in 2006 to $432 million in 2010. Given that NCCI is able to adjust the staffing requirements to accommodate the workflow activities and that the residual market activities have declined relative to the year over year decline in the premium volume, the staffing levels are adequate to administer the pooling mechanisms.

Each participating insurance company's quota share participation in each pool is based on its voluntary market share of direct workers' compensation written premium (Annual Statement Statutory Page 14 basis) in each state during the calendar year corresponding to each policy year (e.g., Policy Year 2010 allocations are based on Calendar Year 2010 market shares). Premium information is also collected through financial Call #1, and is reconciled to the NAIC premium data (Annual Statement Page 14), which NCCI receives directly from the NAIC. The integrity of the premium data is based on this reconciliation and the assumption that the premium information reported to the NAIC is the most accurate. Carriers are required to reconcile differences between Call #1 and the amounts reported to the NAIC.

The voluntary market premiums are adjusted for state specific requirements and take-out–credits, as applicable. In addition, in that the direct written premiums reported by the direct assignment and servicing carriers include the residual market premiums, these premiums are subtracted from the NAIC premium totals to determine the total voluntary premium for these carriers. This process results in the voluntary premium totals for each participating carrier.

Annual statement information provided by NAIC is the basic source of information NCCI relies upon to determine in which states the carriers write workers' compensation business, and thus are required to be pool members/participants. However, through the Plan Pool Membership (PPM) application, NCCI maintains a database of pool membership information, from which it determines each pools membership roster. When carriers begin writing workers' compensation in a state, they are added to the PPM database and also as a pool participant. Likewise, as carriers stop writing workers' compensation in a state, they are deleted from future membership rosters. Adjustments are also made for insolvencies and other events that might impact the membership rosters.

PPM is the single source for all Plan/Pool, Membership/Participation information (by state, year and pool). It provides a list by state of all carriers licensed to write workers' compensation insurance in a given state and the carrier's status in a state (direct assignment, servicing carrier, Pool member).

PPM is interfaced with the Reinsurance Pool Financial System (RPFS) where the ratio management portion of the system is synched with data in the PPM tables. In 2007, the Carrier Assignment System (CAS) was integrated into the PPM System.

Reports from the PPM system are only available for view by logging into the system, which is only accessible to internal resources. Reports are available for the following categories of information: Assigned Risk, Binder Information, Premium Load, Statistical Information, Verification and CAS Reports.

Administrative access to the database and application is well controlled and user accounts are subject to quarterly access reviews. The controls around the PPM and related systems were reviewed by the IS Team.

While communications with state regulators regarding pool allocations and operating results are not required and thus routine reports are not prepared and disseminated to regulators, NCCI responds to questions and requests from regulators. In addition, NCCI makes aggregate pool operating results available via its website. Information is contained in Residual Market State Activity Reports, which provide policy counts and premium volume for individual states. Annually, NCCI also publishes the Residual Market Management Summary, which provides results for the various reinsurance pools serviced by NCCI.

NCCI provides services for the residual market in 30 jurisdictions, including the administration of NCCI's Workers' Compensation Insurance Plan (WCIP), the National Workers' Compensation Reinsurance Pooling Mechanism (NWCRP or Pool), and the New Mexico Workers' Compensation Assigned Risk Pool. Financial, actuarial, and carrier oversight services for other reinsurance pools and customers are also provided, as well as other types of residual market services through contractual agreements. These services are described below:

State	WCIP State	Pool Administrator (NWCRP)	Other Services	Comments
Alabama	yes	yes		
Alaska	yes	yes		
Arizona	yes	yes		
Arkansas	yes	yes		
California				
Colorado				

Connecticut	yes	yes		
Delaware		yes	yes	Delaware Compensation Rating bureau contracts with NCCI to provide certain Plan administration services.
District of Columbia	yes	yes		
Florida				
Georgia	yes	yes		
Hawaii				
Idaho	yes	yes		
Illinois	yes	yes		
Indiana			yes	The Indiana Compensation Rating Bureau contracts with NCCI to provide certain Plan administration services.
Iowa	yes	yes		
Kansas	yes	yes		
Kentucky				
Louisiana				
Maine			yes	NCCI provides limited financial services for the Maine Workers' Compensation Residual Market Pool.
Maryland				
Massachusetts			yes	NCCI provides financial and actuarial services for the Massachusetts Workers' Compensation Assigned risk Pool.
Michigan			yes	NCCI provides financial, servicing carrier selection, carrier oversight, and actuarial services for the Michigan Workers' Compensation Placement Facility.
Minnesota				
Mississippi	yes			Effective May 7, 2007, a new regulation established NCCI's WCIP in the state. The Department of Insurance requested NCCI, in conjunction with CIS, to administer the Plan in Mississippi. NCCI began processing assigned risk applications on this date.

Missouri			yes	NCCI is the Aggregate Excess of Loss Reinsurance Administrator under this mechanism.
Montana				
Nebraska				
Nevada	yes	yes		
New Hampshire	yes	yes		
New Jersey		yes		
New Mexico	yes		yes	NCCI administers the New Mexico Workers' compensation Assigned Risk Pool.
New York				
North Carolina		yes	yes	The North Carolina Rating Bureau contracts with NCCI to provide certain Plan administration services.
North Dakota				
Ohio				
Oklahoma				
Oregon	yes	yes		
Pennsylvania				
Rhode Island				
South Carolina	yes	yes		
South Dakota	yes	yes		
Tennessee				
Texas				
Utah				
Vermont	yes	yes		
Virginia	yes	yes		
Washington				
West Virginia	yes	yes		Effective January 1, 2009.
Wisconsin			yes	NCCI provides carrier oversight for the Wisconsin Worker's Compensation Insurance Pool.
Wyoming				

NCCI establishes the loss reserve needs for the pools it administers. The results are published and distributed to participants annually in the Actuarial Report on Pool Reserves (Actuarial Report).

The Actuarial Report, comprising 13 pages, displays the results of the analysis and explains the approach taken to analyze the data, the issues considered, and the source of the data, but does not actually display the analysis itself. In order to review a sample of the actual analysis, the Agenda of the National Workers' Compensation Reinsurance Pool Reserving Committee Meeting, December 4, 2009 (Reserving Committee Agenda) was

provided. This agenda displays the analysis for National Pool traumatic injuries. When viewed together, the Actuarial Report and Reserving Committee Agenda suggest that NCCI adheres to established actuarial practices and procedures for developing reserves.

The Actuarial Report displays the loss (and ALAE where applicable) reserve needs for the reinsurance pools administered by NCCI. Reserves are shown and analyzed separately for traumatic injuries and Coal Mine Black Lung Occupational Diseases (Coal Mine OD). Results are also displayed by reinsurance pool and by state for the National Pool.

Data for premiums written, losses paid in the quarter, uncollectible premiums, unearned premium reserves, and case loss reserves are sent to NCCI quarterly, within 45 days of the end of each quarter. They are reported by pool, state, and policy year. NCCI maintains a cumulative database of the submitted data. Paid and case outstanding losses were split into their indemnity and medical components beginning with the policy year 1991submission.

Servicing carriers are paid an allowance for handling pool policies including a provision for allocated loss adjustment expenses (ALAE), except for Coal Mine OD and the Massachusetts Pool from policies effective July 1, 2000 and subsequent. Where the allowance includes an ALAE provision, handling claims is the obligation of the service carrier, so it is not necessary for NCCI to reserve for ALAE on this business. For the above exceptions, ALAE are directly reimbursable. Therefore, NCCI establishes reserves for this. The report states that Coal Mine OD ALAE reserves are estimated as a function of case and IBNR loss reserves. After reviewing historical data, separate percentages were applied to the case and IBNR loss reserves based on judgment.

Based on historical indications of ALAE to loss ratios, ratios were selected for each policy year and then multiplied by case and IBNR losses to estimate the indicated ALAE reserves.

The Actuarial Report explains that IBNR and ultimate losses for Coal Mine OD and traumatic injuries were based on several standard actuarial methods, and analyzed in various segments as deemed suitable for analysis.

Only the portion related to National Pool traumatic injuries as of September 30, 2009 of the Reserving Committee Agenda was reviewed. The agenda was used in a teleconference meeting held on December 4, 2009.

Loss reserve analyses for the National Pool traumatic injuries are updated quarterly with a meeting of the Reinsurance Pool Reserving Committee following each analysis and a meeting of the Board of Governors/Board of Directors roughly five to six days after each Reserving Committee meeting to accept the loss ratio selections and reserves. The Reserving Committee has six members who are credentialed actuaries representing six different insurance companies. Every year, two members' terms expire with two new members entering.

Ultimate losses were projected for each state individually and for the total National Pool. The analysis provides various summary and diagnostic exhibits. The analysis includes total National Pool charts of projected hindsight ultimate loss ratios using various methods for each policy year from 2000 through present, and comparing those projections with booked ratios. Given that projections were made at the state level, various combinations of state loss development factors (LDFs) were reviewed. Triangles of several ratios for the National Pool were included in the Actuarial Committee Agenda. The National Pool includes a different mix of states at different periods of time. Therefore, there is a need to be able to view the above triangles for a consistent mix of states. As a result, triangles are also shown based on the 2005, 2001, and 1998 mix of states.

Incurred loss, paid loss, paid-to-incurred ratio, and net written premium (including deferred premium) triangles, as well as triangles of the resulting link ratios, were compiled on two bases, one reflecting the actual historical mix of states, and one with all data consistently reflecting the mix of states applicable in 2005. The states in the National Pool were the same from 2005 through 2008. West Virginia joined the National Pool effective January 1, 2009.

Tail factors were developed for projecting losses from 80 quarters of maturity to ultimate using inverse power curves. Separate medical and indemnity curves were developed for each state mix. The tail factors for each state are the same as the tail factors used for ratemaking purposes. Case incurred losses were used for weights. Exhibits comparing tail factors in consecutive quarters and a history of tail factors used are also displayed.

Loss ratio trends used in this analysis are the same as the trends used in each state's most recent loss cost or rate filing.

Discounted loss reserves are calculated at a discount rate of 3.5% for all pools administered by NCCI except the New Mexico assigned risk pool, which does not allow for discounting. For all other states, the discount applies only to the indemnity portion of pension reserves.

Based on the above review, it was concluded that the advisory organization uses established procedures when administering residual market pool assessments or reinsurance pooling mechanisms.

Calculations of Earned But Unbilled Premium Reserves (EBUB) were also reviewed. These calculations are performed separately for loss sensitive rating plan policies (LSRP) and payroll audits. The methodology is consistent with established actuarial practices and procedures for developing reserves.

EBUB due to payroll audits were estimated at the policy year level for the most recent two policy years. Two indications of the percentage of written premiums earned were calculated, one assuming that policies are effective at the beginning of the month, and

one assuming that policies are effective at the middle of the month. The EBUB-to-earned-premium ratios based on historical averages were also displayed, providing three indications in total for each policy year. The selected EBUB for the sample is based on the historical EBUB-to-earned-premium ratios.

EBUB for LSRP were estimated at the individual policy level due to minimum and maximum premium provisions applying at the policy level, without offsetting among policies. LSRP for Illinois policy year 2009 as of September 30, 2010 was provided as the sample. The methodology is consistent with established actuarial practices and procedures. LSRP reserves were estimated at the individual policy level using the Bornheutter-Ferguson method. Loss development factors were assumed to have been developed and applied appropriately.

INFORMATION TECHNOLOGY CONTROLS

Information Technology General Controls Review

The advisory organization has appropriate Information Technology General Controls in place in keeping with industry standards.

Results: **Pass**

Observations: A procedural review, as well as detailed testing was performed to address this control objective. The Information Technology General Controls are critical at NCCI due to the dependency on Information Systems in every aspect of the business. In order to appropriately evaluate these controls, the NAIC Exhibit C control evaluation from the NAIC Financial Examination Handbook were customized to the needs of this examination and utilized in the assessment of the IT General Controls in place.

The first step was the completion by NCCI of the **Exhibit C Part 1** or the Information Technology Planning Questionnaire (ITPQ). NCCI provided responses in all areas including the following:

- Use of Information Technology
- Information Technology Governance
- Information Technology Infrastructure
- Information Technology Audits, Reviews and Risk Assessments
- Information Technology Security
- System Development/Change Management
- Business Continuity
- Significant Systems

From these responses as well as interviews with NCCI personnel and review of policies and procedures, the extent to which the **Exhibit C Part 2** would be utilized was determined. NCCI was found to have good controls in all of these areas. A few minor suggestions were made for improvement, and are provided herein.

Information Systems – Physical Security:

Access to the data center is by badge access, which is a single factor authentication. The recommended control level is for two-factor authentication, such as: "Something you have." (requirement of badge access); "Something you are." (a biometric control such as a fingerprint or retina scan); or, "Something you know." (a PIN number or RSA password).

Observation: It is suggested that NCCI consider implementing an additional factor of authentication for access to the data center.

The maintaining of a sign-in sheet for visitors to the data center provides a record of who has gained access to this sensitive area. There are cameras located at strategic locations, which is a mitigating control. The addition of a sign-in sheet, however, would provide a record that can easily be reviewed and maintained.

Observation: It is suggested that a sign-in sheet be provided and sign-in be required for all visitors to the computer room.

The security system utilized at the company has the ability to sound an alarm when specific doors are open for longer than a specified period of time. This feature is enabled for loading dock doors but is not enabled for the doors to the computer room. This can allow "piggybacking" - additional personnel entering the computer room when only one person badges in. Additionally, this control can prevent the ability to remove equipment from the computer room without detection.

Observation: It is suggested that the alarm feature be enabled on the security system to alert the guards if the computer room door is open for more than a specified time.

Backups are created of the security data and systems but are not taken offsite for storage.

Observation: It is suggested that the NCCI consider requiring offsite storage of the security systems and backup to be recovered in the event of a fire in the security computer room or other catastrophic event.

Due to technological limitations with other NCCI systems, complex passwords are not enforced in Active Directory. To compensate for weak passwords, NCCI currently requires more frequent password changes.

Observation: It is suggested that the technological limitations be resolved to accommodate the enforcement of more complex passwords.

Evidence of consistent and complete documentation of security incidents or responses to such incidents to support legal action was not observed. Forms or plans for documenting all activities taken as soon as a security incident is suspected is critical to support the organizations activities and chain of custody procedures in the event of legal action, either on the part of the company or if the company is named in a lawsuit.

Observation: It is suggested that NCCI develop consistent and complete documentation of security incidents to support follow-up activity and/or legal action.

During the examination, NCCI implemented new processes to strengthen the documentation of Security Incidents.

Internal audit findings currently drop off the list of open items when they are addressed. Having a list of resolved items with the date that each finding is addressed; including a brief summary of the resolution approach would be helpful for verification that all findings are resolved in a timely manner.

Observation: It is suggested that NCCI implement a process to easily identify the resolution to all internal audits findings.

The Exhibit C Part 2 follows the Control Objectives for Information and Related Technology (COBIT) framework reflecting best practices for IT controls and risk management. This review included the four Domains: Plan and Organize, Acquire and Implement, Deliver and Support and Monitor and Evaluate.

Review of the documentation of the Exhibit C Part 2 controls, as well as observation of the controls in place at NCCI, were performed to assess the effectiveness of the controls. Testing was performed on specific controls where it was needed to complete the assessment.

Based on NCCI's policies and procedures, as well as a review of controls in place and testing performed, NCCI has appropriate Information Technology General Controls in place in keeping with industry standards.

COMPLETENESS AND ACCURACY TESTING

Completeness and Accuracy Testing of the Data

Data is complete and accurate.

Results: **Pass**

Observations: A procedural review and detailed testing were performed. NCCI receives approximately 4.6 million unit statistical reports and 5.3 million policy transactions per year. The unit statistical and policy data was reviewed for completeness and accuracy. Upon receiving a data submission, NCCI automatically

copies the data submission and archives it prior to any processing. This operation was reviewed by the IS team to verify that carrier submissions are not altered or processed in any way prior to being copied and archived. This data was then compared to the corresponding data contained in NCCI's Integrated Database (IDB) to determine if it was complete and accurate.

The sample sizes were calculated using Audit Command Language at a 95% confidence level, with a 5% upper error limit and a 2% expected error rate resulting in a sample size of 184 random sample selections for each data type (unit statistical and policy data types). However, if the random selection did not result in at least one selection for each NCCI state, the sample size was adjusted upward by one additional selection for each state not represented in the original random selection to ensure that the sample had at least one selection for each state. As such, the sample size for unit statistical reports was 226 and 186 for policy data types.

All sample items were traced from the carrier's submission to the IDB, except for submissions that were not in the proper format, order or lacked the proper authentication, which were rejected and thus, not fully processed. These records would not appear in the IDB, as the submissions were not accepted. In these instances, NCCI provided supporting explanations and demonstrated to the examination team that the submissions were defective requiring the carrier to make corrections and resubmit the data for processing. Otherwise, all sample selections were traced to the IDB without exception indicating that the databases contained all data submissions; that the data was complete.

The unit and policy records to be included in the test sample were selected utilizing a random number table. One hundred eighty-four random row numbers were selected for policy and 184 random row numbers were selected for unit data. The original files were opened and the selected row located. All associated rows for that policy or unit were copied to the sample file to be used as the original data to be compared. The examiners observed this process and verified the completeness of this data. A query was then applied to the IDB to extract the corresponding records. These two data sets (original submission and data from the IDB) were provided to the exam team for comparison. The query was reviewed and approved by the Oracle expert.

For each of the sample selections, specific data from each carrier submission was compared to the actual corresponding data contained in the IDB. In all instances, the data selected for comparison agreed with the data contained in the IDB indicating that the data in the IDB is accurate; agrees with the data submitted by carriers.

The Financial Database works differently than the IDB. The data is entered by the carrier either by direct entry or by upload of a spreadsheet. The data is initially entered into the staging database, which is a tool provided by NCCI to enable ease of entry of data call information. The carriers work with the data in the staging database until they are satisfied that it is ready to submit. There are specific dates by which each call must be submitted. The submission is done through the Financial Database online. Once the call is submitted, it is removed from the staging database. No submission file exists.

Reconciliation between the submissions and the Statutory Page 14 of the annual statements (using Call #8 information) is performed to assure completeness of the data provided. No practical way or reasonable need was determined to perform any additional completeness and accuracy testing on the Financial Data Base. Testing of the reconciliation process was performed by the examiners in lieu of completeness and accuracy testing. All testing produced the expected results.

OTHER PROCEDURES

a. Physical Security

Physical Security

Verify that there is a process and systems in place for ensuring and maintaining physical security.

Results: **Pass**

Observations: Review and walkthroughs were performed to evaluate the physical security of both the buildings and the data center. The examiners conducted a walkthrough inspection of the computer facility at the Home Office of NCCI in Boca Raton, FL. The facility is well built and is a building within a building. It has concrete walls and is rated Cat 5 meaning it is constructed to withstand a Category 5 hurricane. Adequate power and air conditioning sources are available as well as power generators. Power comes from three separate grids. Adequate environmental controls are in place for smoke and fire detection and suppression. Temperature is constantly monitored. The security is very good. A few suggestions were provided to management to further strengthen the security; however, these were not significant and do not pose a risk to the security of the data center.

An additional walkthrough was performed with regard to building security. The building security is outsourced to Allied Barton, Inc., which provides onsite security services to NCCI on a 24/7 basis. The security is provided by a combination of desk personnel and rovers both in vehicles and on foot. Entrances to the building are continuously monitored via closed circuit TV. The front desk is staffed 24/7, and the remaining entrances are controlled by key card access. All employees are issued a unique ID badge that is required for building access. Employees who forget or lose a badge are required to enter the building via the front desk and have a new card issued. The expiration of all vendor badges is controlled by their hiring department. All temporary badges expire automatically 30 days after issuance or earlier depending on management's directive.

Based on NCCI's policies and procedures, as well as walkthrough inspections performed, NCCI has satisfactory Physical Security in place.

b. Efficiency

Efficiency

Determine that the advisory organization has implemented sufficient documented procedures and controls to ensure the cost efficient operation of the organization.

Results: **Pass with Recommendation**

Observations: A procedural review was performed to address this standard. The corporate powers, business and property of NCCI are exercised, conducted and administered by the board of directors. The board has established the following committees, which address NCCI's operational and financial matters. Each committee has a written charter that defines its purposes, composition and responsibilities.

Audit Committee – This committee monitors the integrity of the financial reporting process and system of internal controls, as well as the independence and performance of the independent auditors and internal auditing department. The committee also provides an avenue of communication among the independent auditors, management, the internal audit department and the board of directors.

Finance Committee – The finance committee is responsible for overseeing NCCI's financial operations, as well as the board on financial matters.

Compensation Committee – This committee is responsible for reviewing and determining the attainment of corporate goals and performance, as well as ensuring the alignment of the board's chief executive officer and senior staff compensation and benefit philosophy and programs with these goals and business needs. The committee also reviews talent and advises the board on compensation and benefit program matters.

Nomination and Governance Committee - This committee is responsible for identifying, evaluating and proposing qualified candidates to fill vacancies on the board, recommending candidates to serve on board committees, as well as candidates to serve on the Actuarial and the Law committees. The committee is also responsible for formulating and recommending governance principles and policies, and for overseeing all matters of corporate governance for the board.

As of May 2011, the board was comprised of 15 members. The board and its committees met at least quarterly during the period under review. From January 1, 2006 through 2009, there were 21 board meeting. Based on the review of the minutes of the board of directors and all committees, meetings are well attended, the minutes adequately record the deliberations and determinations made by the board and its committees and the minutes indicate that good corporate governance practices exist.

The minutes and the 2009 and 2010 budget documents indicate that the budgets and explanations of variances provided by management provide adequate detail for the board

and its committees to review and tack financial and budgetary information. The minutes also reflect that executive compensation, as well as staffing needs are reviewed and discussed.

The travel and entertainment expense categories are included in the financial and budgetary information provided to the board and its finance committee under a general expense category that includes all overhead expenses except for salaries and benefits. If variances between budgeted and actual travel and entertainment expenses are material, the financial/budgetary package provided to directors includes brief explanations for the variances.

It is noted that a 2008 internal audit of accounts payable included a review of 15 employee reimbursement requests. There were no significant findings related to these requests. The internal audit function has not performed an audit of the travel and entertainment expenses for proper review, authorization and compliance with related policies and procedures since 2008.

Recommendation: It is recommended that NCCI's internal auditor perform an audit of travel and entertainment expenses to determine if the expenses are reviewed, authorized and comply with related policies and procedures, that it periodically perform subsequent audits of the travel and entertainment expenses and that it report its finding to the board of directors.

Directors duly elected and serving as of May 11, 2011 were as follows:

Elizabeth R. Haar
President and CEO
Accident Fund Holdings, Inc.

Louis P. Iglesias
Chairman and CEO
Commercial Casualty Chartis

Bruce G. Kelley
President and CEO
EMC Insurance Companies

Michael F. Klein
Senior Vice President
Business Insurance
Travelers Co.

Stephen J. Klingel

Ernest J. Mrozek
Retired Vice-Chairman
and President
The ServiceMaster Company

Craig L. Nodtvedt
President
Alaska National Insurance
Company

George M. Reider, Jr.
Former Connecticut Insurance
Commissioner and former
NAIC President

John Schapperle, CPCU
President and COO
Island Insurance Company,
Ltd.

Gary Thompson

President and CEO
NCCI Holdings, Inc.

Executive Vice President and
CUO
Commercial Markets
The Hartford

John T. Leonard
President and CEO
MEMIC

Kristen W. Wall
President and CEO
The Louisiana Workers'
Compensation Corporation

Brian J. Melas
Senior Vice President
and Chief Actuary
Commercial Markets
Liberty Mutual Group

Craig Watson
Managing Director
Electronic Knowledge
Interchange

Barbara A. Klein
Former Senior Vice President and
Chief Financial Officer of
CDW Corporation

All directors identified above were currently serving as of the date of this examination.

The internal audit department routinely performs operational audits to determine if NCCI is operating efficiently and effectively. These audits target all critical aspects of operations. Annually, the internal audit department identifies and assesses the operational and enterprise risks, the results of which are used to determine the areas and processes that are audited. The analysis relies heavily on input provided by management. The more significant operational areas targeted include ratemaking, experience rating, residual market activities, classification inspections, data submission and processing, as well as general information systems processes. Internal audit develops the overall audit plan and schedule, which is submitted to the audit committee for its review and approval, and is ultimately submitted to the entire board for review and approval.

As evidenced by the audit committee minutes, internal audit reports the results of its audits directly to the committee. All material exceptions are presented to the committee and management's success in addressing each exception is tracked by the committee until each exception is fully resolved or mitigated.

c. Rule Development

Standard 1 - Rule Development

The advisory organization prepares files and distributes manuals of rating rules in accordance with applicable statutes, rules and regulations and written procedures.

Results: **Pass**

Observations: A procedural review, as well as detailed testing was performed to address this standard. Rating rules are set forth in the following underwriting manuals maintained by NCCI.

- Basic Manual 2001 Edition and accompanying User's Guide
- Experience Rating Plan Manual 2003 Edition and accompanying User's Guide
- Retrospective Rating Plan Manual 2009 Edition and accompanying User's Guide

Testing related to the timeliness of the rule filings and the notification to subscribers and members, as well as the updating of these rules in published manuals is also addressed under Standard 3 of the Operations /Management/Governance section of this report. In summary, based on the testing performed, rules are filed in accordance with state filings laws, manuals are updated accordingly and subscribers and members are notified in a timely manner. For a description of the testing performed, please refer to page 17 of this report.

d. Medical Data Call Program

As one of its core activities, NCCI analyzes and prices proposed legislation for many state regulators and legislatures. Historically, the detailed claim data collected from carriers was the primary data used to price new legislation impacting the cost of workers' compensation. NCCI recognized that more detailed medical data was needed to better analyze and price the impact that legislation may have on medical costs. Consequently, a Medical Data Call that targets the actual costs based on specific codes used in reporting medical diagnoses and procedures was implemented. Mandatory reporting for Medical Data Call begun with medical transactions occurring in the 3rd Quarter of 2010, were required to be reported to NCCI by the end of 4th Quarter 2010. Given the recent implementation of this call, testing of this database was excluded from the scope of this examination.

NCCI developed training programs prior to implementation of the call and required that carriers pass a certification program prior to submitting data.

NCCI developed a Medical Data Call Reporting Guidebook and numerous training materials. This data is processed and validated through a series of edits designed to ensure the accuracy of the data used in the analysis and pricing of proposed legislation.

SUMMARIZATION

Recommendations and observations made as a result of this examination are listed below:

Issue	Page No.	Recommendation or Observation
Form Development Review NCCI does not use the Flesch test or other readability tests/tools. Based on a review of state statutes, some states require the use of the Flesch test or some comparable test.	57	It is recommended that NCCI comply with the readability requirements as set forth in applicable state statutes.
Efficiency It is noted that a 2008 internal audit of accounts payable included a review of 15 employee reimbursement requests. There were no significant findings related to these requests. The internal audit function has not performed an audit of the travel and entertainment expenses for proper review, authorization and compliance with related policies and procedures since 2008.	77	It is recommended that NCCI's internal auditor perform an audit of travel and entertainment expenses to determine if the expenses are reviewed, authorized and comply with related policies and procedures, that it periodically perform subsequent audits of the travel and entertainment expenses and that it report its finding to the board of directors.
Information Systems – Physical Security Access to the data center is by badge access, which is a single factor authentication. The recommended control level is for two-factor authentication.	72	It is suggested that NCCI consider implementing an additional factor of authentication for access to the data center.
The use of sign-in sheet for visitors to the data center provides a record of who has gained access to this sensitive area. There are cameras located at strategic locations, which is a mitigating control. However, a sign-in sheet would provide a record that can easily be reviewed and maintained.	72	It is suggested that a sign-in sheet be provided and sign-in be required for all visitors to the computer room.

Issue	Page No.	Recommendation or Observation
The security system utilized at the company has the ability to sound an alarm when specific doors are open for longer than a specified period of time. This feature is enabled for loading dock doors but is not enabled for the doors to the computer room.	72	It is suggested that the alarm feature be enabled on the security system to alert the guards if the computer room door is open for more than a specified time.
Backups are created of the security data and systems but are not taken offsite for storage.	72	It is suggested that the NCCI consider requiring offsite storage of the security systems and backup to be recovered in the event of a fire in the security computer room or other catastrophic event.
Due to technological limitations with other NCCI systems, complex passwords are not enforced in Active Directory. NCCI currently requires more frequent password changes to compensate for weak passwords.	72	It is suggested that the technological limitations be resolved to accommodate the enforcement of more complex passwords.
Evidence of consistent and complete documentation of security incidents or responses to such incidents to support legal action was not observed.	73	It is suggested that NCCI develop consistent and complete documentation of security incidents to support follow-up activity and/or legal action.
Internal audit findings currently drop off the list of open items when they are addressed. Having a list of resolved items with the date that each finding is addressed; including a brief summary of the resolution approach would be helpful for verification that all findings are resolved in a timely manner.	73	It is suggested that NCCI implement a process to easily identify the resolution to all internal audits findings.

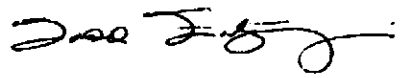
EXAMINATION REPORT SUBMISSION

The courtesy and cooperation of the officers and employees of the Company during the examination are acknowledged.

In addition to the undersigned, the following individuals participated in the examination. The actuarial phase of the examination was conducted by Taylor-Walker & Associates, Inc.

Victor Negron, AIE, FLMI, IR	Supervisor - Market Conduct Examinations
Rachelle Gowins, CFE	Supervisor - Financial Examinations
Douglas Befort, CIE, CFE	Examiner In charge
John Hall, CIE, CPCU	Examiner
Wayne Stevens, CIE, CPCU, MCM, APA	Examiner
Jack Casper, CIE, CPCU	Examiner
Tammy Gavin, ARe, MCM	Examiner
Stanley Kaplan, CFE, CPA	Examiner
Stephen Zellich, CIE, FLMI	Examiner
Jenny Jeffers, CISA, AES	Supervising IT Auditor
Denise Mainquest, CISA, QSA	IT Auditor
Deanna Leyden, CISA, CFE	IT Auditor
Anna Goff	Senior Applications DBA
R. Glen Taylor, ACAS, MAAA	Supervising Actuary
Randall D. Ross, ACAS, MAAA	Actuary
Brent Sallay, FCAS, MAAA	Actuary
Charles White, CPCU, FCAS, MAAA	Actuary

Respectfully submitted,



Examination Resources, LLC
Todd Fatzinger, CFE, CIE, FLMI
Examination Manager